Inflation Report

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Inflation Report

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Statistical Conventions:

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

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

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

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Foreword

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

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

Executive Summary

Economic activity has been growing gradually and continuously over the year, as signaled by the evolution of quarterly GDP growth. This evolution reflects in part the expansion of domestic demand for consumption – which up to August was concentrated on semi-durable and non-durable consumption goods – and the growth of exports.

The factors supporting economic activity include the release of FGTS (Warranty Fund for Severance Pay) funds and this year's agricultural income, which have partly neutralized the effects of higher risk aversion linked to international and domestic uncertainties. In this context, corporations continued to postpone investment decisions and families avoided consumption of goods with higher unit values.

Although the stimuli provided by some of these factors are expected to decline, the economy is expected to continue to grow moderately for the next few months. An inventory adjustment in the industrial sector, a relatively low default rate, prospects of less pressure on the 13th salary afforded by the disbursements of FGTS funds, and improved consumer and business expectations are elements that may contribute to a consolidation of the scenario mentioned above.

The likely recovery of capital flows to Brazil will be favored by the adjustment of the current account of the balance of payments, which declined from 4.6% of GDP late in 2001 to 1.7% of GDP in the twelve-month period ending in November 2002. The favorable result of the trade balance has played a major role in ensuring this performance.

Regarding the demand for investment, most indicators have declined as a result of the uncertainties that characterized the recent period and the lower dynamism of economic activity compared to the expectations that prevailed early in 2002. The production of capital goods for agricultural and transportation purposes constitute exceptions.

The less favorable results for investment led to a drop in the ratio of gross fixed capital formation to GDP, which declined to an estimated 18.5% in the third quarter of 2002 from 20.2% in the second quarter of 2001.

Regarding the labor market, despite the number of employed people, demand has nonetheless been insufficient to absorb the supply of labor, leading to a higher unemployment rate as compared to the levels registered in 2001.

In this context, an analysis of the price indices indicates that the recent acceleration of inflation was caused mainly by supply-related factors. The effects of the exchange rate depreciation observed since April and the significant impact of the inter-harvest period experienced in the last two months account for most of the increase in inflation. Against this backdrop, the evolution of service prices provides an indication of a lesser role for inertia or indexation mechanisms in inflation. However, it should be noted that the higher level of economic activity and increased consumer confidence observed recently may lead to price hikes in the future in sectors that were not directly impacted by the supply shocks.

Despite this possibility, the rate of inflation is expected to slow down as of December, when the most critical moment of the period between harvests will be over and the prospects for the behavior of the exchange rate will become more favorable. Partial results for price indices in December seem to corroborate this forecast. This drop, however, will tend to be gradual, due to delayed effects on consumer prices, from the exchange rate depreciation, and from higher wholesale prices resulting from the inter-harvest period.

Special mention should also be made of the importance of maintaining the fiscal consolidation process undertaken in recent years. In this scenario, the fiscal surplus at all levels of government keeps the public sector’s net debt dynamics on a sustainable path, despite oscillations caused by pressures from the foreign exchange market. The continuity of this fiscal effort and the positive perception of the commitment to maintain economic stability will contribute toward improving country risk perceptions and consolidating a declining path for the debt in the next few months.

The central path expected for inflation accumulated in 12 months declines steadily from the third quarter of 2003 to 9.5% late in 2003 and to 4.5% in the last quarter of 2004. There has been, therefore, a significant increase in projected inflation since the September *Report*, when the inflation projected for 2003 was 4.5%. This increase was caused by the inertial effects of high inflation in the fourth quarter of 2002, by the effects of the exchange rate depreciation in 2002 on the projected adjustment of managed prices in 2003, and by pessimistic expectations. It should be noted, however, that the inflation fan chart associated with the baseline scenario is marked by asymmetry, with a higher dispersion for values below the central path. This asymmetry incorporates the larger weight that the Copom attributes to a scenario in which the real is more appreciated and inflation expectations improve more rapidly. This is expected to happen as uncertainties regarding the adoption of consistent macroeconomic policies by the next federal administration are eliminated, strengthening the role of monetary policy in coordinating expectations.

An alternative scenario outlined by the Copom is also presented, in which expected inflation for 2003 drops more rapidly to 8%, and the exchange rate stabilizes at R$3.20, as opposed to the R$3.55 rate anticipated in the baseline scenario. The inflation estimated according to these underlying assumptions is 7.3% in 2003 and 3.4% in 2004.

As a result of the recent improvements observed in indicators of economic activity, the core projection for output growth in 2002 rose from 1.4% to 1.6% since the last *Report*. In 2003, GDP is projected to grow by 2.8%.

1 – Activity level

Despite the uncertainties of the international scenario and internal financial market volatility caused, to some extent, by expectations surrounding the electoral process, the activity level in the third quarter of the year and early part of the fourth continued on a gradual growth curve. Among the highlights of the period, mention should be made of the positive performance of the retail trade sector, powered mainly be disbursements of the Employment Compensation Fund (FGTS). Other factors that contributed to growth in recent months were increased exports, driven mostly by exchange depreciation, and sales to the farm sector. In the latter case, just as occurred in recent years, the excellent results achieved by the sector have generated significant reinvestments in this activity. Taken together, these factors produced strong positive impacts on industrial output in the period, particularly in light of the fact that, in previous months, the flow of production was somewhat curtailed by the need to adjust the stock levels of final products.

1.1 Retail sales

Following the negative results of the first half of the year, trade sector activity turned upward in the following months. This growth was one result of the exceptional level of FGTS disbursements, increased farm sector income and improvement in consumer confidence indices.

According to the Monthly Trade Survey of the Brazilian Institute of Geography and Statistics (IBGE), which is national in scope, the Retail Sales Volume Index registered 1% growth in the third quarter of 2002, in comparison to the same period of the previous year.

Viewed under the prism of accumulated expansion in the year, the reduction in the negative growth figures that marked the third quarter is expected to intensify in the following months, particularly as a result of the excellent performance of retail activity toward the end of 2001. A segment-by-segment breakdown indicates that sales of fuels and lubricants expanded by 5.5% and those involving furniture and electric appliances increased by 1%, while fabrics, apparel and footwear and other items for personal use showed significant recovery over the course of the year, despite negative growth of 1.8% and 1.4%, respectively.

Sales volume index in the retail sector - Brazil

Percentage change

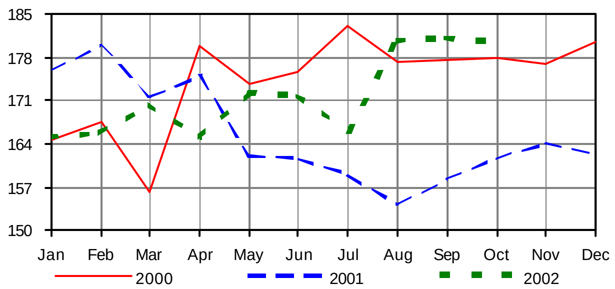
Itemization	2002		
	I Q	II Q	III Q
Same period of the previous year			
Retail sector	-0.8	-0.9	1.0
Fuel and lubricants	5.3	1.5	9.7
Supermarkets	0.0	-1.7	-1.5
Textiles, clothing and footwear	-2.5	-5.3	2.8
Furniture and white goods	-1.4	4.3	0.1
Other domestic goods	-4.6	-0.6	1.1
Vehicles, motorcycles	-23.4	-19.8	-12.2
Accumulated in the year			
Retail sector	-0.8	-0.8	-0.2
Fuel and lubricants	5.3	3.3	5.5
Supermarkets	0.0	-0.9	-1.1
Textiles, clothing and footwear	-2.5	-4.1	-1.8
Furniture and white goods	-1.4	1.5	1.0
Other domestic goods	-4.6	-2.6	-1.4
Vehicles, motorcycles	-23.4	-21.6	-18.7

Source: IBGE

Real sales of the retail sector in São Paulo

Seasonally adjusted data

2000=100



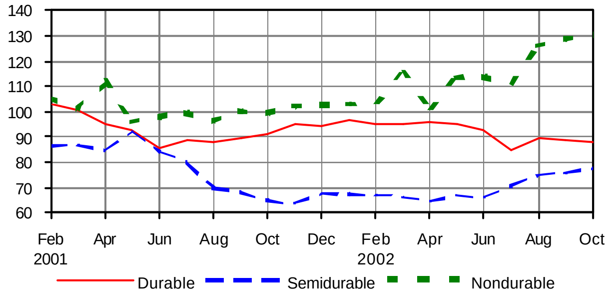
Source: Fecomercio SP

Sales of the automotive sector, which is not included in the formation of the general index, also evolved favorably in recent months. Thus, following negative results of 23.4% and 19.8% in the first and second quarters, compared to the same periods of 2001, the segment's sales dropped by 12.2% in the third quarter. Once this figure is incorporated into the overall result, the accumulated decline in the year fell from 21.6% up to June to 18.7% up to September.

Statistics released by the Trade Federation of the State of São Paulo (Fecomercio SP) for the period up to October confirmed the process of recovery under retail sales in the third quarter and start of the fourth. In this context, based on the statistical series from which seasonal factors have been purged, real revenues of the sector expanded by 8.8% and 0.2% in August and September, respectively, before dropping slightly (0.4%) in October.

The analysis by trade segments indicates that increases in sales of nondurable and semidurable consumer goods were the major determinants underlying the recovery process, with average monthly growth of 3.2% and 5.5% respectively from August to October, based on figures free of

Consumer goods - real sales
Seasonally adjusted data
Quarterly moving average 2000=100



Source: Fecomercio SP

Real sales of the retail sector in São Paulo

Percentage change

Itemization	2002					
	May	Jun	Jul	Aug	Sep	Oct
In the month[1/]						
General	4.4	-0.3	-3.3	8.8	0.2	-0.4
Consumer goods	4.2	-0.4	-4.6	10.0	0.4	0.4
Durable	-1.2	-2.5	-8.3	5.3	-0.6	-1.1
Semidurable	3.7	-0.9	6.6	6.0	1.3	2.3
Nondurable	11.4	0.4	-2.0	12.8	2.3	1.3
Automotive trade	-9.7	1.6	-1.1	8.7	-1.6	-2.7
Vehicle dealers	-11.6	2.4	-1.0	8.7	-1.4	-4.2
Autoparts and accessories	0.2	-6.1	6.6	2.0	-1.9	3.1
Building materials	3.7	-1.3	2.3	3.6	6.4	-5.7
Quarter/previous quarter[1/]						
General	2.9	1.6	1.8	2.2	3.7	6.3
Consumer goods	4.1	1.6	1.2	1.2	3.0	6.8
Durable	0.3	-1.1	-4.9	-6.8	-7.3	-2.3
Semidurable	-2.2	-1.6	2.9	7.1	12.0	12.0
Nondurable	6.8	2.2	5.6	6.3	11.3	13.6
Automotive trade	-5.8	-2.9	-6.3	-1.4	1.5	6.3
Vehicle dealers	-6.6	-2.3	-6.6	-1.6	1.5	6.3
Autoparts and accessories	0.3	-2.9	-2.5	-1.0	3.0	3.9
Building materials	6.3	5.4	5.6	4.6	7.3	7.0
In the year						
General	-2.5	-1.4	-0.5	1.5	2.8	3.8
Consumer goods	0.8	2.0	2.7	4.6	5.6	6.6
Durable	-2.2	-1.0	-1.1	-1.0	-1.2	-1.7
Semidurable	-23.3	-23.5	-20.9	-18.0	-15.4	-12.8
Nondurable	4.0	5.6	6.8	10.1	11.7	13.8
Automotive trade	-22.3	-22.7	-21.6	-19.3	-17.3	-17.0
Vehicle dealers	-26.6	-26.8	-25.6	-22.8	-20.6	-20.3
Autoparts and accessories	-0.2	-1.6	-1.3	-1.7	-1.7	-1.6
Building materials	-19.3	-18.3	-15.9	-13.9	-10.9	-9.3

Source: Fecomercio SP

1/ Seasonally adjusted data.

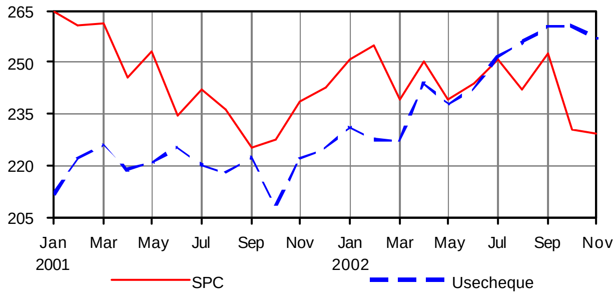
seasonal influences. It should be noted that these segments tend to be more intensely impacted by FGTS disbursements, since they normally market items of lesser unit value.

Based on statistics from which seasonal factors have been eliminated, sales by factory authorized outlets increased by 8.7% in August in a month-by-month comparison and generated a strong impact on the results registered in the period by Fecomercio SP. Though the two following months were marked by negative results, sales in the segment expanded by 6.3% in the quarter ended in October, when compared to the previous quarter. This performance was a consequence of the August reduction in the rates of the IPI levied on the production of automobiles and increases in the number of clearance sales in the period. At the same time, net outflows of resources from financial funds, particularly in the third quarter of the year, and expectations of automobile price increases in the near future, had the impact of invigorating sales performance. For the year, however, revenues of the segment dropped by 17%.

With regard to sales of building materials, the downward trend in recent months is gradually being reversed, as October closed with –9.3% compared to –19.3% in May.

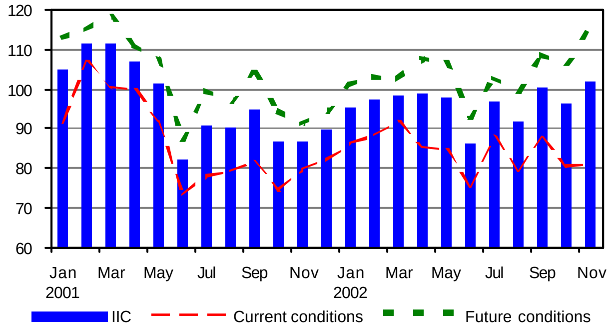
Data released by the São Paulo Trade Association (ACSP) and purged of seasonal influences confirmed expansion of the São Paulo retail trade sector. Consultations with the Credit Protection Service (SPC) and Usecheque expanded by 0.6% in the period from September to November, when viewed against the previous quarter. An individual analysis of the accumulated growth in these two

Retail sales indicators in São Paulo
Seasonally adjusted data
1992=100



Source: ACSP

Consumer Intention Index (IIC)



Source: Fecomercio SP

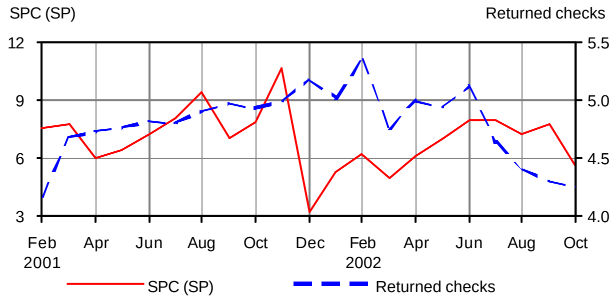
indicators shows that consultations with Usecheque, which covers cash payment sales and small value transactions, turned in growth of 12% up to November, while consultations with the SPC, which encompasses installment sales, remained stable in the period. These percentages confirmed the change in consumer behavior, shifting preferences to small value items and immediate payment, in detriment to installment purchases.

The performance of the retail trade sector in the second half of the year was compatible with the evolution of consumer expectations. In this sense, the Index of Consumer Intentions (IIC), released by Fecomercio SP, has followed an upward curve since June when it registered its worst result of the year. In November, the general index expanded by 6% compared to October, closing at the highest level of the year. For the most part, recovery under the IIC is a consequence of growth in the Index of Future Intentions, which accounts for 60% of the composition of the general index. This conclusion is further evinced by the fact that the Index of Current Intentions not only fluctuated sharply but remained at relatively low levels during practically the entire second half of the year. According to Fecomercio SP, the end of the uncertainties that had marked the electoral process, lesser concern with unemployment and the absence of new adverse events on the international scenario are the factors that explain the recovery in consumer confidence.

Another factor that has contributed positively to improvement in trade sector performance is the downward slide in default levels registered in the period from May 2002 to the present. To some extent, this movement is attributed to extraordinary releases of FGTS resources.

With this, the ratio between checks returned due to insufficient backing and total checks cleared through the banking system, which

Default rates
Seasonally adjusted data
%



Source: ACSP

Default rates

Rate

Itemization	2002						
	I Q	II Q	Jul	Aug	Sep	Oct	Nov
SPC (SP)[1/]	6.0	8.0	7.2	4.7	6.7	4.4	5.7
Returned checks[2/]	5.2	5.0	4.6	4.3	4.2	4.6	...
Telecheque (RJ)[3/]	3.4	1.6	1.8	1.6	1.7	1.6	1.4
Telecheque (national)[3/ 4/]	2.7	2.0	1.9	1.7	1.7	1.9	1.5

Source: ACSP, Bacen and Teledata

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

had already declined in the July-September quarter, turned in an additional reduction in October and closed at 4.25% based on the statistical series from which seasonal factors have been purged.

In the case of the SPC, the net rate of defaults measured by the ACSP moved general downward, through some degree of volatility was evident in the period. In this context, the final result came to 5.7% in November, compared to 4.4% in October and 6.7% in September. The average rate of default in the period from January to November 2002 came to 6.8%, as against 7.9% in the corresponding period of 2001. The other default indicator that is national in scope is released by Teledata and also pointed to downward movement over the course of 2002, as evident in the median rates of 1.7% in the October-November period, compared to 2.7%, 2% and 1.8%, respectively, in the first three quarters of the year.

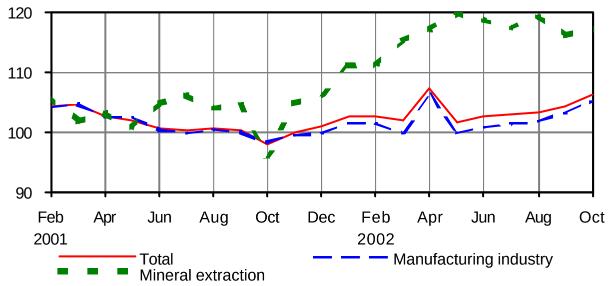
The decline in defaults suggests that Christmas bonus payments, known as the 13th monthly wage, are to a great extent being channeled into consumer spending. Parallel to the positive evolution of consumer expectations, this factor is expected to leverage the performance of the retail sector in the final months of the year.

1.2 Output and Gross Domestic Product

1.2.1 Industrial output

In the August-October quarter, industrial production expanded by 2.3%, compared to the previous quarter, as reported by IBGE's Monthly Industrial Survey (PIM). In the year, general industrial output, which had expanded by 0.5% up to July, as a result of 11.6% positive growth under mining and a drop of 0.9% in the product of

Industrial production
Seasonally adjusted data
2000=100



Source: IBGE

Industrial production

Percentage change

Itemization	2002				
	Jun	Jul	Aug	Sep	Oct
Industry (total)					
In the month1/	1.0	0.2	0.4	0.9	1.7
Quarter/previous quarter1/	1.4	- 1.5	- 0.6	- 0.2	2.3
Same month of the previous year	0.7	3.3	1.0	5.5	8.9
Accumulated in the year	0.0	0.5	0.5	1.1	1.9
Accumulated in 12 months	- 1.0	- 0.8	- 0.7	- 0.1	0.9
Manufacturing industry					
In the month1/	1.1	0.5	0.4	1.5	2.0
Quarter/previous quarter1/	1.3	- 1.9	- 0.6	- 0.2	2.7
Same month of the previous year	- 0.8	2.5	- 0.5	4.8	7.4
Accumulated in the year	- 1.5	- 0.9	- 0.8	- 0.2	0.6
Accumulated in 12 months	- 1.8	- 1.6	- 1.6	- 1.1	- 0.2
Mineral extraction					
In the month1/	- 1.1	- 1.1	1.8	- 2.7	0.8
Quarter/previous quarter1/	5.4	3.5	0.8	- 0.8	- 0.9
Same month of the previous year	13.4	10.4	14.7	11.4	22.3
Accumulated in the year	11.9	11.6	12.0	12.0	13.0
Accumulated in 12 months	5.5	5.8	6.6	7.6	10.3

Source: IBGE

1/ Seasonally adjusted data.

the manufacturing sector, increased to 1.9% in October, reflecting respective rates of expansion of 13% and 0.6% in the two subsectors cited.

Among the factors that influenced the behavior of the industrial sector in recent months, the following deserve mention: increased exports of manufactured products, sales targeted to the crop/livestock sector, continued expansion in internal sales of consumer goods of lesser unit value and recent growth in the sales of the automotive industry.

Up to the month of October, exports of manufactured products increased by 1.8% in the year and were particularly strong in the second half of the year as a result of the added incentive of exchange depreciation. Among the industrial segments that registered increased export flows, one should cite the segments of sugar, cellulose and wood paste, petroleum and gas, vegetable oils, furniture and poultry and animal slaughters.

Growth in farm production which came to 6.5% up to the third quarter of the year, according to IBGE National Accounts data, has sustained expansion in the industrial subsectors that produce the inputs and implements channeled to the sector. Output of farm machines increased by 25.9% up to November, when compared to the corresponding period of 2001, according to the National Association of Automotive Vehicle Manufacturers (Anfavea). Parallel to this, production of fertilizers and plant food expanded by 13.5% and output of foodstuffs for animal feed increased by 9.2% up to October, according to the PIM.

Analysis of manufacturing activity by use categories pointed to increased output in all segments in the period from August to October. Capital goods production, which is more sensitive to the uncertainties

Industrial production by category of use - selected sectors

Itemization	% accumulated growth in year 2001	2002 [1/]
Capital goods	12.7	-1.4
Rail equipment	37.3	30.5
Farm machines	25.8	14.2
Intermediate goods	-0.2	2.4
Fertilizers	-7.5	13.5
Gas and oil	4.6	15.3
Sugarcane industry	19.0	11.7
Animal feed	6.0	9.2
Celulose	0.0	9.1
Plant oils	3.9	7.6
Durable consumer goods	-0.6	1.6
Household appliances	-9.9	7.9
Furniture	-1.1	1.5
Semidurable and nondurable consumer goods	1.8	0.6
Slaughtered poultry	8.7	8.5
Animal slaughtering	8.0	8.0

Source: IBGE

1/ Up to October.

common at the time, started to turn upward only in the month of October. In the category of consumer goods, output of consumer durables moved sharply upward while production of nondurables and semidurables moved along a steady growth trajectory, quite similar to the results registered under intermediate goods.

From August to October, output of consumer durables increased by 6.5% when compared to the three previous months, according to data free of seasonal factors. This growth reversed the 3.4% negative result accumulated in the first seven months of the year to a positive figure of 1.6% up to October. The increased dynamism of this segment was mostly a consequence of the performance of the automotive sector in the period.

Following a 3.9% decline in August, vehicle production turned in accumulated growth of 30.9% in the three subsequent months, according to seasonally adjusted Anfavea data. Internal industrial sales expanded by 17.7% in the quarter while foreign sales increased by 20.7% following growth of 7.4% and a decline of 4.2% in August, respectively.

In the third quarter and early part of the fourth, output of nondurable and semidurable consumer goods, which are less sensitive to changes in the overall economic scenario, remained on the slight upward curve that has marked the entire year. Based on seasonally adjusted data, the segment registered growth of 2.3% in the August to October period, when compared to the previous quarter. With this result, accumulated growth in the year came to 0.6%, the same level as in July. In this context, particular mention should be made of 4.6% growth in the output of the food industry.

Production of intermediate goods registered the best performance over the course of the year, with accumulated growth of 2.4% up to October. In the August to October period, the category's output expanded by 1.7% in relation to the average in the previous quarter,

Industrial production by category of use

Percentage change

Itemization	2001	2002			
	Dec	Jul	Aug	Sep	Oct
In the month[1/]					
Industrial production	1.1	0.2	0.4	0.9	1.7
Capital goods	- 0.7	0.6	- 2.3	- 0.7	4.3
Intermediate goods	1.2	- 0.2	0.3	1.5	0.8
Consumer goods	0.7	1.1	0.9	- 0.1	1.9
Durable	5.5	2.5	- 0.9	2.2	4.9
Semi and nondurable	- 0.7	0.7	1.5	- 0.9	1.3
Quarter/previous quarter[1/]					
Industrial production	- 0.7	- 1.5	- 0.6	- 0.2	2.3
Capital goods	- 5.9	- 3.8	- 1.7	- 2.3	0.7
Intermediate goods	- 1.7	- 0.6	- 0.1	0.1	1.7
Consumer goods	2.1	- 4.5	- 2.1	- 0.7	3.3
Durable	8.0	- 5.8	- 3.5	- 0.5	6.5
Semi and nondurable	0.8	- 3.9	- 1.9	- 1.0	2.3
In the year					
Industrial production	1.5	0.5	0.5	1.1	1.9
Capital goods	12.7	- 0.9	- 2.2	- 1.9	- 1.4
Intermediate goods	- 0.2	0.7	1.0	1.5	2.4
Consumer goods	1.3	- 0.3	- 0.4	0.1	0.8
Durable	- 0.6	- 3.4	- 2.2	- 0.2	1.6
Semi and nondurable	1.8	0.6	0.1	0.2	0.6

Source: IBGE

1/ Seasonally adjusted data.

Vehicles - production and sales

Percentage change

Itemization	2002				
	Jul	Aug	Sep	Oct*	Nov*
In the month[1/]					
Production	-3.0	-4.3	19.2	10.2	-0.3
Sales	0.2	4.2	11.4	10.8	-10.2
Domestic sales	-2.5	7.2	13.8	14.6	-9.7
External sales	6.3	-3.6	8.0	5.9	5.6
Quarter/previous quarter[1/]					
Production	-5.3	-6.7	-1.7	9.7	22.1
Sales	-3.7	1.7	7.6	18.3	18.5
Domestic sales	-7.3	0.2	8.8	24.0	25.2
External sales	7.9	-0.8	1.1	4.0	13.8
In the year					
Production	-11.3	-11.2	-9.1	-5.8	-4.0
Sales	-11.8	-10.1	-6.7	-3.4	-2.7
Domestic sales	-13.5	-11.8	-7.9	-3.7	-3.5
External sales	-5.1	-3.3	-2.5	-2.1	-0.1

Source: Anfavea

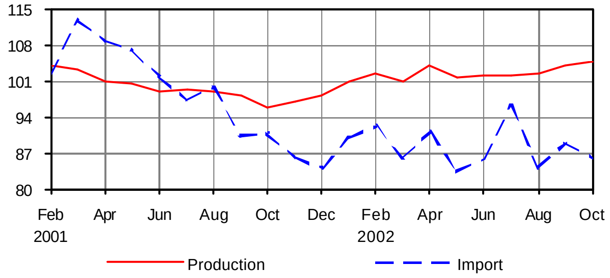
1/ Seasonally adjusted data.
* Preliminary.

based on data purged of seasonal factors. Independently of the basis of comparison, this growth has been attributed to expansion of the mining sector and the process of import substitution. The latter factor is evident in the asymmetry between the volume of imports of intermediate goods and growth in the output of the manufacturing sector in the year.

Production of capital goods expanded by 0.7% in the August to October period, in relation to the average for the three previous months, closing with the lowest rate of the entire industrial sector. However, it should be noted that the activity inherent to this category is fundamentally tied to investment decisions that have a much longer maturation horizon and very large sums of financial resources. Consequently, the activities of this heading are considerably more sensitive to changes in the general economic panorama and in financing conditions. In this sense, the 1.4% drop registered in the year should be viewed in the framework of deteriorating expectations and credit conditions and increased internal and external uncertainties. At the same time, one should emphasize that the performance of capital goods production has benefited from growing demand for machines and equipment for the sectors of agriculture and transportation, a fact that has somewhat attenuated the previously mentioned negative results.

The increase in manufacturing activity was reflected in the level of idle capacity. Thus, the median level of utilization of installed manufacturing capacity came to 80.4% in October, compared to 79.8% in the same month of 2001 and 79% in July 2002, according to the quarterly Getulio Vargas Foundation (FGV) survey. The headings of

Intermediate goods
Seasonally adjusted data
2000=100



Source: IBGE and Funcex

transportation equipment, which includes the automotive industry, wood, furniture and textiles registered the sharpest falloffs in idle capacity. In contrast to this performance, the segments of pharmaceutical and veterinary products, food products and tobacco operated with a higher level of idle capacity. Although some sectors, particularly intermediate goods, registered relatively high levels of utilization of installed capacity, even these were below their historic peaks as registered by the survey.

Utilization of installed capacity[1/]

Level

Itemization	Maximum level since 1990	2002 Jan	Apr	Jul	Oct
Manufacturing industry	86.0	79.5	79.1	79.0	80.4
By segment					
Nonmetallic minerals	88.0	84.2	84.7	79.3	79.3
Metallurgy	93.0	88.1	84.8	89.3	89.3
Mechanics	85.5	79.7	78.2	82.1	81.4
Electric and communications eq.	84.0	70.2	65.9	60.2	59.9
Transportation equipment	92.0	73.4	72.9	69.8	77.7
Wood	93.0	80.0	84.1	79.8	86.0
Furniture	87.0	77.3	76.3	74.4	79.3
Paper and cardboard	95.0	93.4	93.5	91.6	93.4
Rubber	95.0	87.2	90.9	90.1	88.2
Leather and hides	89.5	75.6	79.2	79.6	79.5
Chemicals	91.0	83.5	81.9	84.3	85.3
Pharmaceuticals	87.0	54.1	67.6	71.3	65.7
Perfumes, soaps and candles	93.0	59.9	78.8	65.8	74.8
Plastics	88.0	84.6	82.4	81.8	82.6
Textiles	86.8	84.2	87.4	80.0	85.8
Clothing, footwear	88.4	82.9	81.5	84.4	86.6
Food products	84.0	78.3	77.9	83.4	78.9
Beverages	90.0	63.8	70.3	66.0	68.7
Tobacco	98.0	60.1	74.0	69.4	52.1
Editorial	91.0	62.6	74.8	74.4	73.7
Others	89.5	81.8	80.6	78.8	89.5

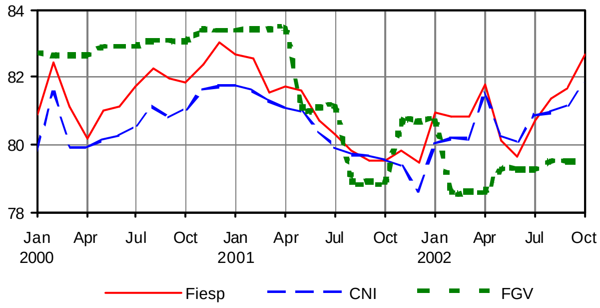
Source: FGV

1/ A complement of 100 represents the average level of idleness.

Data on the levels of utilization of industrial production capacity released by the National Confederation of Industry (CNI) and Federation of Industries of the State of São Paulo (Fiesp) also reflected the process of recovery in the sector. After introducing seasonal adjustments, the monthly results registered positive growth as of the month of July and, in October, reached a plateau equivalent to the start of 2001. In the case of São Paulo industry for which sectoral data are available, the largest increases in utilization of installed capacity occurred in the segments of nonmetallic minerals, paper and cardboard and food products.

Among other factors, the more dynamic level of manufacturing activity in September and October reflected the process of stock adjustments that companies had to make, as a result of their very large higher-than-planned volume, registered at the end of the second quarter, particularly in the case of final goods. In this context, at the start of the third quarter, companies began adjusting their production to sales volume. This is clear in the more recent results of the same survey, which shows reductions in the stocks of final goods from 53.1 at the end of the second quarter to 48.5 at the end of the third, utilizing a scale of zero to one hundred.

Utilization of installed capacity
Seasonally adjusted data
Average percentage



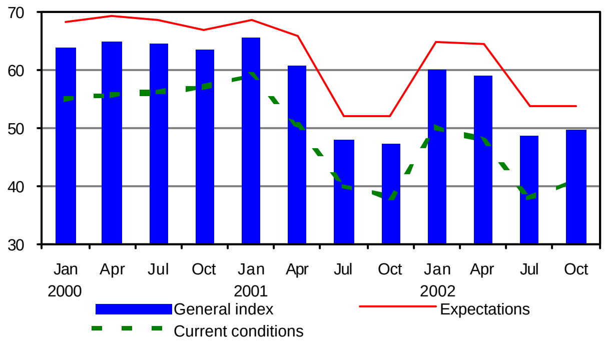
Manufacturing industry stocks[1/]

Itemization	2001 III	2001 IV	2002 I	2002 II	2002 III
Manufacturing industry					
Final products	50.9	48.0	50.4	53.1	48.5
Raw materials and interm. goods	49.7	48.6	47.7	48.2	49.2
Large companies					
Final products	52.4	47.8	50.4	53.7	49.9
Raw materials and interm. goods	53.4	50.5	49.5	50.7	51.2
Small and medium companies					
Final products	50.0	48.2	50.3	52.8	47.7
Raw materials and interm. goods	47.7	47.5	46.7	46.9	48.1

Source: CNI

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

Industrial Business Confidence Index



Source: CNI

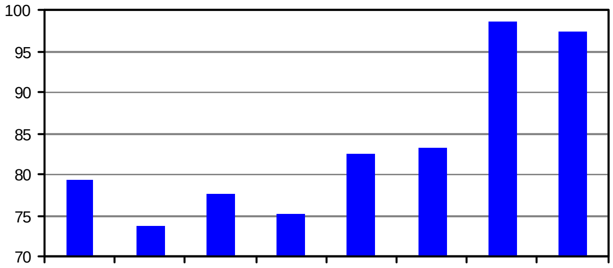
With regard to expectations in this sector, the Industrial Confidence Indicator (ICEI), calculated by the CNI, registered recovery in the month of October, shifting to 49.5% compared to 48.5 in July, on a scale from zero to one hundred. Among other factors, this result reflected the agreement with the International Monetary Fund (IMF), gradual restoration of foreign trade credit lines and the end of the electoral process. The shift toward more positive expectations was a consequence of adjustments in stock levels and the prospects for a positive sales trajectory both internally and externally and should contribute significantly to continued growth in manufacturing activities in coming months.

1.2.2 Crop/livestock output

Recent farm production results confirmed a grain harvest that would be slightly below the 2001 level, while output of such other crops – particularly, coffee, sugar cane and oranges – turned in more positive growth. Early information regarding the next harvest indicates that growth in area cultivated will be restricted to soybeans. Other economically relevant crops, such as corn, could still achieve output growth on the basis of gains in yield per area. In the livestock segment, there is a larger statistical gap. However, up to the second quarter, it is evident that the process of growth that marked previous quarters continued.

Crops

For all practical purposes, the 2002 grain harvest has been completed. Of the major crops, the only cycle not yet concluded is



that of wheat, now in the final stage of harvesting. Total output of grains, legumes and oil-bearing crops is expected to close at 97.266 million tons, or 1.3% less than the previous year. These figures are drawn from the Systematic Farm Production Survey (LSPA) carried out by IBGE in October. This forecast is below that presented by IBGE in the month of July. The reasons for the cutback are prolonged drought at the start of the third quarter and atypical frosts in early September, with a particularly strong impact on the wheat crop.

The 14.4% reduction that occurred in corn production was the major cause of the downturn in the grain harvest. Aside from a reduction of 3.9% in area planted, the crop was hit by climatic adversities over the course of the year, provoking a decline of 10.9% in productivity compared to the previous year. In the same sense, output of cotton in seed and wheat dropped by respective rates of 18% and 1.8%.

Among the grains that turned in positive growth, one should emphasize beans with 25%, soybeans with 11.3% and rice with 3%. Insofar as other crops are concerned, accentuated growth was registered under coffee beans (26.7%), oranges (12.1%) and sugar cane (8%), all of which are items of importance to the nation’s exports.

Prognosis for the 2003 harvest

In the month of October, IBGE carried out a survey of intentions as regards the crops to be planted and the area to be cultivated in the next harvest. This study encompassed nine different products: soybeans, corn, sugar cane, beans, rice in husk, white potatoes, herbaceous cotton, manioc and onions, in the southeast, south, central-west regions and in the states of Rondônia, Bahia, Maranhão and Piauí. The estimate of the area to be planted totals 33,791 hectares, for growth of 2.4% in relation to the area planted in 2002. Basically, this increase is due to growth in the soybean

Crops in 2002

Itemization	Production	Area	Average production
		Percentage change	
Grain production	-1.3	6.1	-7.0
Cotton (seed)	-18.0	-13.4	-5.4
Rice (in husk)	3.0	0.8	2.2
Beans	25.0	20.3	3.9
Corn	-14.4	-3.9	-10.9
Soybean	11.3	17.1	-5.0
Wheat	-1.8	22.3	-19.7
Other products			
Potatoes	2.7	1.8	0.9
Coffee fruit	26.7	0.7	25.8
Oranges	12.1	0.4	11.7
Sugar cane	8.0	3.7	4.2
Manioc roots	1.3	1.0	0.4

Source: IBGE

Agricultural production

In thousands of tons

Itemization	Production 2001	Production 2002[1/]	Percentage change
Grain production	98 544	97 266	-1.3
Cotton (seed)	1 716	1 407	-18.0
Rice (in husk)	10 195	10 498	3.0
Beans	2 436	3 046	25.0
Corn	41 439	35 479	-14.4
Soybean	37 683	41 937	11.3
Wheat	3 261	3 203	-1.8
Others	1 814	1 696	-6.5
Other products			
Bananas	5 959	6 398	7.4
White potatoes	2 787	2 863	2.7
Cocoa (beans)	184	173	-6.0
Coffee (beans)	1 918	2 431	26.7
Sugarcane	345 941	373 544	8.0
Tobacco (in leaf)	565	658	16.5
Oranges	16 844	18 886	12.1
Manioc roots	22 479	22 781	1.3
Tomatoes	3 043	3 526	15.9

Source: IBGE

1/ Refers to the October/2002 Systematic Survey of Agricultural Production.

crop, since the areas planted in other crops are expected to decline or remain stable. Among other factors, growth in the soybean crop was stimulated by price increases in recent months, movement into new agricultural areas and even substitutions of previously planted crops, particularly in the case of corn.

Estimates of a downturn in the area cultivated in crops of importance to internal supply should be somewhat attenuated by several positive factors. In the case of corn, significant growth is expected in both the first and second harvests, since the strong reduction in the productivity of this crop that marked 2002 is not expected to be repeated. Aside from this, in the cases of both corn and beans, cutbacks in the area of the first harvest are expected to be offset by growth in the second harvest, since the prices of these goods in the recent past have been evolving in a more positive manner. In the case of the rice crop, the drop in forecast area planted is the result of reductions in the southeast and central-west regions, which normally turn in lesser yields than in the south, where about 50% of national output is concentrated. The estimate for the latter region points to positive growth in the output of this crop.

Livestock

All segments of the livestock sector have registered positive results, mostly due to steadily expanding exports.

In the first half of 2002, IBGE estimates indicate cattle slaughters at 9.3 million head, corresponding to growth of 6.5% in relation to the same period of 2001. In much the same way, the overall carcass

Agricultural production - harvested area forecast

In thousands of hectares

Itemization	Harvested area 2002	Harvested area 2003[1/]	Percentage change
Grain production	33 011	33 791	2.4
Cotton (seed)	686	680	-0.8
Rice (in husk)	2 654	2 649	-0.2
Beans - 1st harvest	1 407	1 405	-0.2
Corn - 1st harvest	7 328	7 286	-0.6
Soybean	16 218	17 142	5.7
White potatoes - 1st harvest	84	80	-4.8
Sugar cane	4 055	4 017	-0.9
Onion	57	57	0.1
Manioc roots	523	475	-9.2

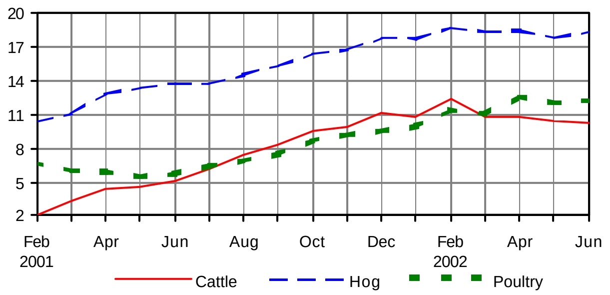
Source: IBGE

1/ Cultivated area or being prepared for crops.

Livestock production

Total weight

Percentage change in 12 months



Source: IBGE

weight of the slaughtered cattle increased in the period to 2.2 million tons.

As far as swine production is concerned, the number of animals slaughtered in the first half of 2002 and total carcass weight reflected growth of 17.1% and 18.4% over the figures for the same period of 2001.

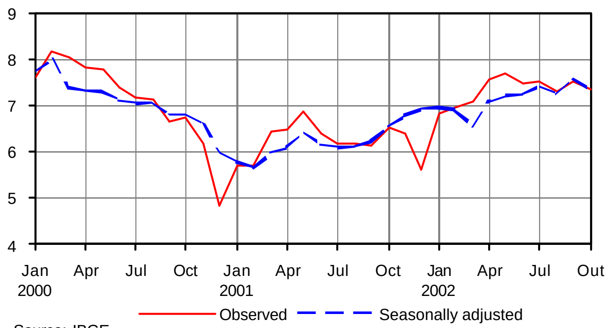
With respect to chicken meat, 1.5 billion chickens were slaughtered in the half-year period, for growth of 12.1% in relation to the same period of the previous year. Despite this increase, it should be noted that the prices of the product have been following an upward curve as a result of increased export flows and, principally, higher feed costs. In the latter case, the rise in these prices was caused basically by exchange depreciation and the limited supply of corn in the latter part of the year.

1.2.3 Labor market

Employment

Labor market indicators point to an almost generalized process of positive evolution. Despite this, the rate of open unemployment remains high, reflecting the fact that the overall labor force has expanded at a rate higher than the economy’s capacity to generate jobs.

As measured by IBGE’s Monthly Employment Survey (PME), the rate of open unemployment in the six metropolitan regions analyzed came to 7.35% in October, compared to 7.61% in the previous month. This reduction was a consequence of the falloff in the total labor force, since the number of those working remained stable in the two month period.



Source: IBGE

One should highlight the fact that, since April, the jobless rate has remained above the 7% mark, registering an average of 7.34% up to October, compared to 6.27% in the corresponding period of 2001. The rise in unemployment was accompanied by a process of job generation, as evinced by the fact that the total number of people working in October 2002 was 3.16% greater than in the same month of 2001. However, this growth was less than that of the overall labor force, which came to 4.2% on the same basis of comparison.

On a sector-by-sector basis, the accumulated results in the first ten months of the year indicated that job generation was more intense under services (3.8%) and commerce (3.5%), followed by manufacturing (1.4%). Only the construction industry registered a reduction in the number of job positions (6%), which was clearly a reflection of the falloff in the pace of activity in this sector.

When one considers employment categories, the first ten months of 2002 were marked by across-the-board growth, particularly among unregistered workers, a segment that witnessed creation of 215 thousand job positions or 5.1% above the same period of 2001. Following that came registered workers, with 79 thousand new positions, corresponding to growth of 2.9% using the same basis of comparison. The headings of employers and the self-employed registered less expressive rates of growth, with 0.3% and 0.2%, respectively.

In recent months, formal employment has followed the upward curve that began toward the beginning of 2000. According to the Ministry of Labor's General File of Employed and Unemployed Persons (Caged), which is national in scope, 1,023.7 thousand jobs were created, for growth of 20.4% over the jobs generated in the same period of 2001. This was the sharpest rate of growth in job positions registered in the year up to October, since the statistical series was first calculated in 1983, and resulted in a rise of 3.2% in the average result of the formal employment index

Occupied people by activity and by categories of employment

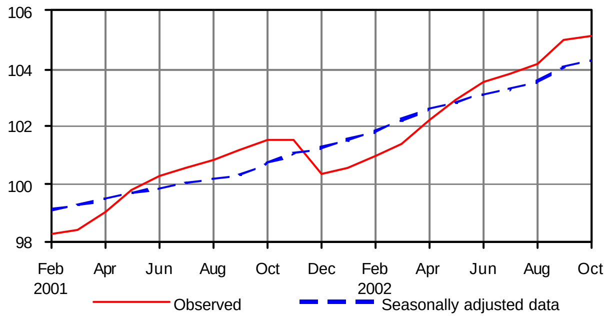
% accumulated growth in year

Itemization	2002					
	I Q	II Q	Jul	Aug	Sep	Oct
Total of occupied people	2.1	2.4	2.5	2.6	2.7	2.7
By activity						
Manufacturing industry	-0.2	0.6	1.0	1.3	1.4	1.4
Building	-6.3	-6.5	-6.5	-6.2	-6.3	-6.0
Commerce	3.5	2.9	3.5	3.6	3.5	3.5
Services	3.0	3.4	3.4	3.5	3.6	3.8
By categories of employment						
Registered	2.2	2.5	2.6	2.8	2.8	2.9
Nonregistered	5.0	4.9	5.1	5.1	5.1	5.1
Self-employed	-0.9	-0.6	-0.4	-0.2	0.0	0.2
Employer	1.2	0.5	0.3	0.0	0.1	0.3

Source: IBGE

Formal employment

2001=100



Source: Ministry of Labor and Employment

Formal employment

New job openings (1,000 employees)

Itemization	2001	2002			
		I H	III Q	Oct	In the year
Total	591.1	680.8	306.6	36.4	1 023.7
Manufacturing industry	103.8	128.5	92.8	16.7	238.0
Commerce	209.8	87.9	93.8	37.5	219.3
Services	311.0	209.9	102.6	21.0	333.5
Building	-33.4	16.6	10.7	-1.6	25.7
Public utilities	1.5	3.3	2.3	0.3	6.0
Others[1/]	-1.6	234.5	4.4	-37.6	201.3

Source: Ministry of Labor and Employment

1/ Includes mineral extraction, public administration, crop and livestock and others.

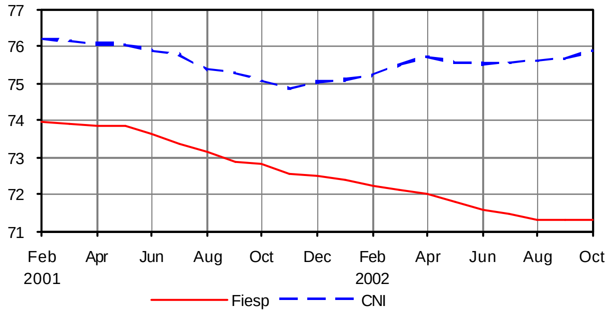
in the year, compared to the same period of 2001. A sector-by-sector analysis indicates that job generation in the year was led by the sector of services, with 333.5 thousand, followed by manufacturing, with 238 thousand and commerce, with 219.3 thousand.

Specific surveys of employment in the manufacturing sector also registered a positive trajectory. According to CNI data covering twelve states, the monthly rates registered in the statistical series purged of seasonal impacts were positive and have been moving gradually upward since July. According to IBGE's PIM, this movement has been caused by expanded manufacturing activity. Consequently, from January to October of this year, compared to the same period of 2001, industrial employment registered a drop of 0.3%, compared to 0.8% at the end of the first half of the year.

In an analogous way, the improved performance of industry benefited employment in São Paulo which, according to Fiesp, has broken out of the downward slide registered since the start of the year and stabilized since September. Despite this turnaround, the accumulated figure for the year was a loss of 2.4% up to October. It should be stressed that the difference between Fiesp and CNI statistical results on industrial employment up to October 2002 (respective downturns of 2.4% and 0.3%) is mostly a consequence of the varying regional performances of the industrial sector. Thus, while manufacturing activity in São Paulo dropped by 2.1%, the country as a whole registered positive growth of 1.7% in the period.

Earnings

Industrial employment
Seasonally adjusted data
1992=100



Overall real wages and average real earnings

Percentage change

Itemization	2001	2002				
		I Q	II Q	Jul	Aug	Sep
In the period[1/]						
Average real earnings	-3.8	0.9	0.8	0.0	-0.6	-0.3
By activity						
Manufacturing industry	-5.1	3.1	0.1	3.9	0.2	-1.0
Building	-5.2	-1.7	4.3	1.6	0.0	-0.5
Commerce	-5.7	-1.6	-2.5	-0.1	1.6	0.7
Services	-3.4	0.5	1.8	-1.3	-2.2	0.3
By categories of employment						
Registered	-4.8	2.5	0.1	-0.1	0.1	-1.1
Nonregistered	-2.1	1.4	2.3	-0.4	-0.2	-1.1
Self-employed	-1.4	-2.6	4.4	0.8	-3.4	-1.2
Employer	-2.6	-0.8	-2.8	2.2	-3.2	6.0
Overall real wages	-3.2	-2.0	2.6	0.6	-1.0	-0.6
In the year						
Average real earnings	-3.8	-5.6	-4.3	-4.1	-3.9	-3.7
By activity						
Manufacturing industry	-5.1	-4.1	-3.4	-3.2	-2.7	-2.4
Building	-5.2	-12.0	-9.6	-9.3	-8.7	-8.0
Commerce	-5.7	-8.5	-9.5	-10.0	-9.5	-9.0
Services	-3.4	-6.2	-4.4	-4.1	-4.2	-4.1
By categories of employment						
Registered	-4.8	-6.0	-4.9	-4.6	-4.2	-3.9
Nonregistered	-2.1	-1.2	0.6	0.4	0.4	0.1
Self-employed	-1.4	-8.7	-5.2	-4.4	-4.4	-4.4
Employer	-2.6	-8.6	-8.9	-8.7	-9.0	-7.9
Overall real wages	-3.2	-3.6	-2.0	-1.7	-1.4	-1.2

Source: IBGE

1/ Seasonally adjusted data (refers to the previous period).

Following a process of recovery in the first half of the year, real earnings and wages registered a decline in purchasing power between July and September, particularly in the service sector.

Based on data from which seasonal factors have been eliminated, a comparison between the third quarter and second quarter of this year indicates that IBGE's PME in the metropolitan regions of Recife, Salvador, Belo Horizonte, Rio de Janeiro, São Paulo and Porto Alegre registered downward movement of 1.2% in real average earnings, deflated by the National Consumer Price Index (INPC). In comparison to 2001, losses came to 3.7% up to September. When one considers the various occupational categories, the largest reduction was registered among employers (7.9%), followed by the categories of the self-employed (4.4%) and registered workers (3.9%). With regard to the earnings of unregistered workers, an increase of 0.1% was detected. On a sector-by-sector basis, there was a generalized reduction in purchasing power in 2002, with the largest losses being concentrated under commerce (9%), followed by construction (8%), services (4.1%), and manufacturing (2.4%). At the same time, one should not overlook the fact that the trend toward losses in real earnings was aggravated in the final three months of the year, as a consequence of the sudden rise in inflation.

Over the course of the second half of the year, the results of collective bargaining agreements have reflected the evolution of the economy as a whole. Those categories due for negotiation at the end of the year have managed to obtain more positive results, as a consequence of expectations of recovery in the level of activity and growth in inflation when compared to the job categories with negotiation dates close to the election. In the latter case, these negotiations were surrounded by a general spirit of uncertainty. This can be exemplified by way of comparisons between, for instance, the agreement reached by bank workers in September and those of the metalworkers and chemical industry workers in November. Aside from wage bonuses and participation in profits and earnings, the first group was able to obtain a 2% increase from Banco do Brasil and 7% from most of the other banks. In the latter case, the workers obtained an increase equivalent to the 10.26% increase in the INPC in the last twelve months.

Real wages in the manufacturing industry

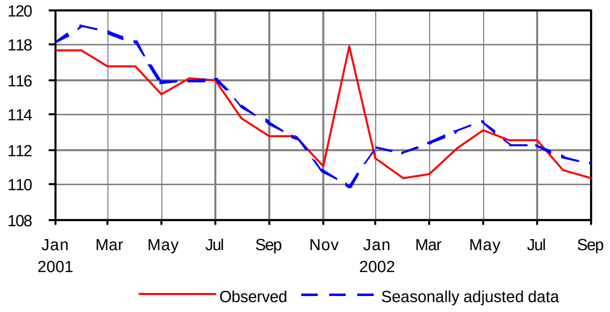
% accumulated growth in year

Itemization	2002					
	I Q	I H	Jul	Aug	Sep	Oct
CNI						
Overall real wages	-0.8	-0.7	-0.7	-0.6	-0.4	-0.3
Fiesp						
Overall real wages	2.6	2.7	2.9	2.9	3.2	3.4
Average real wages	5.4	5.6	5.8	5.8	6.0	6.1

Source: CNI and Fiesp

Real average earnings

1993=100



Source: IBGE

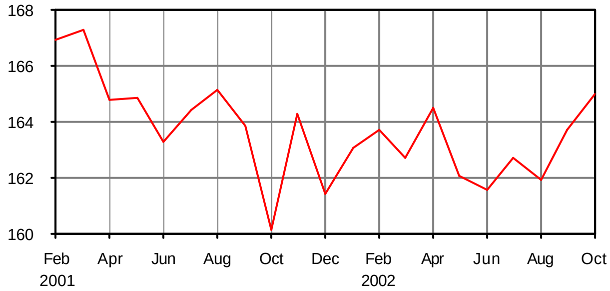
With regard to the wages paid in the manufacturing sector, Fiesp and CNI data indicated highly distinct results. Here, Fiesp figures shows that real salaries paid in the manufacturing sector in São Paulo increased by 6.1% in accumulated terms up to October. Overall wages accompanied this movement, registering a high of 3.4% in the period. However, the CNI survey carried out at the state level points to an average drop in overall wages equivalent to 0.3% in the period.

Part of the difference here is explained by the use of various deflators. CNI data are corrected by the INPC, which accumulated growth of 8.06% up to October, while Fiesp data are adjusted by the Consumer Price Index of the Institute of Economic Research Foundation (IPC-Fipe), which increased by 5.16% in the same period.

Productivity and Unit Cost of Labor (UCL) in the manufacturing sector

The productivity indicator of the manufacturing sector is obtained by the ratio between the physical output index, registered by IBGE's PIM, and hours worked in production, measured by the CNI.

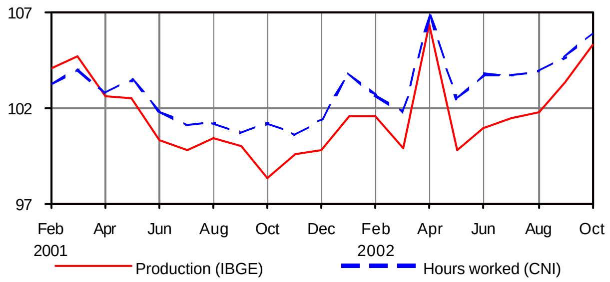
Productivity
Seasonally adjusted data
1992=100



Source: IBGE. CNI and Banco Central do Brasil

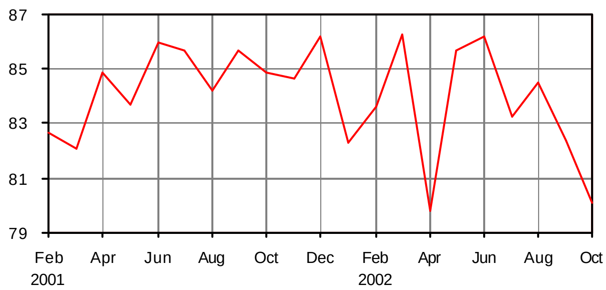
Following a downward trend in 2001, the behavior of this indicator in 2002 suggests some degree of gradual recovery, despite oscillations in monthly data. This movement is confirmed by the increases registered in September and October, closing at 1.1% and 0.8%, respectively, based on data from which seasonal factors have been purged. These results reduced the year's accumulated decline from 1.7% up to August to 1.1% up to October.

Manufacturing industry - production and number of hours worked
Seasonally adjusted data
2000=100



An analysis based on quarterly median data confirmed the positive performance of productivity. Thus, the median for the quarter ended in October was 0.9% greater than in the previous period and 0.3% above the result for the corresponding quarter of 2001.

Unit Labor Cost
Seasonally adjusted data
1992=100



Source: IBGE. CNI and Banco Central do Brasil

In the manufacturing sector, the UCL, which is defined as the ratio between total wages paid by companies within the scope of the CNI, deflated by the INPC, and physical industrial production, calculated by IBGE, has shown a tendency to decline in the second half of the year. When one eliminates seasonal factors, September and October registered declines of 2.5% and 2.8%, respectively. As a result, the average for the three months between August and October came to 3.2% below the figure for the previous quarter. In accumulated terms up to October, the indicator registered a falloff of 0.7% compared to a rise of 1.6% at the end of the first half of the year. The positive performance of the UCL, which was as much a result of the decline in real overall wages in the period, as it was a result of production growth, suggests that part of the impact of the costs consequent upon exchange depreciation is being absorbed by the reduction in the participation of the labor factor in industrial output.

1.2.4 Gross Domestic Product (GDP)

Gross Domestic Product

Itemization	Quarter/previous quarter seasonally adjusted				
	2001		2002		
	III	IV	I	II	III
GDP at maket prices	-0.57	-0.10	0.85	0.86	0.93
Crop and livestock	0.24	3.51	2.37	0.95	0.75
Industry	-1.62	-1.11	1.60	1.37	1.30
Services	0.05	0.24	0.72	0.11	0.71

Source: IBGE

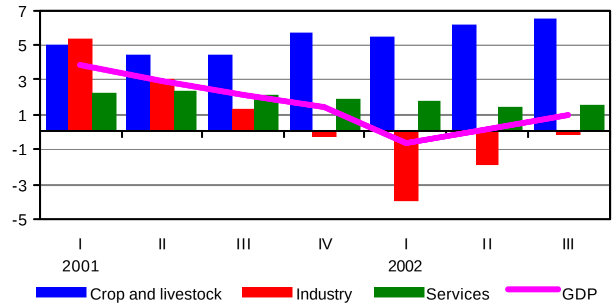
In the third quarter of the year, GDP expanded by 0.93% in comparison to the previous period, according to the statistical series from which seasonal factors have been removed, thus confirming the growth perceived by monthly activity level indicators. This growth was spread over all sectors, though industry led the way with 1.3%.

When one considers the first nine months of 2002 compared to the same period of 2001, GDP expanded by 0.94%. The only sector to register negative growth was industry, with a decline of 0.22% caused by reductions in the subsectors of construction (5.25%) and public utility industrial services (1.74%). In the latter case, the recovery in relation to the previous results was a consequence of the decline in electricity consumption caused by the period of rationing in 2001. Other subsectors turned in positive growth, with 0.39% under manufacturing and 12.24% under mineral extraction, mostly as a result of expanded petroleum production.

The crop/livestock sector registered positive growth of 6.46% in the year up to September due, among other factors, to the performance of soybeans, beans, coffee, oranges and sugar cane, and steady growth in livestock farming. In the same time frame, the service sector turned in growth of 1.52%, as a result of increases in its different subsectors, with the sole exception of commerce, which remained stable. Parallel to these results, the heading of communications registered growth of 7.21%.

Another aspect that should be highlighted in any analysis of GDP growth refers to the relatively high difference between growth rates registered under the concepts of market prices (0.94%) and basic prices (1.32%), explained by the decline of 2% in the inflow of taxes on products in the period. This drop reflected the performances of those sectors that are most heavily taxed such as automobile, truck and bus production, electric and electronic equipment and manufacturing of machines and equipment.

Gross Domestic Product
% growth accumulated in the year



Source: IBGE

With incorporation of the result of the third quarter of 2002, the accumulated rate of GDP growth in the four quarters moved from 0.06% in June to 0.52% in September, reflecting improved performances in the crop/livestock and service sectors and recovery in the industrial sector, though growth remained negative. It should be emphasized that the deceleration of GDP over 12 months registered since the start of 2001 began turning upward, as expected, in the third quarter of the year, and it is now forecast that the upward trend will continue through the coming months.

Gross Domestic Product

Percentage change

Itemization	2001		2002		
	III	IV	I	II	III
Accumulated in the year	2.16	1.42	-0.62	0.21	0.94
Accumulated in four quarters	2.64	1.42	0.33	0.06	0.52
Quarter/same quarter					
of the previous year	0.58	-0.78	-0.62	1.01	2.38
Quarter/previous quarter					
seasonally adjusted	-0.57	-0.10	0.85	0.86	0.93

Source: IBGE

In this context, the estimate of GDP growth for 2002 came to 1.6%, due not only to a more dynamic recent pace of economic activity, but also to a more favorable basis of comparison, corresponding to the fourth quarter of 2001.

On a sector-by-sector basis, the growth expected for the crop/livestock sector (5.9%) is based on the performance of crop output up to October and continued growth in livestock output.

For the industrial sector, 1.3% expansion considers moderate growth in the product of the construction industry as of the month of August, plus recovery in public utility industrial services. In the latter case, these services are expected to expand in relation to 2001, though still below the level registered prior to electricity rationing. At the same time, the manufacturing sector has registered rather discreet recovery, as demonstrated by the various indicators for the sector. It is important keep in mind the fact that the results of the manufacturing sector have important direct impacts on the subsectors of commerce and transportation.

For the service sector, estimated 1.6% growth not only reflects the impacts of the crop/livestock and industrial sectors on transportation and commerce, but also the positive growth registered by the

Gross Domestic Product Estimates for 2003

Gross Domestic Product - estimate

Itemization	Weight [1/]	Percentage change in the year 2002	2003
Crop and livestock	8.4	5.9	6.0
Industry	37.6	1.3	3.2
Mineral extraction	2.9	12.1	8.0
Manufacturing	22.6	1.5	2.4
Construction	8.5	-2.8	3.6
Public utilities	3.6	1.4	3.5
Services	59.1	1.6	2.1
Commerce	7.5	0.6	3.2
Transportation	2.7	1.2	3.2
Communications	3.0	7.1	5.0
Financial institutions	6.6	1.6	2.0
Other services	11.2	0.7	1.8
Rents	12.0	1.9	1.7
Public administration	16.3	1.4	1.4
Financial dummy	-5.1	2.0	2.2
Value added at basic prices	100.0	1.8	2.8
Taxes on products	12.7	-0.4	2.6
GDP at market prices	112.7	1.6	2.8

Source: IBGE

1/ 2001 weight.

The 2.8% GDP growth estimate for 2003 is based on forecasts of expansion of 6% in the crop/livestock sector, 3.2% in industry and 2.1% in services.

Among the assumptions underlying this growth estimate, grain production is expected to expand by 8%, a figure slightly below the forecast issued by the National Supply Company (9.7%) in its field survey.

Grain production[1/]

In thousands of tons

Itemization	Production 2002	2003	Percentage change
Grain production	96 702	106 090	9.7
Cotton (seed)	1 245	1 288	3.5
Rice (in husk)	10 656	10 927	2.5
Beans	2 939	2 923	-0.5
Corn	35 268	37 054	5.1
Soybean	41 907	47 597	13.6
Wheat	2 894	4 500	55.5
Others	1 794	1 800	0.3

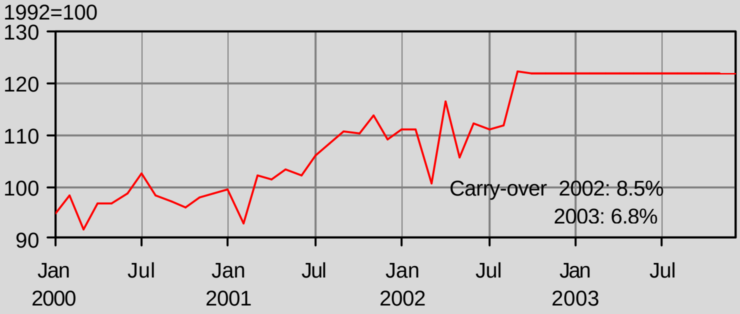
Source: Conab

1/ Refers to the 2nd. Systematic Survey of Agricultural Production.

The second factor considered is the steady growth in livestock output. In this sense, IBGE estimates for animal slaughters – excluding poultry – indicate growth of more than 8% in the current year and conclude that, should the pace registered in October 2002 be maintained in 2003, growth in the coming year will reach a level in the range of 6.8%.

Animal slaughtering (except poultry) and meat processing

Seasonally adjusted data



Source: IBGE

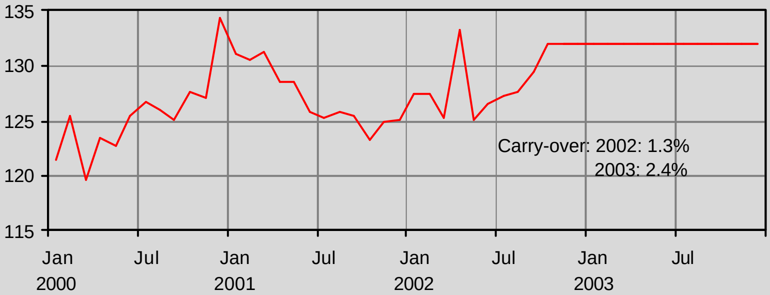
Growth in primary sector indicators coupled with the results forecast for coming months clearly support an estimate of 6% growth in the crop/livestock sector in 2003, a level quite similar to that registered in 2002.

In the industrial sector, the 2003 growth forecast of 3.2% is founded basically on expectations of expansion of 2.4% in the manufacturing sector, a rate equivalent to the productive levels registered in October 2002 when analyzed on the basis of data from which all seasonal factors have been removed.

In the case of the construction industry, the growth rate for the year was forecast at 3.6%, based on a slight reduction in the pace of the sector's activity – statistics free of seasonal factors – in relation to the October 2002 results.

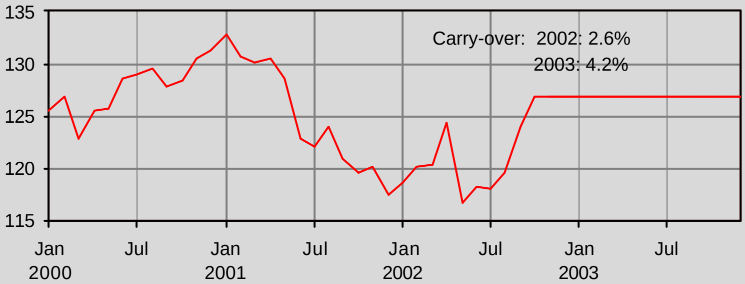
The following graphs indicate the carry-over of the manufacturing and construction industries for 2002 and 2003. Carry-over was estimated by projecting data for October of this year, based on statistics free of seasonal influences, to November and December of 2002 and all of 2003.

Manufacturing industry production
Seasonally adjusted data
1992=100



Source: IBGE

Production of construction inputs
Seasonally adjusted data
1992=100



Source: IBGE

In the service sector, the estimated growth of 2.1% is based on the following factors: reduction in the rates of growth registered in such subsectors as rents, a trajectory that has been noted for several years, and communications, due to the reduction in demand. In the subsectors of commerce and transportation, growth is a consequence of the behavior of the sectors of industry, crop/livestock farming and imports. Expansion in the subsector entitled "other services" is estimated at 1.8% and reflects expectations regarding growth in formal employment, as well as increases in the subitem of industrial output "engines and vehicle parts", utilized by IBGE as proxy for part of the services rendered to families.

Gross Domestic Product

Percentage change in the year

Itemization	2000	2001	2002		
			I H	III Q	Year[1/]
Crop and livestock	2.15	5.71	6.11	6.46	5.9
Industry	4.81	-0.31	-1.89	-0.22	1.3
Mineral extraction	10.36	3.90	12.98	12.24	12.1
Manufacturing	5.46	0.95	-0.82	0.39	1.5
Construction	2.62	-2.60	-7.42	-5.25	-2.8
Public utilities	4.23	-5.64	-6.71	-1.74	1.4
Services	3.80	1.86	1.39	1.52	1.6
Commerce	4.47	1.53	-0.97	-0.05	0.6
Transportation	3.07	5.18	5.32	1.73	1.2
Communications	15.60	9.92	7.40	7.21	7.1
Financial institutions	4.05	0.30	0.30	1.59	1.6
Other services	5.64	1.26	0.68	0.64	0.7
Rents	2.62	2.12	1.76	1.89	1.9
Public administration	1.47	0.82	1.36	1.42	1.4
Financial *dummy*	4.16	1.31	-1.04	0.76	2.0
Value added at basic prices	4.01	1.37	0.69	1.32	1.8
Taxes on products	7.34	1.78	-3.56	-2.05	-0.4
GDP at market prices	4.36	1.42	0.21	0.94	1.6

Source: IBGE

1/ Banco Central do Brasil estimates.

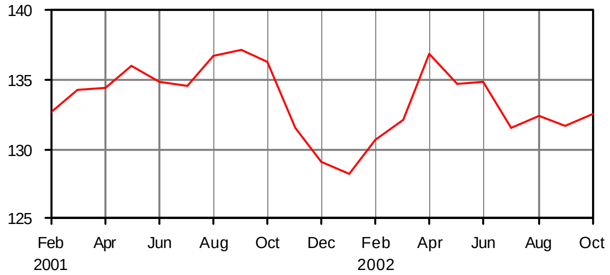
subsectors of communications and financial institutions. For items such as government and real estate rentals, which account for approximately 30% of GDP, it was necessary to utilize the quarterly performance figures for recent years since growth rates under these headings were stable. In the case of activities classified as “other services”, the outlook for formal employment was included in the calculation.

At the time of its publication of GDP results for the third quarter, IBGE takes advantage of the opportunity to introduce revisions into its measurements, with the objective of incorporating statistical information and alterations of a methodological nature. As a result of these procedures, 2001 GDP moved from 1.51% to 1.42% and the accumulated total for the first half of 2002 was raised from 0.14% to 0.21%. In the half-year period, the adjustment was basically a result of incorporation of more positive results for crop/livestock farming, as the overall growth figure was revised upward from 4.4% to 6.1%. In the industrial sector, the alterations were relatively discreet.

1.3 Investment and output capacity

Fundamentally, investment indicators reflected deteriorating expectations as of the start of the second quarter of the year. Thus, utilizing data from which seasonal factors have been removed, output of capital goods which had registered growth of 2.4% in the first quarter of 2002 and 2% in the subsequent quarter, compared to the immediately previous quarters, declined by 2.3% in the third quarter. In the month of October, the indicator closed with monthly expansion of 4.3%.

Capital goods production
Seasonally adjusted data
Quarterly moving average



Source: IBGE

Investment indicators

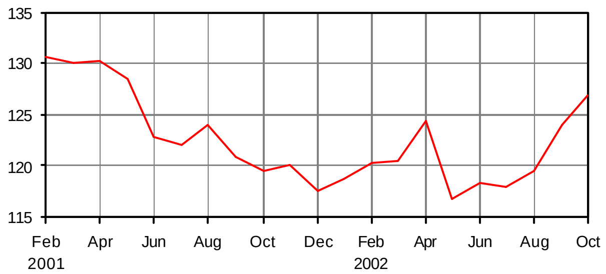
% accumulated growth in year

Itemization	2001	2002			
		I Q	II Q	III Q	Oct
Capital goods					
Absorption[1/]	18.7	-2.8	-3.8	-3.9	-9.3
Production	12.7	-1.8	-1.0	-1.9	-1.4
Imports	16.0	-19.6	-19.4	-13.0	-15.2
Exports	-13.7	-10.2	-17.8	-16.1	-12.3
Inputs for the building industry	-2.3	-8.7	-7.3	-5.4	-4.2
BNDES financing	9.4	17.8	25.7	45.4	51.0

Source: IBGE, Funcex and BNDES

1/ Capital goods production + imports - exports.

Production of construction inputs
Seasonally adjusted data
1992=100



Source: IBGE

The lesser dynamism of investments is also evident in a comparison of the accumulated results in the year with the corresponding periods of the previous year. In this framework, production of construction inputs and capital goods dropped by 4.2% and 1.4%, respectively, when one compares accumulated flows up to October. However, it should be noted that output of construction inputs registered positive monthly rates of growth from August onward, suggesting that the sector has moved into a process of recovery. Insofar as capital goods are concerned, October also registered a positive result. At the same time, the decline in absorption of capital goods intensified, with an overall drop of 5.1% accumulated in the year up to October, revealing reductions of 1.4% in the production of capital goods, 15.2% in imports and 12.3% in exports.

A breakdown of capital goods production figures according to product destination indicates that, up to the month of October, the falloff in investments was most heavily felt in the production of capital goods for the electricity sector, as a result of the relatively high basis of comparison in the same period of the previous year, and the virtual conclusion of the investment cycle generated by the energy crisis. In the same sense, one should highlight the decrease in the production of goods for the construction industry and goods produced in series, both of which are more sensitive to changes in the economic panorama. On the other hand, the segments that produce capital goods for the sectors of transportation and crop/livestock farming have continued registering relatively high performance levels. In the latter case, this result reflects the increase in income in the sector. Parallel to these results, production of industrial equipment on an order basis turned in very significant results,

Production of capital goods

Percentage change

Itemization	2001 Dec	2002 Jul	Aug	Sep	Oct
Quarter/previous quarter[1/]					
Capital goods	-5.9	-3.8	-1.7	-2.3	0.7
Industrial	-12.2	-2.7	-2.5	-0.2	4.0
Serial	-15.0	-2.8	-2.9	0.3	4.7
Nonserial	1.5	-2.0	-2.1	-5.1	-0.7
Agricultural	16.3	1.7	12.2	19.5	26.4
Farm parts	-6.4	5.5	4.5	5.2	5.0
Building	-8.2	-1.6	-2.8	-8.4	-12.5
Electric energy	-18.1	-24.7	-26.4	-36.0	-29.1
Transportation	2.9	0.0	2.8	3.2	1.2
Mixed	-7.9	4.8	6.8	2.0	1.2
In the year					
Capital goods	12.7	-0.9	-2.2	-1.9	-1.4
Industrial	4.1	-1.7	-3.3	-2.2	-0.7
Serial	3.5	-3.8	-5.5	-4.1	-2.3
Nonserial	6.6	8.6	7.5	6.9	6.7
Agricultural	20.0	13.4	15.9	18.7	20.0
Farm parts	3.4	-1.7	-3.0	-1.7	-0.2
Building	18.3	3.4	0.2	-1.6	-4.1
Electric energy	42.6	-9.9	-16.8	-21.8	-25.6
Transportation	12.2	5.2	5.1	6.1	6.6
Mixed	2.8	-5.3	-4.7	-2.9	-0.6

Source: IBGE

1/ Seasonally adjusted data.

Production of automotive vehicles

Percentage change

Itemization	2002 Jul	Aug	Sep	Oct	Nov*
In the month[1/]					
Farm machines	16.9	17.1	18.2	18.6	18.0
Buses	-8.7	4.3	7.9	3.3	21.7
Trucks	6.4	-9.9	5.0	4.9	7.1
Quarter/previous quarter[1/]					
Farm machines	2.8	6.7	13.1	16.1	15.7
Buses	-24.1	-19.4	-12.7	1.9	18.1
Trucks	-12.8	-13.4	-10.5	-3.0	5.7
In the year					
Farm machines	16.5	16.8	17.9	18.5	18.1
Buses	4.5	0.6	-0.5	-3.3	-3.8
Trucks	-14.1	-15.0	-14.6	-14.1	-12.6

Source: Anfavea

1/ Seasonally adjusted data.
* Preliminary.

through still on a declining trajectory. Given the specific characteristics of project maturation in this segment, it tends to respond to changes in the economic scenario with a considerable lag.

Going on to the mechanics industry, statistics released by the Association of the Machine and Equipment Industry (Abimaq) indicated an upward trajectory in the production of mechanical capital goods up to October. Compared to the same period of 2001, growth in the utilization of installed production capital came to 0.5%, with expansion of 2.2% in the number of employees in the industry. Deflated by the Wholesale Price Index (IPA) (production goods – machines, vehicles and equipment), the revenues of the sector registered accumulated 0.8% growth in the year. For the most part, this performance reflected intensification of demand for machines and implements for the farm sector, goods produced on an order basis and textile machines and accessories.

Corroborating this result, data released by Anfavea on output of farm machines up to November indicated 18% growth compared to the same period of 2001. All segments closed with significant expansion, with 34% under harvesters, 17.1% under wheel tractors and 8.6% under the heading of “sundry”, which includes motorized planters, caterpillar tractors and rear-end ditch diggers. Moving in the opposite direction, output of buses and trucks declined by respective rates of 3.8% and 12.6%, using the same basis of comparison.

Disbursements by the BNDES System, which encompasses the National Bank of Economic and Social Development (BNDES), the Special

BNDES disbursement[1/]

Itemization	2001	2002 Jul	Aug	Sep	Oct
	Accumulated in the year (in R$ million)				
Total	25 217	16 103	20 921	24 635	29 004
Manufacturing industry	12 760	8 482	10 117	11 699	13 962
Commerce and services	9 298	5 390	8 207	9 850	11 358
Crop and livestock	2 762	2 133	2 494	2 884	3 475
Extraction industry	396	98	103	202	208

Source: IBGE

1/ Includes BNDES, Finame and BNDESpar.

Investment as proportion of GDP

GDP share

Itemization		Gross fixed capital formation	Changes in inventories	Gross capital formation
1999	I	19.6	-0.3	19.2
	II	19.2	2.8	22.0
	III	19.3	0.7	20.0
	IV	19.1	1.2	20.3
2000	I	21.7	1.1	22.7
	II	20.3	2.3	22.6
	III	19.7	2.6	22.4
	IV	19.4	2.3	21.7
2001	I	20.6	1.8	22.4
	II	20.2	2.0	22.2
	III	20.0	2.1	22.1
	IV	19.4	1.5	21.0
2002	I	19.0	1.7	20.7
	II	18.8	1.5 [1/]	20.3 [1/]
	III	18.5 [1/]	1.5 [1/]	20.0 [1/]

Source: IBGE

1/ Banco Central do Brasil estimates.

Industrial Financing Agency (Finame) and BNDES Participações S.A. (BNDESpar), totaled R$29 billion up to October, for growth of 51% over the same period of 2001. On a sector-by-sector basis, the resources channeled into mining increased by 179%, those targeted to commerce and services grew by 70.9% and those absorbed by the crop/livestock and manufacturing sectors expanded by 60.3% and 35.2%, respectively. The Long-Term Interest Rate (TJLP), which is the reference used for calculating the cost of financing contracted with the BNDES System, was held to 10% per year in the fourth quarter of 2002.

Reductions in absorption of capital goods and the product of the construction industry, coupled with positive GDP growth, have been the factors that have led to cutbacks in the participation of investments in GDP over the course of the year. In this framework, estimates based on monthly investment indicators suggest that the ratio between gross fixed capital formation, which excludes stock variations, and GDP will decline from 18.8% in the twelve month period ended in June 2002 to 18.5% at the end of the subsequent quarter, using the same basis of comparison.

1.4 Conclusion

Economic activity has turned gradually and steadily upward over the course of the year, as demonstrated by the rates of quarterly GDP growth in the first three quarters of the year. To some extent, this evolution reflects increased internal consumption demand up to August, concentrated mostly under semi and nondurable consumer goods, and growth in exports.

Among the factors underlying these movements, mention should be made of releases of FGTS resources, farm income in the period and exchange incentives. Parallel to these factors, demand for consumer durables expanded in both August and September, powered by clearance sales and migration of resources out of financial funds.

Though the incentives provided by several of these factors have since cooled, a scenario propitious to continued economic growth in the coming months would seem to be on the horizon. Stock adjustments in the industrial segment, the relatively low default level, the outlook for a lesser level of commitment of the Christmas bonus made possible by larger releases of FGTS funds, and recovery in both consumer and business expectations, are all factors that contribute to the improvement in the prospects of the economy.

In relation to demand for investments, the major share of these indicators reflects the uncertainties that characterized the second and third quarters and produced rather negative repercussions.

The change that occurred in the formation of expectations in the final months of the year and the more recent outlook for expanded manufacturing activity are factors that could certainly contribute to a reversal in current trends.

Furthermore, one should note the trajectory of the labor market and the positive growth registered in most of the available employment indicators, even though the improvements registered are insufficient to absorb available labor and, consequently, still point to higher levels of joblessness when compared to 2001 levels.

2 – Prices

Consumer prices

Percentage growth

Itemization	2002										
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
Monthly											
IPCA	0.5	0.4	0.6	0.8	0.2	0.4	1.2	0.7	0.7	1.3	3.0
IPC-Fipe	0.6	0.3	0.1	0.1	0.1	0.3	0.7	1.0	0.8	1.3	2.7
IPC-Br	0.8	0.1	0.4	0.7	0.3	0.6	1.0	0.8	0.7	1.1	3.1
Accumulated in the year (annualized)											
IPCA	6.4	5.4	6.1	7.1	6.1	6.0	7.3	7.4	7.5	8.4	11.2
IPC-Fipe	7.1	5.1	3.7	2.9	2.5	2.7	3.5	4.6	5.1	6.2	8.7
IPC-Br	9.9	5.7	5.5	6.4	5.8	5.9	6.9	7.2	7.4	8.1	11.0
12 months											
IPCA	7.6	7.5	7.7	8.0	7.8	7.7	7.5	7.5	7.9	8.4	10.9
IPC-Fipe	7.3	7.5	7.0	6.4	6.3	5.7	5.2	5.0	5.5	6.1	8.2
IPC-Br	8.1	7.8	7.7	7.5	7.4	7.4	7.1	7.3	7.9	8.3	10.8

Source: IBGE, Fipe and FGV

In the quarter extending from September to November, the major price indices registered strong upward movement, closing with the highest rates of inflation since introduction of the Real Plan. It is important to note that the major factors underlying this behavior consisted basically of the impact of exchange devaluation and increases in government managed prices which, in turn, also reflected the currency depreciation process. Aside from these factors, mention should also be made of the repercussions of shortages of several important farm products, such as rice and corn. This specific problem will only be resolved after the off-season harvest period has come to an end.

2.1 Consumer price indices

Consumer prices

Percentage growth

Itemization	Weight	2002						
		Jun	Jul	Aug	Sep	Oct	Nov	In the year
IPCA	100.0	0.4	1.2	0.7	0.7	1.3	3.0	10.2
Food and beverages	22.7	0.1	1.1	1.9	2.0	2.8	5.9	15.0
Housing	16.4	1.1	1.8	0.4	-0.4	0.3	2.0	11.4
Domestic goods	5.7	0.1	0.2	0.7	1.7	2.3	2.9	10.6
Clothing	5.4	1.4	0.9	0.2	0.6	1.2	1.0	7.8
Transportation	21.4	0.3	0.6	-0.2	0.3	1.2	4.7	8.5
Health and personal care	10.6	0.2	0.5	0.5	0.6	0.6	0.9	7.3
Personal disbursements	9.4	0.3	1.0	0.5	0.6	1.1	0.4	6.0
Education	4.8	0.2	0.1	0.3	0.4	0.1	0.2	8.1
Communication	3.6	0.2	9.3	0.5	0.1	0.1	0.0	11.2

Source: IBGE

Broad National Consumer Price Index (IPCA)

In the quarter extending from September to November, the IPCA registered growth of 5.12%. The headings with the most intense rates of price growth were food (10.94%), household articles (7.04%) and transportation (6.3%). In the year, the IPCA accumulated expansion of 10.22% up to November.

Consumer prices

Percentage growth

Itemization	Weight	2002 Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	In the year
IPCA	100.0	0.8	0.2	0.4	1.2	0.7	0.7	1.3	3.0	10.2
Managed	27.7	2.2	0.3	1.1	2.6	0.2	-0.1	1.2	4.3	13.6
Farm	15.8	-0.3	-0.5	0.0	0.8	0.7	1.3	2.0	5.5	12.1
Exchange	14.3	0.1	-0.1	0.3	1.1	2.7	2.3	3.0	4.1	15.5
Services	21.6	0.5	0.4	0.1	0.7	0.4	0.4	0.2	0.4	4.8
Others	20.6	0.7	0.6	0.2	0.3	0.2	0.6	1.1	1.4	6.6
Exchange rate	...	-1.1	6.9	9.4	8.1	6.0	7.5	13.9	-6.0	51.4

Source: IBGE

Analysis of the IPCA components into different types of groupings makes it possible to highlight the impacts of the major inflationary factors on the recent dynamics of price behavior. With this, growth in the grouping of products with prices that are more sensitive to changes in the rate of exchange[1] came to 15.4% up to November, compared to exchange expansion of 51.4% in the same period of the year. It should be noted that changes in the prices of the items included under this heading intensified as of July, registering upward movement through to November, despite exchange appreciation in that month. By way of comparison, in 1999 this grouping registered growth of 15.2% as against growth of 8.94% in the IPCA and exchange depreciation of 52.9%. The items that registered the strongest price variations in the period from September to November were soybean oil (36.8%), chickens (22.1%), flour and pastas (21.6%), table bread (17.1%) and cattle (12.4%).

With regard to the grouping of government monitored prices, in the September to November period, the most important items were increases in airline tickets (24.6%) and fuel prices. In the latter case, with passthrough of 75% of the price increase at the refinery level to consumer prices, gasoline rose by 12.5%, alcohol by 46.3% and bottled gas by 3.7%, impacted by the residual impact of the price reduction that occurred in August. It should be stressed that of the 5.12% registered by the IPCA in the quarter, monitored prices contributed 1.49 p.p. and free prices with 3.56 p.p.

With regard to products with prices that are impacted mainly by the supply conditions of the farm sector[2], growth was registered in these rates as of September and, particularly, in November. Price growth in this segment reflected the off-season harvest period, and was

1/ In selecting the products included in this grouping, the correlation coefficients between the rate of exchange and 330 items from the grouping of tradables were calculated. In both cases, twelve month growth figures were utilized for the period from January 1996 to October 2002. The items with a correlation of more than 0.25 were included in the grouping.

2/ Under the item of food, prices respond both to factors characteristic of the agricultural situation in general and to the behavior of the rate of exchange, such as in the case of meats. These products were grouped under the heading of “exchange”.

further aggravated by climatic adversities caused by late rains that postponed the planting of several important crops, such as rice and beans, and by high temperatures that exerted pressures on the prices of *in natura* products, particularly in the month of November, when price growth in this segment totaled 5.8%.

In the segment of services, which accounts for approximately 25% of the weight of the IPCA, one should note that price growth in recent months has not varied significantly from that of the rest of the year. Specifically in the month of November – precisely the month in which the IPCA expanded most sharply – none of the service items or groupings turned in significant rates of price growth.

Aside from these figures, the grouping of "others"[3] has expanded since September, suggesting an across-the-board price increase. However, when one analyzes these prices more closely, it becomes evident that the increases were partly a consequence of growth in costs generated by exchange depreciation. In November, 25% of the grouping's contribution to this result was due to increased vehicle prices; 10% to higher prices for goods derived from cellulose (books, newspapers, magazines, toilet paper); and another 10% to the performance of items that contained imported components, albeit on a small scale, such as several types of home appliances, particularly refrigerators[4]. Therefore, it should be stressed that the recent increase in the prices of this grouping is mostly due to cost increases.

2.2 General price indices

In the period from September to November, price indices measured by the FGV followed the pattern of inflationary acceleration evident since the month of March. The General Price Index – Internal

3/ Included under this heading are such items as furniture, utensils and decorative items, footwear and accessories, glasses and lenses, reading, new and used automobiles and stationary products.

4/ It is possible that these products would not be classified under the heading of the exchange grouping (since they do not have a sufficient correlation with the rate of exchange) because they have only very small participation in total cost on the part of components that are sensitive to exchange, or because there are other factors responsible for the intensity and, above all, the length of the intervals between price increases (typical of cases like automobiles, which are subject to sectoral policies).

General indices

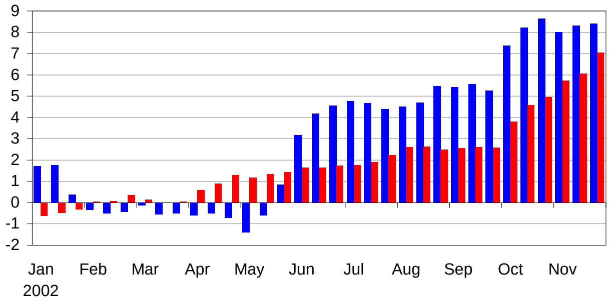
Monthly % change

Itemization	2002										
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
IGP - DI	0.2	0.2	0.1	0.7	1.1	1.7	2.1	2.4	2.2	4.2	5.8
IPA	-0.1	0.1	-0.1	0.8	1.3	2.5	2.8	3.3	3.3	6.0	7.5
IPC	0.8	0.1	0.4	0.7	0.3	0.6	1.0	0.8	0.6	1.1	3.1
INCC	0.4	0.6	0.5	0.3	2.5	0.6	0.3	1.0	0.6	1.1	2.5

Source: FGV

Evolution of IPA (10, M and DI) - agriculture and industry

Monthly % change



Source: FGV

Supply (IGP-DI) registered a monthly average of 4.23% in the period as comapred to 2.05% from June to August and 0.64% from March to May. To a great extent, general price indices were pressured by exchange depreciation and by the ongoing off-season farm period, which affected prices at both the wholesale and consumer levels.

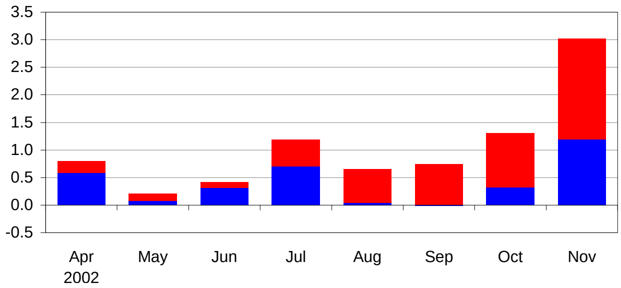
From September to November, the Wholesale Price Index – Internal Supply (IPA-DI) registered monthly average growth of 5.77% as a result of strong median growth rates under the prices of industrial goods (5.02%) and farm products (7.64%). A breakdown of the two subgroupings demonstrates the importance of the rate of exchange and the off-season farm period. Among farm products, particular emphasis should be given growth accumulated under the prices of such commodities as corn (68.9%), soybeans (31.9%) and wheat (28%), as well as items impacted by the shortage of internal supply, including rice (45.4%) and beans (15.8%). Among industrial goods, exchange depreciation impacted the prices of most products in the quarter, particularly in the cases of paper and cardboard (21.1%) and fertilizers (15.9%). The prices of industrialized food products moved upward by 26.5% in the period and also reflected off-season farm product pressures.

The other two components of the IGP-DI also registered increasing growth over the course of the quarter. The National Cost of Construction Index (INCC) expanded by 4.3% in the period, mostly reflecting the 7.3% rise in the prices of building materials, as the prices of such goods as cement and steel increased by 14.7% and 16.2%, respectively. Insofar as the Consumer Price Index – Brazil (IPC-BR) is concerned, growth in the quarter came to 4.65%. In this case, the major impact originated under items with government monitored prices and the grouping of foodstuffs, particularly in October and November, just as occurred in the IBGE indices.

2.3 Monitored prices

Evolution of IPCA

Contribution % change

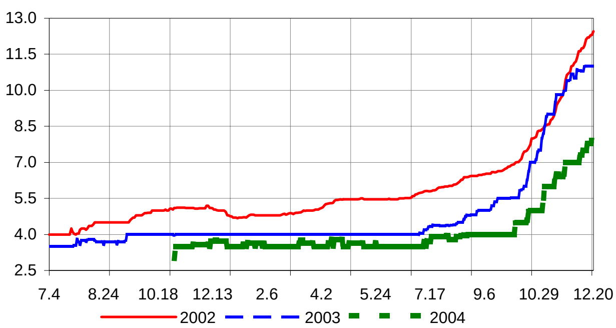


Source: IBGE

The grouping of IPCA items into free prices and monitored prices indicated a growth tendency in the two segments in the period from September to November that came to 5% and 5.4%, respectively. Expansion under monitored prices accounted for 1.48 p.p. of the IPCA rate in the quarter, registering increases in the prices of several items with significantly high weight in the composition of the index. In this context, the price of bottled gas, which had been reduced by 12.4% on August 19 and impacted the September and October rates, increased once again on November 5 (22.8%), reflecting upward movement in international prices as well as exchange depreciation up to October. The same factors were responsible for increases of 12.09% and 20.5% in the prices of gasoline and diesel oil, respectively, on November 4. In the quarter, electricity rates increased by 13.24% in Goiânia, 19.88% in Porto Alegre and 17.11% in Rio de Janeiro. Urban bus fares rose by 8.33% in Rio de Janeiro, 17.65% in Belém, 7.14% in Curitiba, 25% in Goiânia and 26.6% in Brasília. Parallel to this, price increases in the quarter under alcohol (46.3%) and airline tickets (24.6%) contributed importantly to the result.

2.4 Market expectations

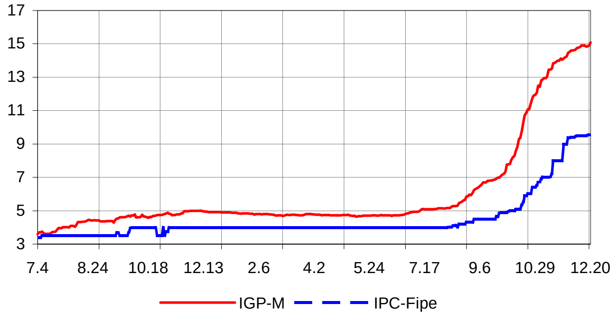
Daily evolution of market expectations for inflation (IPCA) (median)



Banco Central's Investor Relations Group (Gerin) carries out a daily survey involving a sampling of an average of about one hundred consulting companies and financial institutions, in order to detect market expectations regarding the evolution of the major economic variables.

As measured by the IPCA, the median expectation for 2002 moved from 6.64% on September 20 to 12.46% on December 20, 2002. For 2003 and 2004, expectations shifted from 5.5% and 4% to

Daily evolution of market expectations for inflation for 2003 (median)

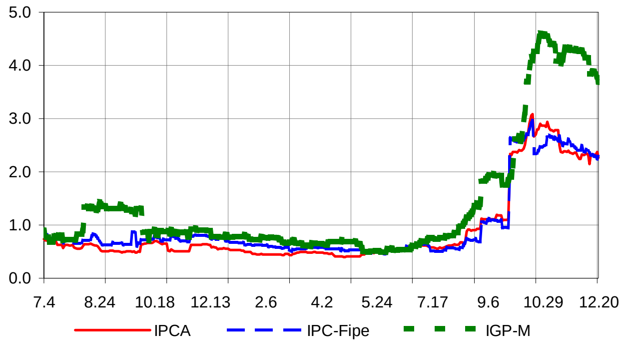


11% and 7.9%, respectively, between the two dates cited above. With respect to the median of the top five short-term forecasting institutions, their expectations increased from 6.64% to 12.64% for 2002, from 5.27% to 11.1% for 2003, and from 4% to 8.5% for 2004.

Going on to the IGP-M, median expectations for 2002 moved from 11.99% on September 20 to 25.61% on December 20. For 2003 and 2004, the figures increased from 7% and 4.5% to 14.9% and 8.46%, respectively. Expectations surrounding the IPC-Fipe for 2002 increased from 5% on September 20 to 9.85% on December 20, For 2003 and 2004, expectations increased from 4.5% to 9.54% and from 3.92% to 6%, based on the same dates.

Insofar as the median expectations of the top five short-term forecasting institutions are concerned, the result increased from 12.98% to 25.91% in 2002, from 7% to 14.23% for 2003 and from 4.5% to 9% for 2004, in the case of the IGP-M.

Standard deviation of market expectations for inflation in 2003



The standard deviations of the price indices expected for 2002, which had registered 0.38% for the IPCA, 1.34% for the IGP-M and 0.4% for the IPC-Fipe on September 20, 2002, shifted to 0.83%, 0.87% and 0.46%, respectively, on December 20, 2002. For 2003, expectations of the standard deviation rose from 1.09% for the IPCA, 1.74% for the IGP-M and 0.94% for the IPC-Fipe on September 20, 2002, to 2.27%, 3.67% and 2.28% on December 20, 2002, in the same order.

2.5 Conclusion

Analysis of price indices indicates that the causes of the recent inflationary spurt have, up to the moment, been the effects of exchange depreciation since April and the worsening of the impacts of the off-season agricultural period in the last two months. It should be stressed that analysis of the prices of those services (segment of nontradables), the prices of which do not incorporate exchange depreciation, and those consequent upon climatic adversities indicates that it is still possible to affirm that the recent price increases originated in changes in relative prices and not in an increase in the level of inflation. However, one should consider the possibility that the recently corroborated growth in the level of activity and recovery of consumer confidence may generate future price increases in segments that have not been directly impacted by supply shocks.

Despite this possibility, inflation is expected to lose momentum as of the December results, since the more critical part of the off-season agricultural period will have passed at the same time in which the outlook for the rate of exchange will have improved considerably. The partial results of those price indices that include part of December in their calculations already point in this direction. However, this cooling-off process will be gradual as a result of the lag in generated effects on consumer prices, exchange depreciation and increases in wholesale prices caused by the off-season agricultural period.

3 – Credit, monetary and fiscal policies

3.1 Credit

The volume of financial system credit operations in the September-November quarter was influenced basically by exchange rate fluctuations. In this context, demand for banking reserves in recent months has remained stable, particularly as a result of the uncertainties of the economic scenario and upward movement in interest rates.

Growth in credit operations

R$ billion

Itemization	2002				Growth	
	Aug	Sep	Oct	Nov	3 months	12 months
Total	354.0	375.8	372.5	376.4	6.3	11.8
Nonearmarked	208.2	218.8	214.1	213.7	2.6	8.0
Legal entities	132.0	142.0	137.1	136.7	3.6	7.1
Ref. to exchange	60.8	67.9	62.7	59.6	-1.8	2.1
Individuals	76.2	76.8	77.0	77.0	1.0	9.6
Earmarked	125.0	135.4	138.3	142.4	13.9	21.6
Housing	21.4	21.7	21.8	21.9	2.5	3.7
Rural	27.7	29.2	30.9	31.9	15.2	19.1
BNDES	74.8	83.9	84.5	86.4	15.5	32.5
Others	1.2	0.7	1.2	2.2	83.0	-43.4
Leasing	10.3	10.4	10.2	10.2	-0.9	-14.9
Public sector	10.4	11.2	9.9	10.0	-3.8	4.1
% participation:						
Total/ GDP	26.3	27.0	25.5	24.9		
Nonearm./GDP	15.5	15.7	14.7	14.1		
Earmarked/GDP	9.3	9.7	9.5	9.4		

With regard to the supply of resources, the financial market instability generated to a certain extent by exchange volatility led institutions to adopt a more cautious stance in granting credits. Though defaults dropped in the quarter, financial institutions became much more conservative and selective in their credit operations and sought to concentrate them in lower risk transactions.

As a result, the overall volume of credit operations, including nonearmarked and earmarked resources, came to a total of R$376.4 billion in November, corresponding to growth of 6.3% in the quarter and 13.2% up to November. The participation of loans in relation to GDP ended at 24.9%.

Operations with specifically targeted resources totaled R$142.4 billion in November, for 13.9% growth in the quarter. The factors that contributed to this growth were expansion of 15.5% in financing granted by the BNDES, with a total balance of R$86.4 billion, and seasonal growth in operations contracted by the rural sector. In the latter case, this expansion reflected greater demand for current expenditure credits to meet the needs of the 2002/2003 farm harvest. The balance of credits targeted to the housing sector came to R$21.9 billion, for growth of 2.8% in the period.

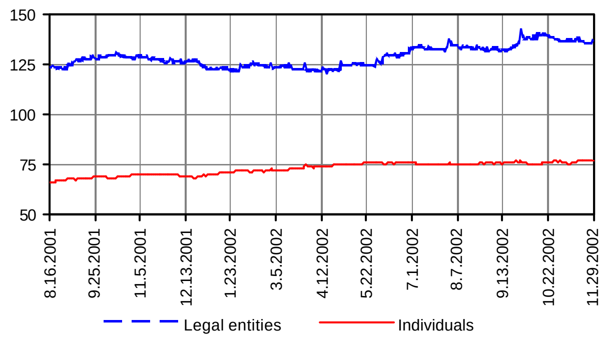
In the September-November quarter, BNDES disbursements totaled R$11.4 billion, for growth of 72.2% in relation to the corresponding period of 2001. Of this total, R$4 billion were targeted to export activities and, in keeping with the nation's economic policy guidelines, had the purpose of complementing external trade credit lines.

A breakdown according to sectors of activity indicates that disbursements absorbed by the manufacturing industry totaled R$5.3 billion in the quarter, reflecting growth of 66.6% in relation to the volume registered in the same period of the previous year. Here, financing was channeled principally to the segments of transportation, food, chemical products and machines and equipment. Financing channeled to commerce and services added up to R$4.9 billion, with growth of 89.1% on the same basis of comparison. The major targets of investment operations were infrastructure projects in the areas of energy and electricity, as well as the sectors of commerce, vehicle repairs and land transportation. Disbursements to the crop/livestock sector accounted for 9.4% of the total and expanded by 31.2% in the period. It should be noted that the most representative share of these operations was channeled into micro, small and medium businesses.

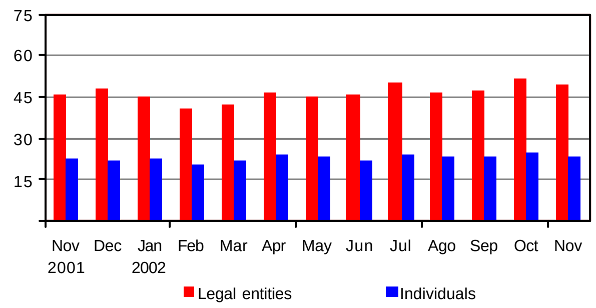
Consultations with the BNDES, which indicate business intentions regarding the use of new investments, came to a total of R$10.3 billion in the quarter, for a reduction of 15% in relation to the corresponding period of the previous year. Basically, the decline in the volume of consultations should be ascribed to the large number of requests for investment projects in infrastructure in the second half of 2001, principally as a result of the repercussions of the period of electricity rationing.

Financing contracted by the public sector totaled R$9.8 billion in November, for a decline of 5.1% in the quarter, while leasing operations closed at R$10.4 billion, remaining stable in the period.

Credits with nonearmarked resources - stock
R$ billion



Credits with nonearmarked resources - total grantings in the month
R$ billion



The volume of credit operations based on nonearmarked resources accounted for 56.8% of the total financial system stock and closed the month of November at R$213.7 billion. The 2.6% growth registered in the quarter was a consequence of the evolution of operations contracted with legal entities, which increased by 3.6% to R$136.7 billion. With regard to new credits granted to this segment, growth came to 4.9% in comparison to the average for the previous quarter.

The modalities that utilize internal resources turned in the highest growth figures, with 8.2% in the stock level and 7.8% in quarterly average disbursements. This performance can be attributed to restrictions on external financing lines, resulting in migration of these operations to the domestic credit market, particularly those referenced to Interbank Deposits (DI). In this context, it should be noted that the results under working capital operations showed growth of 11.6% in volume and 16.6% in average credits granted in the quarter. Parallel to this, seasonal growth in sales of farm inputs for the sowing of the 2002/2003 harvest stimulated vendor operations with agribusiness companies, as demonstrated by growth rates of 22.7% and 20.1%, respectively, in the stock and in the quarterly average of credit operations contracted in the segment.

As far as credits based on external operations are concerned, reductions were registered in the balance of operations (1.8%) and in average quarterly credits granted (8.9%). This was a direct result of cutbacks in external trade credit lines and a significant volume of settlements of external onlending operations. Furthermore, it should be emphasized that Banco Central's role in providing funding to financial institutions to finance exports partly offset the shortage of international credit lines for the foreign trade sector.

The volume of operations with individual borrowers came to R$77 billion in November, for growth of 1% in the quarter. This behavior reflected the defensive posture assumed by families when confronted with decisions involving commitments of future income, as well as greater availability of resources as a result of larger than normal releases of Employment Compensation Fund resources. With regard to average credits granted to these borrowers, growth came to 5.2% in relation to the previous quarter and mostly involved rotating credit systems, special overdraft checks and credit cards.

Sectoral distribution and credit quality

The volume of credits targeted to the private sector totaled R$366.4 billion in November, for growth of 6.6% in the quarter. These operations were heavily concentrated in industry and the rural sector. Aside from exchange indexing of credits, other factors that contributed to this growth were loans to the export sector and loans earmarked to coverage of grain harvest expenditures.

Credits contracted by the industrial sector expanded by 10.8% and closed at R$118.8 billion. Here, the most important operations were those involving financing based on BNDES onlending operations for investments in the energy sector and exports of the aircraft industry. Credits targeted to the service sector came to R$66.3 billion, representing growth of 4.4% in the quarter. Operations with these segments were characterized by partial substitution of external credit lines with domestic lines, with an increasing volume of liquidations of external import financing and onlending operations, principally in the sectors of telecommunications, supermarkets and energy distribution. The stock of loans to the sector of commerce came to R$40.6 billion in November, or 5.8% more than in August.

Rural sector financing added up to R$31.9 billion. The 15.2% growth registered in the quarter reflects the seasonal nature of demand for resources to cover current expenditures as well as recovery in the prices of agricultural products. An analysis of the ends to which rural credit financing has been put shows that participation of investments and current expenditures came to 50.8% and 39.1%, respectively, while funding for marketing operations accounted for 10.1%. In the month of August, these participation levels had closed at 55.1%, 37.4% and 7.5%, respectively.

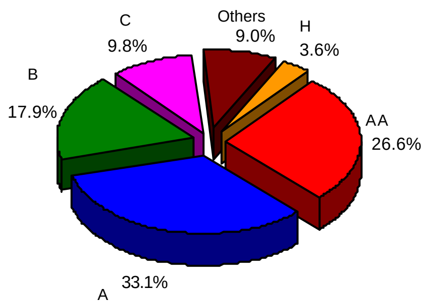
With the aim of improving the investment and productivity levels of the rural sector, additional resources totaling R$790 million were made available by BNDES and the Finame to be used by 12.20.2002 for acquisitions of agricultural machines under the terms of the Program of Modernization of the Farm Tractor Fleet and Associated Implements and Harvesters (Moderfrota).

Financing granted to the housing sector, including both targeted and free resources, totaled R$24.4 billion, with growth of 1.8% in the September-November quarter. Here, the most important operations were those carried out through the use of resources drawn from the Worker Support Fund (FAT) and FGTS. The accumulated flow of operations in residential financing totaled R$1.7 billion in the twelve month period ended in October 2002, compared to R$1.9 billion in the corresponding period of the previous year. Of this total, 72.5% were invested in real estate acquisitions and 27.5% were channeled to construction. Financing at interest rates defined by the Housing Finance System (SFH) added up to R$1.4 billion while those based on market rates totaled R$309 million.

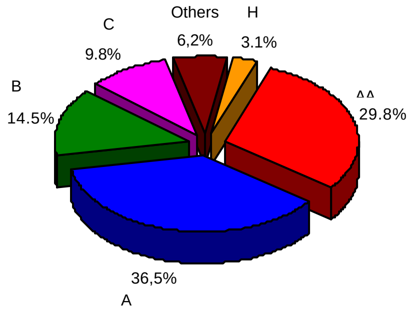
The banking debt contracted by the states and municipalities added up to R$6.6 billion in November. The 2.1% decline registered in the quarter evinces operations in which state debts were exchanged for receivables pertaining to sanitation companies. The federal government debt came to R$3.4 billion, reflecting a reduction of 6.8% due to securitization of liabilities related to the capitalization of federal banks by the government under the terms of Provisional Measure 2,196-3, dated 8.24.2001.

With regard to the profile of the financial system credit portfolio, operations rated as normal risk (levels AA to C) totaled R$329.2 billion in November, representing 87.4% of the total. Loans classified

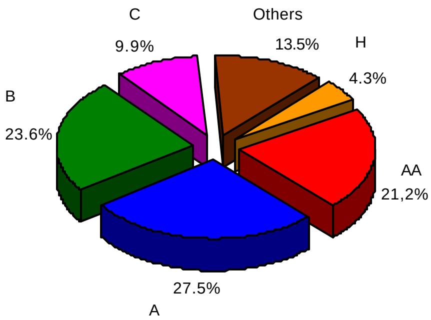
Credit operations in the financial system by levels of risk - November 2002



Credit operations in the private financial system by levels of risk - November 2002



Credit operations in the public financial system by levels of risk - November 2002



under risk level 1 (D to G) added up to R$33.8 billion and those rated as risk level 2 (H) totaled R$13.5 billion, corresponding to 9% and 3.6% of the total, in the same order. It should be noted that the relative participation levels registered in August were maintained.

Private financial system operations accounted for 62.4% of the total, with a volume of R$234.9 billion in November, with growth of 4.6% in the quarter. Here, the most important heading was that of seasonal financing targeted to the rural sector. Once the credit portfolio is broken down by risk level, assets rated as normal risk accounted for 90.7% of the total and those classified at risk level 1 ended at 6.2%. It should be noted that loans registered under risk level 2, which demands total provisioning, were stable in the period and closed at those R$7.3 billion, with participation of 3.1%.

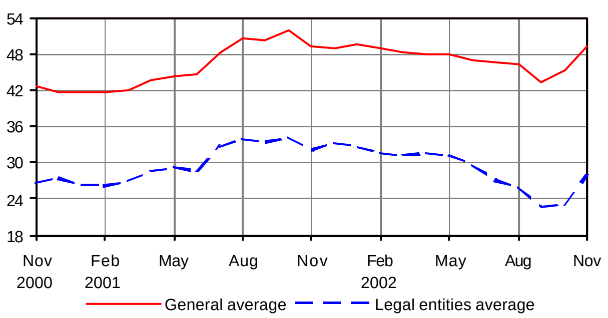
The public financial system credit portfolio added up to R$141.5 billion, for growth of 9.3% in the quarter. Here, the most important components were operations targeted to the industrial and rural sectors. A breakdown according to risk rating indicated that 82.2% were classified as normal risk and 13.5% at risk level 1. The percentage identified as risk level 2 accounted for 4.3% of total credits, the same level as in August.

Provisions set aside by the financial system totaled R$26.2 billion in November. Quarterly growth of 4.5% was due basically to recovery in credits written off as losses and classified at risk level H.

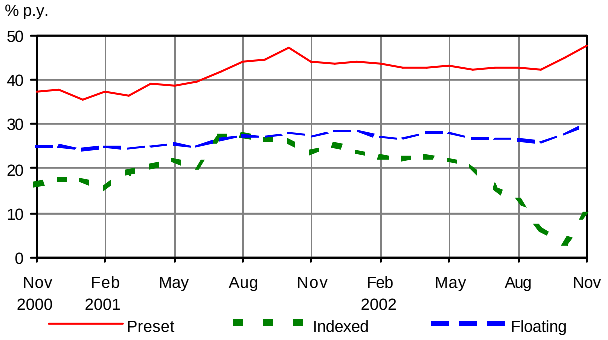
The relative participation of provisions in relation to total credits remained in the range of 7% over the course of the quarter. The total amounts provisioned by public and private banks came to respective levels of 8.1% and 6.3% of total credits granted by those segments in November. At the same time, defaults in the credit portfolio fell from 7.6% in August to 6.8% in November.

Interest rates on credit operations funded by free resources

Interest rates on credit operation preset rates - market average



Interest rates on credit operations - legal entities

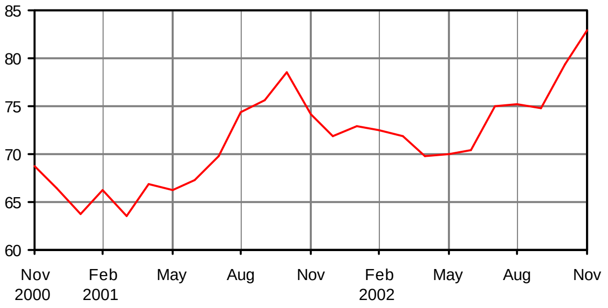


The average rate of interest on credit operations based on free resources increased by 3.2 p.p. in the last three months and closed at 49.5% per year in November. The rise in the Selic rate, the increase in futures market interest rates and the rates of additional compulsory reserves and reserve requirements on demand deposits, time deposits and savings accounts were the major factors underlying the increase in the period.

The share of credits targeted to the segment of legal entities in November accounted for 64% of the portfolio of credits funded through free resources. These operations consisted of transactions negotiated at preset interest rates, accounting for 35%, those negotiated at postset interest rates, with 46%, those referenced principally to exchange and operations contracted at floating interest rates, with 19%, and those referenced to the rates paid on Certificates of Interbank Deposits (CDI). The average rate of interest on operations with legal entities registered growth of 1.9 p.p. in the quarter, reaching 27.9% per year. One item that should be highlighted in the period was growth of 4.8 p.p. in operations at preset interest. The annual rate projected for loans referenced to exchange, which consists of the negotiated rate plus expectations of exchange rate growth, declined by 2.7 p.p. in the quarter, a period marked by strong volatility as a result of the uncertainties that affected the exchange market in recent months. In operations at floating rates of interest, the average rate increased by 3.5 p.p.

Interest rates on credit operation preset rates - Individuals

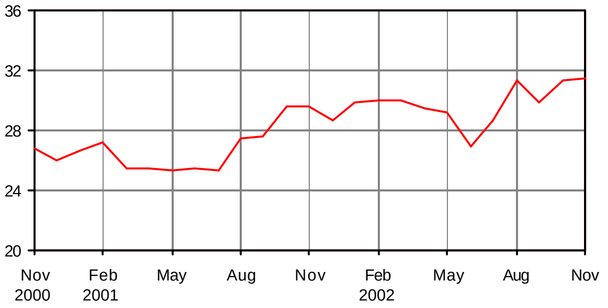
% p.y.



The median rate on loans granted to individual persons and negotiated mostly at preset interest came to 82.9% per year in November, or 7.6 p.p. more than in August. To some extent, this result reflected expansion of 9.6 p.p. in the rates on personal credit operations. In cases involving vehicle acquisitions, which account for the major share of operations with individual borrowers, the rate increased by 4.9 p.p. in the quarter, due to the rise in futures market rates and the fact that the installment periods used in this type of financing tend to be quite long.

Spread on credit operation preset rates - market average

p.p.

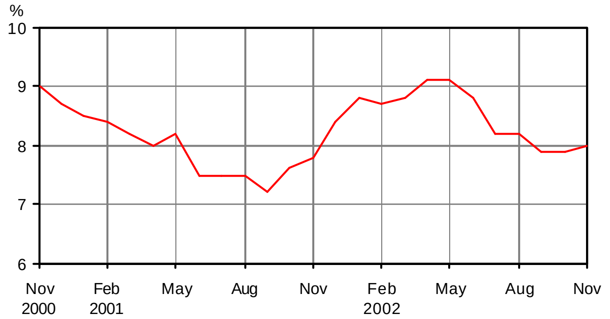


In credit operations based on nonearmarked resources, the banking spread remained stable in November at 31.5 p.p., revealing the symmetry that exists between the growth of the lending rate in the last two months and the rise in funding costs that resulted from upward movement in the Selic rate and futures market interest rates. As of August, the rate came to 1.5 p.p. more than in the first half of the year, reflecting growing financial market uncertainties.

The average terms of the credit portfolio funded with free resources remained relatively stable over the last fourteen months, closing November at 228 days. In the segment of legal entities, the average dropped by three days and closed at 178 days. Here, one should note the sixteen day drop that occurred between August and November in working capital operations and the thirteen day reduction in the terms of Advances on Exchange Contracts (ACC). The portfolio composed of individual borrowers registered growth of three days in the average financing term in the quarter to a level of 317 days. This result was a consequence of an increase of fourteen days in the term of personal credit operations to 223 days.

The default rate in loans based on nonearmarked resources dropped by 0.2 p.p. in the quarter, closing November at 8%. This performance reflected the channeling of FGTS resources into

Default rate of credit[1/]



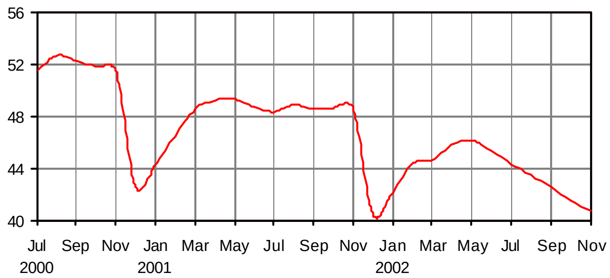
1/ Portfolio's percentage share of nonearmarked funds in arrears of more than 15 days.

payments of debts, at the same time in which financial institutions adopted a more selective stance in their credit operations in recent months. In operations with legal entities, the default rate remained stable to 4.3%, while the rate in the segment of individual borrowers dropped by 0.4 p.p. to 14.6% in November.

3.2 Monetary policy

Monetary aggregates

Currency outside banks - income-velocity[1/]



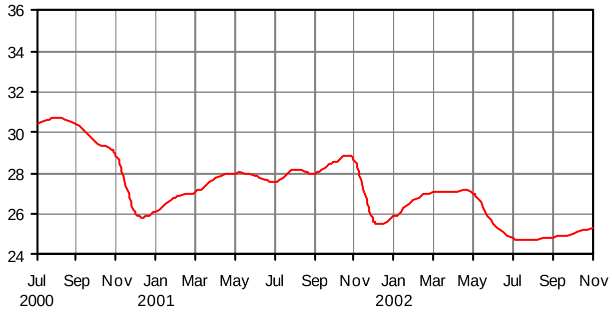
1/ Defined as the ratio between 12 month accumulated GDP (valuated by IGP-DI) and the monthly average balance of the monetary aggregate.

Viewed under the prism of average daily balances, the money supply (M1) came to R$91.3 billion in the month of November, for growth of 33.2% in the twelve month period, including increases of 35.7% in currency held by the public and 31.7% in demand deposits. The income velocity of currency held by the public has been moving downward over the course of 2002, indicating growth in this aggregate above nominal product. In relation to demand deposits, income velocity increased as of September, when nominal product began reflecting growth in the IGP-DI with greater intensity.

As of the month of June, several factors have directly or indirectly impacted growth in M1 components. Among these, disbursements up to November came to R$6.6 billion as a result of continued extraordinary releases of the FGTS, the volume of resources utilized to cover the expenses of the electoral process and the uncertainties consequent upon the elections themselves and, furthermore, the cost shock that followed the passthrough of the impact of exchange devaluation to price indices. In this framework, the average balance of currency held by the public totaled R$34.5 billion in November, and demand deposits came to R$56.8 billion.

Following a period of stability in the first half of the year, average daily monetary base balances increased as of July in a manner

Demand deposits - income-velocity[1/]

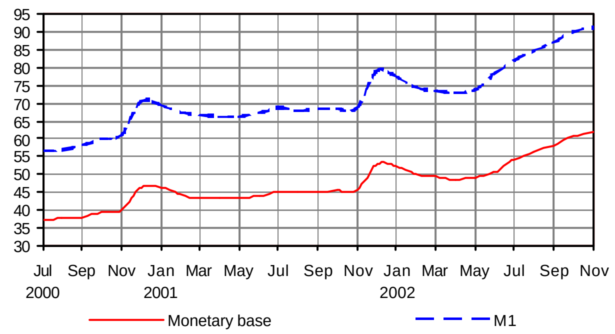


1/ Defined as the ratio between 12 month accumulated GDP (valuated by IGP-DI) and the monthly average balance of the monetary aggregate.

compatible with simultaneous growth in demand deposits, which closed November at R$61.3 billion, with growth of 34.6% in the last twelve months. The average balance of currency issued came to R$40.7 billion and that of banking reserves ended the period at R$20.6 billion, accounting for respective increases of 36% and 31.8%.

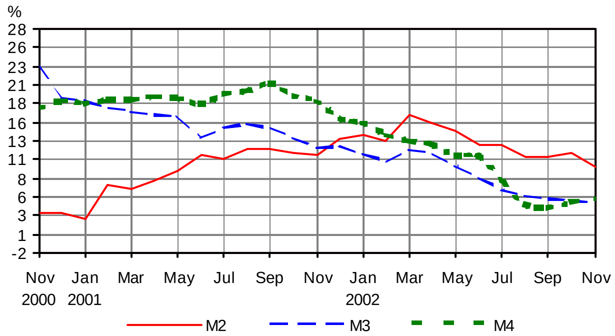
Monetary base and M1 - average daily balances

R$ billion



One factor that deserves highlighting is the September adoption of a new monetary base concept, designated B1, corresponding to the sum of the restricted monetary base and additional amounts of reserve requirements on demand resources. In November, the average daily monetary base balance in the B1 concept came to R$65.4 billion, of which R$4.1 billion refer to the additional amount of reserve requirements on demand resources. In order to adjust money market liquidity, Banco Central altered the additional reserve requirement on deposits in the banking system, based on the terms of Circular 3,157, dated 10.11.2002, raising the rate on demand and time deposits from 3% to 8% and that on savings deposits from 5% to 10%. The measure produced a contractive monetary impact of R$14.4 billion.

Broad money supply - 12 month percentage growth

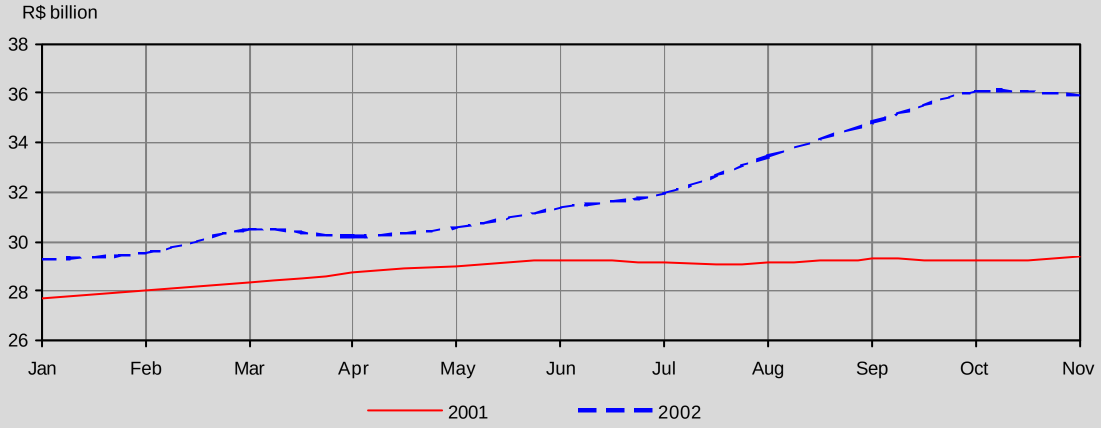


With regard to the broad money supply concept, evolution of the value of investment fund quotas in the September-November quarter reversed the trajectory of successive declines registered since April of the current year. The M2 concept, which is equal to M1 plus savings account deposits and securities issued by financial institutions, expanded by 4.8% in the quarter, with growth of 4.4% in the stock of private securities. M3, which includes M2, the portfolio of fixed income funds not included in the more restricted concepts and nonfinancial sector public securities consequent upon the net position of financing granted in repo operations, increased

Recent behavior of the M1 monetary aggregate

The atypical expansion of the restricted money supply noted as of the end of the second quarter of the year has given rise to debate on the possibility that the increase in currency demand may actually ratify the recent upturn in price indices. Data deflated by the IPCA and purged of seasonal factors indicate different growth trajectories for the M1 monetary aggregate between 2001 and 2002. Calculated on a twelve month basis, the growth rate rose by 4.1% in November 2001 to 19.8% in the same month of 2002.

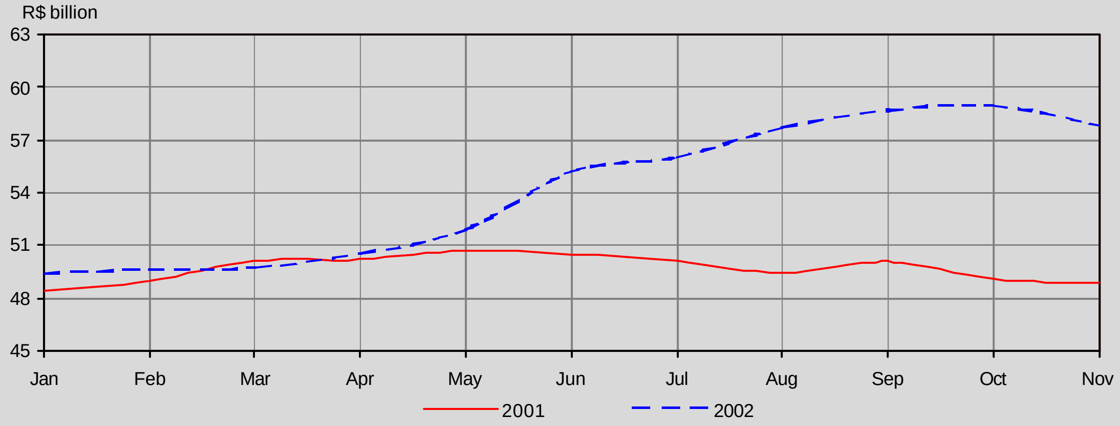
Currency outside banks - seasonally adjusted at November 2002 prices



Evolution of the M1 components is explained by a combination of factors that impacted the behavior of the public in the distribution of its monetary and financial assets:

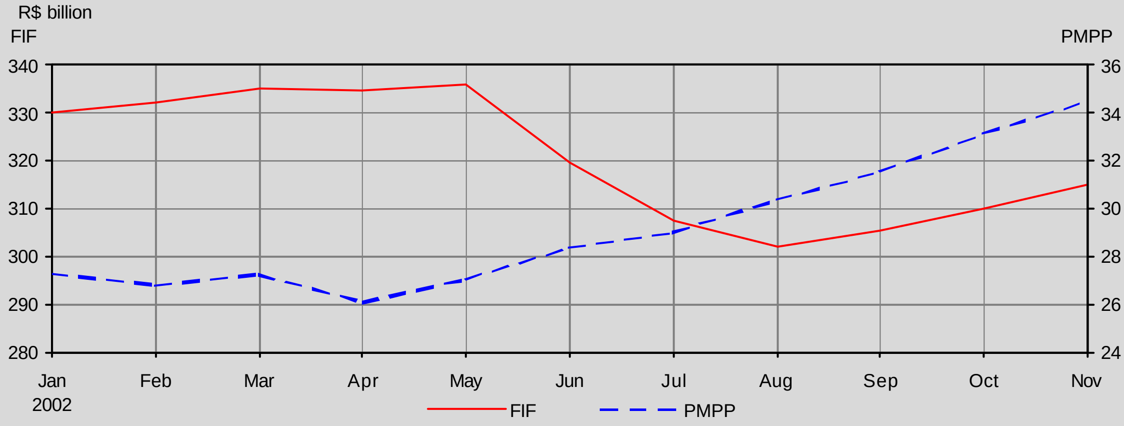
a) in the period from May to August, the migration of resources out of Financial Investment Funds (FIF) into other modalities of financial investments caused by the volatility of public security prices, particularly in the case of LFT. In the consolidation of these flows, it was

Demand deposits - seasonally adjusted at November 2002 prices



noted that part of the withdrawals effected against FIF was reallocated into demand deposits (DV) and currency held by the public (PMPP), either by necessarily transiting through current accounts or through simple withdrawal of the funds from FIF. Consequently, daily money supply balances turned in growth of R$18.3 billion in the period between May and November 2002, compared to R$4.8 billion in the same period of the previous year. The increases in the components of the restricted monetary aggregate reveal the magnitude of the uncertainties faced by economic agents in reallocating their resources, particularly those with less access to market information;

Financial Investment Fund and growth of currency outside banks



b) Complementary Law 110, dated June 29, 2001, authorized the Federal Savings Bank to credit the remaining portion of monetary updating resulting from cumulative application of the percentages of 16.64% and 44.8% to the balance of the FGTS accounts that existed in the period from December 1, 1988 to February 28, 1989 (Summer Plan) and during the month of April 1990 (Collor Plan). At the same time, it was determined that the costs involved

Severance Fund Contribution - Complementary credits

Payments in the month

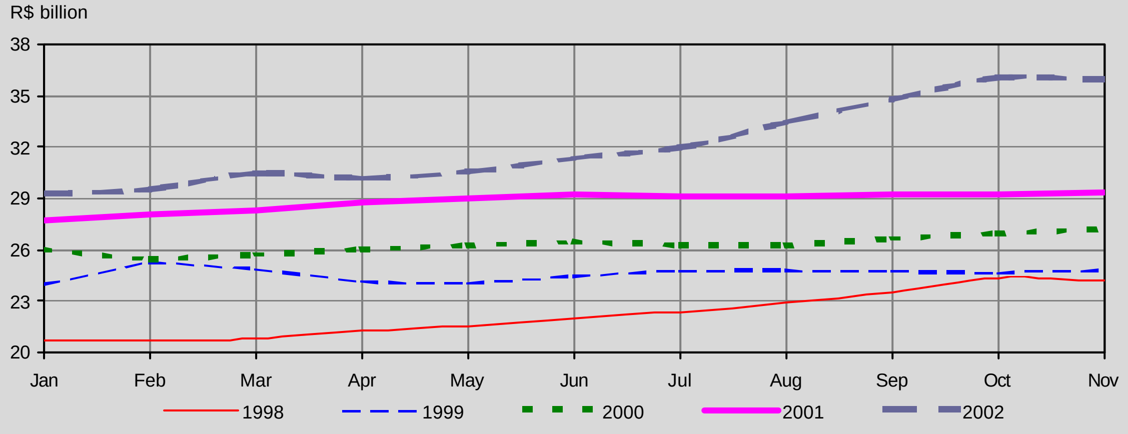
Period		Total payments effected		Payments effected up to R$100,00[1/]	
		Quantity	R$ million	Quantity	R$ million
2002	May[2/]	137	907		
	Jun	2 747	372	1 811	55
	Jul	9 716	1 632	5 992	178
	Aug	8 084	1 713	4 770	141
	Sep	9 270	1 132	6 713	191
	Oct	4 165	659	2 991	81
	Nov[3/]	1 847	379	1 480	38
Total		**35 965**	**6 793**	**23 757**	**683**

1/ Includes all types of withdrawals as provided by law, including those referring to Provisional Measure 55/2002.
2/ Payments referring to judicial decisions carried out up to May/2002.
3/ Estimates.

in this operation would be borne by the Fund itself. In the following month, Provisional Measure 55, dated 7.7.2002, permitted releases of resources not previously foreseen. The amounts were to be released in a single payment and involved the crediting of the complement of monetary indexing to those holding FGTS accounts with balances equal to or less than R$100, in which case there would be no need for corroborating formalization of the Statement of Compliance, and to FGTS account holders of 70 years of age or more. Since the first releases were made up to November 2002, the amounts credited to bank accounts or paid in cash came to approximately R$6.8 billion. Though the tendency is for these resources to be channeled into financial investments, they initially transit through the components of the restricted monetary aggregate where they tended to remain for shorter or longer periods of time, depending on the expectations of each agent in relation to the uncertainties of the electoral process;

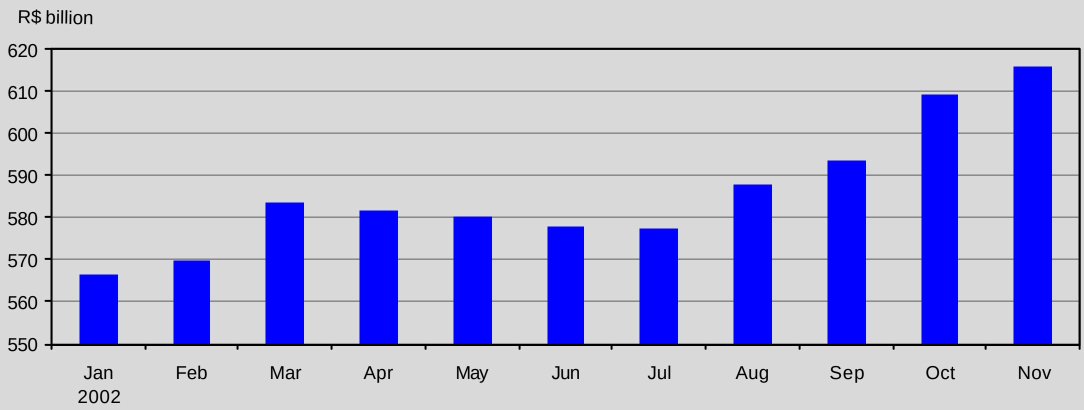
c) as of the second half of the year, funding was also channeled into paying the costs of the electoral process and this, in turn, directly impacted DV and, principally, PMPP. Once purged of seasonal impacts, a comparison of data from election years points to greater demand for currency in the months leading up to elections. Thus, one may draw a conclusion that the increase in the money supply is a consequence of three factors present in the current economic environment which have changed the economic agents demand for currency. The above mentioned factors only have an accidental nature and consequently tend to cause temporary impacts on growth of the aggregates.

Currency outside banks - seasonally adjusted at November 2002 prices



The performance of financial savings, defined here as the sum of the balances in savings accounts, investment funds and time deposits reinforces that idea. With the exception of the period in which investment funds registered high levels of withdrawals, the overall balance of financial investments followed an upward curve over the course of the year that was compatible with the nominal rates of interest of the economy. Particularly in recent months, the evolution of the balance of financial savings indicates renewed confidence in the system.

Overall balance of financial investments



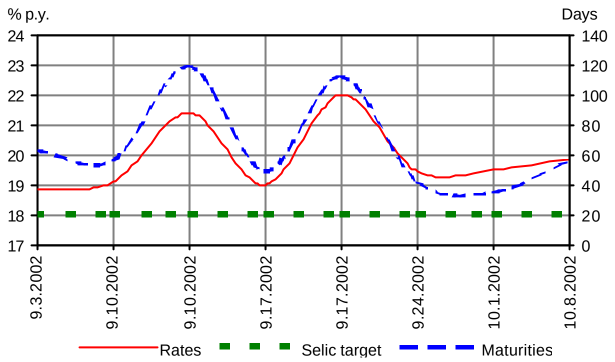
by 4.8% and closed above the level of capitalization of its components. The M4 concept, which encompasses M3 plus public securities held by the nonfinancial sector, came to R$797.5 billion in November, with growth of 4.4% in the quarter. Basically, this performance is a consequence of growth in federal public securities held by the public, impacted by exchange devaluation.

Public securities

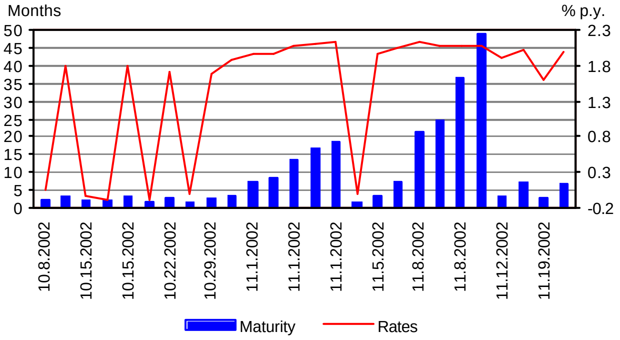
In the period from September to November, National Treasury operations were conditioned by declines in demand for federal public securities, a trajectory that impacted primary market placements of preset securities – National Treasury Bills (LTN).

As a result, there was a sharp increase in the interest rates proposed by financial institutions for papers with maturities of more than thirty days. Consequently, in the month of September, when the Selic rate target was 18% per year, preset papers with terms of less than four months were placed at rates of 22% per year. As of mid-October, even after the 3 p.p. increase in the basic interest rate, there was no consensus as to the proposals put forward by institutions for papers with preset profitability.

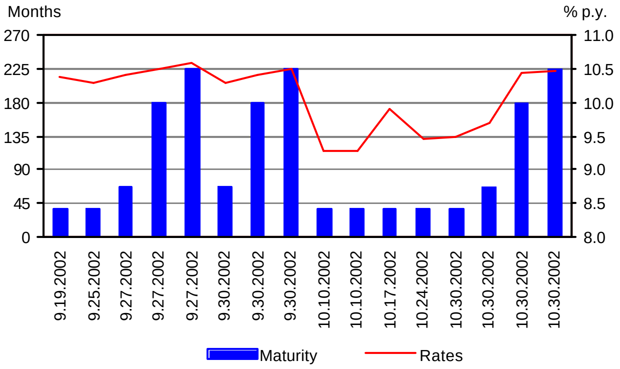
LTN placements



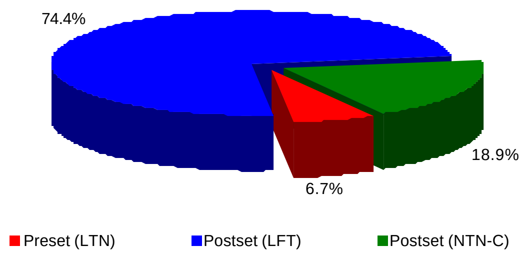
LFT placements on primary market - maturity x rates



NTN-C placements - maturity x rates



Competitive issues of federal public securities - primary market
9.3.2002 to 11.19.2002



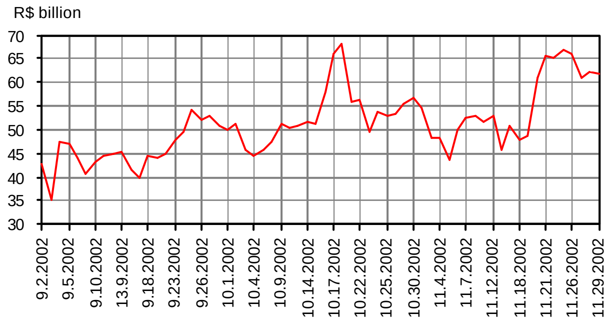
In this context, the National Treasury began issues postset papers referenced to the Selic rate (Treasury Financing Bills – LFT), with terms of no more than three months. The crisis of confidence that broke out in the weeks prior to elections was evident in the volatility of these rates. However, once the election had been decided, papers were negotiated with much longer terms, sometimes reaching as high as 48 months, with relatively stable discounts in the range of 2% per year.

Greater demand was also noted for federal public securities indexed to the General Price Index – Market (IGP-M) (National Treasury Notes – Series C – NTN-C). The reason for this was that financial institutions recognized the possibility of higher earnings on these papers since the index in question tends to be higher than other indices. Placements of NTN-C were made with greater frequency, at rates that varied between 9.3% and 10.5%, plus the growth in the IGP-M.

From September to November 2002, primary market placements of postset papers represented 93.3% of the total, with 74.4% corresponding to LFT and 18.9% to NTN-C, while preset papers accounted for 6.7%.

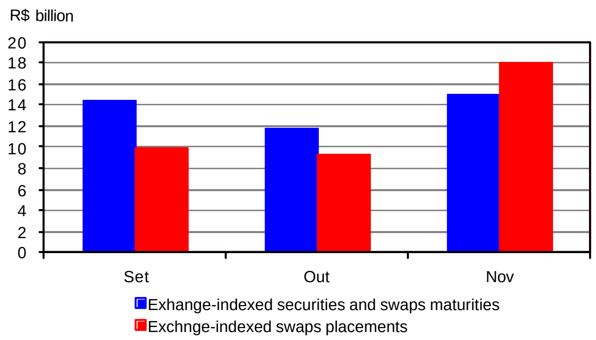
In general, public security operations in the quarter resulted in an increase in banking liquidity. The net financing position of federal public securities, which measures the difference between the value of the banking reserve account of the banks and the volume of public securities outside the Banco Central portfolio, registered an increase in the range of R$22 billion. At the end of November, financing taken by Banco Central with reversion agreements in open market operations registered amounts in excess of R$60 billion.

Federal public securities financing position



The process of rolling public securities tied to the rate of exchange was carried out through Banco Central operations on the derivative market of exchange swap contracts with maturities between 2002 and 2005. In the quarter, exchange swap contracts in the amount of approximately R$37 billion were placed while, in the same period, other securities and exchange swap operations equal to about R$41 billion matured. In other words, these operations resulted in the rolling of 90% of redemptions.

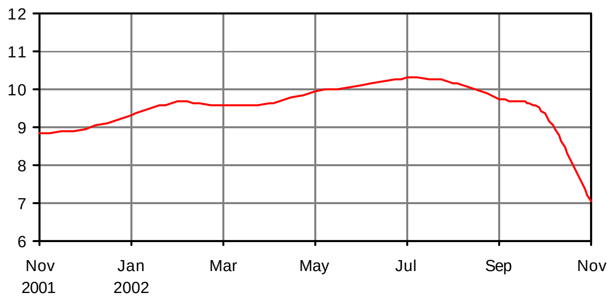
Exchange-indexed securities and exchange-indexed swaps



In the secondary market context, the process of purchasing and exchanging long-term postset (LFT) and exchange indexed (National Treasury Notes – Series D (NTN-D) and Banco Central Notes – Series E (NBCE)) federal public securities with maturities between 2002 and 2005, for short-term postset papers from the Banco Central portfolio continued. These operations were carried out with the objective of reducing the volatility of the prices of the public securities included in investment fund portfolios, while adapting these portfolios to the rules that allow marking according to the interest curve of the securities for papers with maturities of up to one year.

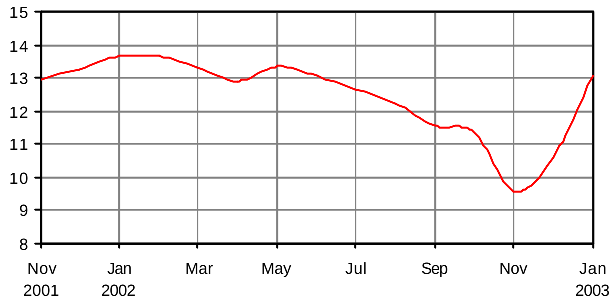
Real interest rates and market expectations

Ex-post real interest rate deflated by IPCA
% accumulated in 12 months

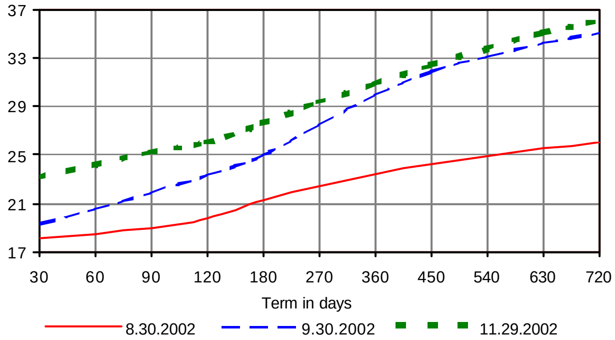


The twelve month accumulated Selic rate, deflated by the IPCA, dropped by 3.1 p.p. in the final quarter and closed at 7.1% per year, the lowest level since October 1991. This reduction resulted from the price rise that occurred in the period as a result of growth in the rate of exchange since May. In response to inflationary pressures, Banco Central raised the Selic rate target by 3 p.p. in October and by additional amounts of 1 p.p. in November and 3 p.p. in December.

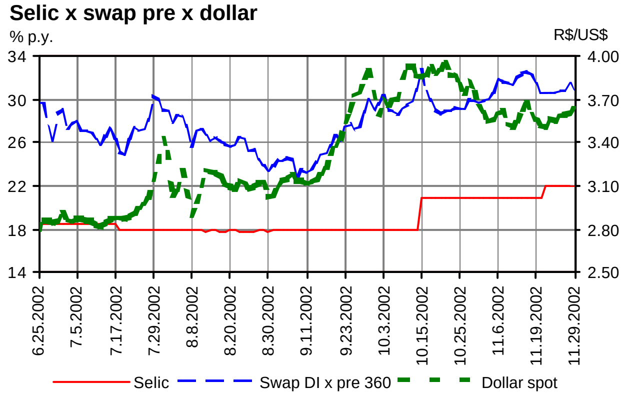
Ex-ante real interest rate deflated by IPCA
% accumulated in 12 months



Yield curve - swap pre
% p.y.



Selic x swap pre x dollar
% p.y.



Looking at market expectations for inflation, maintenance of the basic rate of interest at its current level of 25% per year will result in real interest (ex-ante) of approximately 13% per year, which is quite close to the rate of the first half of 2002.

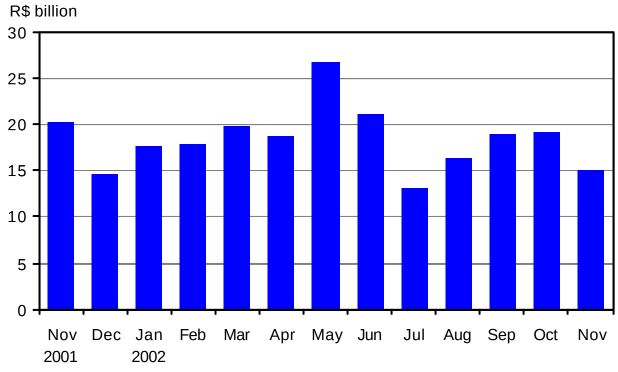
The increase in the basic rate reduced the incline of the preset interest curve in relation to that of September, the period of most intense exchange market volatility. The difference between the rates on contracts with terms equal to 1 year and the rates on those with terms of thirty days dropped by 2.9 p.p. to 7.8%. However, this amount is still higher than the August level of 5.4 p.p., explained by the uncertainties present on the internal and external scenarios.

The increase in financial market volatility in the quarter also impacted growth in the value of the dollar. In this case, growth came to 23.6% in the second half of September, accompanied by interest rates on one year contracts negotiated on the futures market, with growth of 5.9 p.p. in the same period.

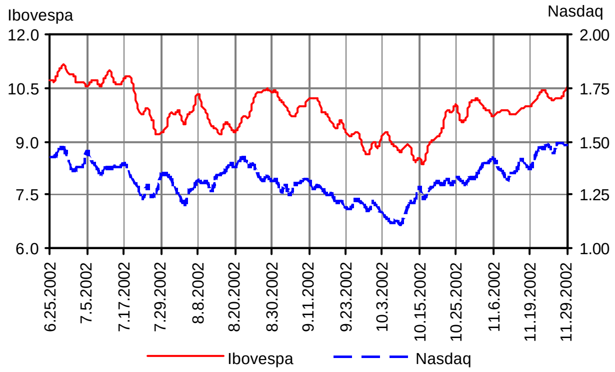
The conclusion of the electoral process and the statements by the president-elect that he intended to continue the government's commitment to harnessing inflation and exercising a policy of fiscal austerity contributed to dissipating the climate of uncertainty. In this framework, the rate of exchange which had come quite close to R$4/US$ in mid-October, settled back into the range of R$3.5/US$to R$3.6/US$ in the final days of November.

The average daily volume negotiated in one day DI contracts came to R$19 billion in September and October and was impacted by expectations of upward movement in the basic rate of interest. In November, the average volume dropped to R$15 billion as a

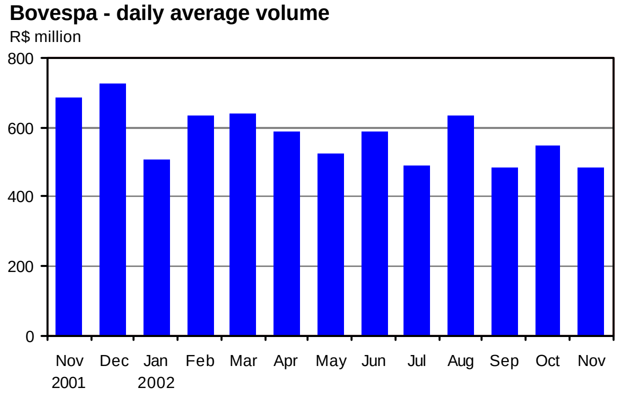
One day DI - average negotiated volume



Stock exchanges - thousand points



Bovespa - daily average volume



consequence of market expectations of an interest rate hike consistent with the inflation targeting system, as well as uncertainties surrounding selection of the new team of economic authorities.

Capital market

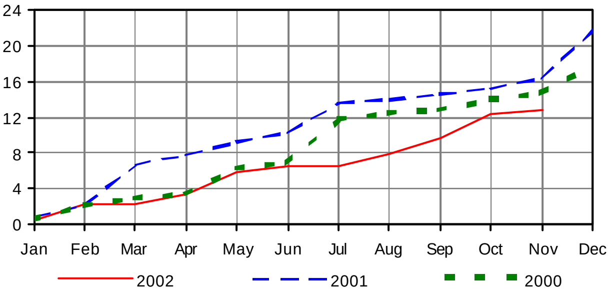
The São Paulo Stock Exchange Index (Ibovespa) closed November at 10,508 points after dropping to 8,370 points on October 16 the lowest mark since 1999. The upward movement of 25.5% in relation to the minimum October level was caused by the end of the electoral process and recovery in the American stock market. In the quarter, Ibovespa turned in growth of 1.2%, while the Dow Jones Industrial Average (DJIA) and the National Association of Securities Dealers Automated Quotations (Nasdaq) expanded by respective rates of 2.7% and 12.5%.

The average daily volume of trading at the São Paulo Exchange (Bovespa) from September to November came to R$505 million or 11% less than in the previous quarter. The negative performance of the Ibovespa in September and the lack of definition regarding the choice of the new economic authorities contributed to the falloff in the volume of trading in the quarter.

The climate of uncertainty generated by internal and external factors coupled with the low value of the papers traded on the exchange has clearly inhibited business demand for capital market financing. In this context, the financial volume of issues of stocks, debentures and promissory notes registered at the Securities and Exchange Commission (CVM) up to November was 20.9% below the 2001 level. In the quarter, financial volume came to R$5.1 billion or 50% more than in the previous quarter.

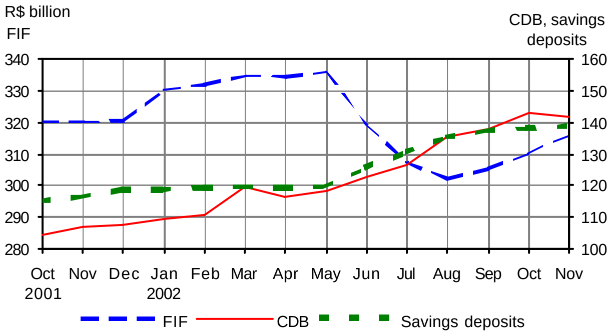
Primary issues - Stocks, corporate bonds and commercial papers

R$ billion - accumulated in the year



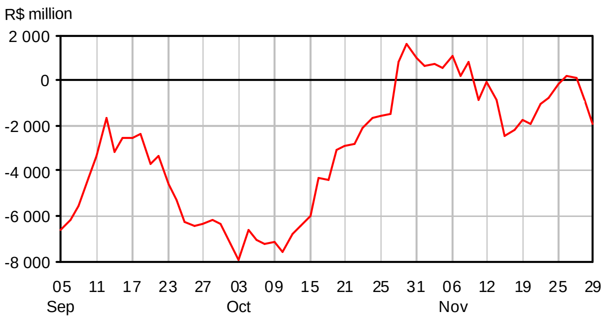
Source: CVM

Portfolio evolution of time deposits, FIF and savings deposits



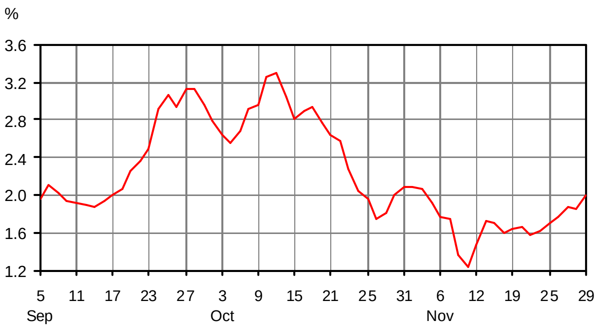
FIF - Daily net inflow

In accumulated terms during 21 working days



FIF daily earnings

In accumulated terms during 21 working days



Financial investments

The balance of financial investments, which encompass savings accounts, investment funds and time deposits, came to R$615.8 billion in November, for growth of 4.8% in comparison to the August level. The net worth of financial investment funds (FIF) totaled R$315.9 billion, for growth of 4.6% in the quarter. This result reflects the sharp reduction in losses in the quarter.

Among the various current fund profiles, investors showed clear preference for allocations to those with portfolios backed by federal public securities indexed to inflation indices.

FIF profitability was high in the period from September to November, with respective levels of 3.13%, 1.93% and 1.96%. This performance was related to the upward movement in the value of the funds referenced to the dollar and to assets tied to the IGP-M.

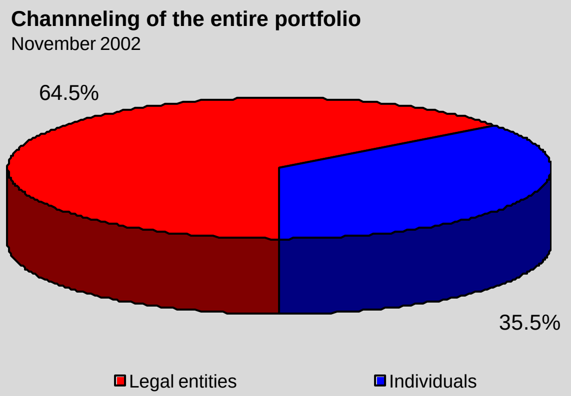
The net worth of stock funds, which encompass stock and security investment funds (FITVM) and mutual privatization funds (FMP) totaled R$25.9 billion in November, for growth of R$2 billion in the quarter, basically as a result of strong profitability in the month of October. In that month, the stocks listed on Ibovespa registered value growth of 17.9%, providing Stock Funds with earnings in the range of 13.6%.

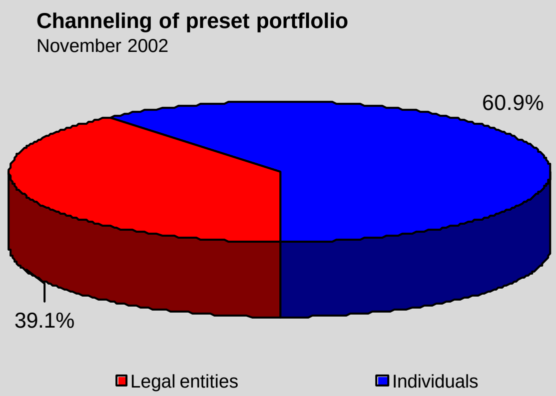
As far as nominal profitability accumulated in the year by the major financial investments is concerned, the FIF registered an average of 19%,

Median interest rate of credit portfolio funded by free resources

In 1999, Banco Central developed a methodology for calculating the interest rates and banking spread applied by the financial system to credit operations based on nonearmarked resources. This methodology took account of negotiated rates in loans at preset interest, since these accounted for the major share of credit portfolio operations (54% in October 1999) based on free resources and also in light of the limited information available at the time regarding other types of operations. This methodology did not include a variety of different types of postset contracts – loans referenced to the TJLP, Reference Rate (TR), the rate on Interbank Deposit Certificates (CDI) and exchange rate variations.

By limiting the universe of data to preset operations, the calculation methodology for both interest rate and spread overestimated the relative participation of loans granted to individuals, since these contracts are mostly tied to preset rates. In October 1999, loans to individual persons accounted for 23.4% of the total portfolio and 38.8% of the preset credit portfolio. Credit growth in 2000 and 2001 raised the participation of this segment in the total portfolio to 35.5% and to 60.9% in the preset portfolio. Since operations targeted to individual persons are characterized by rates that are higher than in operations with legal entities, the increase in the weight ascribed to this segment provokes an increase in the weighted median rate.



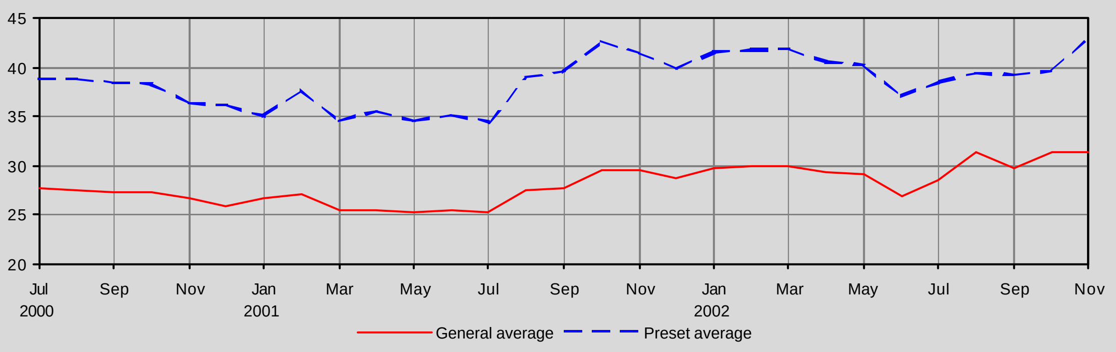


Based on the terms of Circular 2,957, dated 12.30.1999, Banco Central has, as of June 2000, received data segregated according to the type of agreed upon charge, thus increasing information with respect to operations that utilize floating interest rates. In this way, it was possible to revise the methodology then being utilized in such a way as to correct the distortion of weightings in the calculation of the median rate, including postset operations referenced to exchange, particularly for Advances on Exchange Contracts (ACC) and External Onlendings and floating operations.

In order to group the new data with those referenced to preset rates, it became necessary to measure the total cost of these operations, including the amount referring to the variable share of these contracts. In the case of floating rate operations, the daily value of the CDI was used, as determined by Circular 2,957. In loans tied to exchange, the share of cost associated to exchange was calculated according to the annualized differential between the median rate of the dollar on the spot market and the contract rate in dollar futures as negotiated on the Commodities & Futures Market (BM&F), corresponding to the term of each exchange modality. The median rate of the credit portfolio based on free resources was obtained by weighting the rates of each modality by the respective volumes.

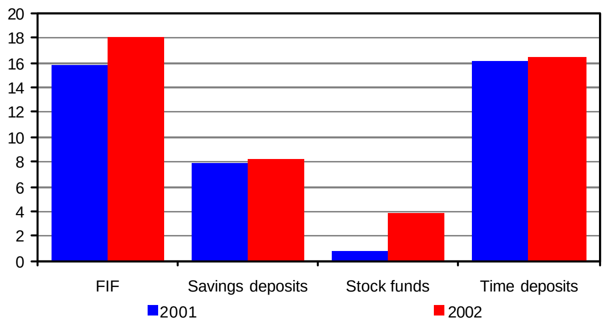
By aggregating the date for postset and floating operations for purposes of calculating the median rate, a distribution of the weights associated to each type of charge quite similar to that found to exist in the portfolio was obtained, with 56% referring to preset operations, 31% to postset operations and 12% to floating operations. The median rate of interest of the credit portfolio funded by free resources in November came to 49.6% per year, or 19.2 p.p. below the average rate referenced solely to preset loans. In the segment of credits to legal entities, the median rate calculated according to the new methodology came to 28.3% per year, compared to 47.4% per year in the previous calculation. This differential is explained by the characteristics of postset and floating rate operations generally contracted with large companies that are capable of generating additional banking business parallel to their credit activities. Interest in increasing the volume of business with these clients, the transfer of the market risk and low levels of default make it possible for financial institutions to apply more competitive rates than those practiced in preset operations.

Spread of credit operations preset rates - market average

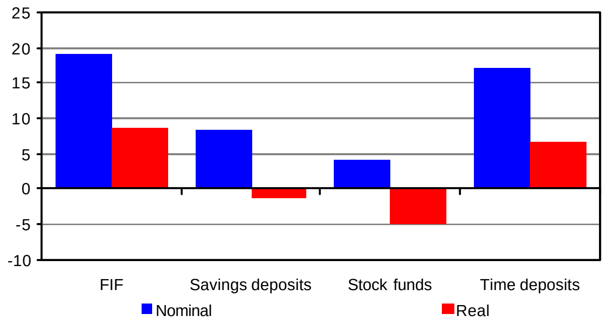


With the new methodology for verifying interest rates, alterations have also been introduced into calculation of the banking spread. Thus, the funding costs of financial institutions now include the Libor rate, the reference of exchange operations, plus the expected exchange variation, and the CDI rate, the cost reference of operations contracted at floating interest. In the month of November, the spread calculated with these alterations came to 31.4 p.p., closing 9.9 p.p. below the spread of preset operations.

Financial investments earnings
% accumulated until November



Financial investments earnings
2002 - % accumulated up to November



while demand deposits closed with 17%, savings accounts with 8.2% and stock funds with 4.1%.

In real terms, investments in savings accounts and stock funds registered negative returns in the period, when compared to growth in the IPCA in the period.

With respect to the performance of savings accounts, the unfavorable result should be analyzed in light of the inexistence of risk inherent to this type of investment and, principally, the recent evolution of retail prices. Thus, it is worth recalling the performance of the real rates of interest credited to these investments, considered the most popular of the different systems of private savings: since the first of July 1994, savings accounts have registered earnings of approximately 281%, while the IPCA has risen by 132%, corresponding to real interest of 65% in the period.

3.3 Fiscal policy

Public sector borrowing requirements

The primary surplus of the nonfinancial public sector came to R$57.1 billion, equivalent to 4.82% of GDP in the period from January to November 2002, compared to R$46.6 billion or 4.35% of GDP in the same period of the previous year. It should be noted that the steady positive results that have been achieved made it possible to go beyond the target of a R$50.3 billion surplus.

The improvement registered in the year's accumulated surplus was fundamentally due to the performance of the Central Government, which includes the Federal Government, Banco Central and National Social Security Institute (INSS), with an accumulated nominal result that moved from R$27.9 billion, or 2.61% of GDP, in the first eleven months of 2001, to R$36.3 billion, or 3% of GDP, in 2002. The results for regional governments and state enterprises remained stable.

With regard to the Central Government, the National Treasury registered a surplus of R$51 billion, or 4.32% of GDP, while the Social Security System and Banco Central closed with negative results of R$14 billion and R$707 million, respectively.

Revenue inflows came to R$287.8 billion, of which R$227 billion corresponded to inflows to the National Treasury, with growth of 20% in the period, and R$60.9 billion in Social Security revenues, representing an increase of 13.1%. Growth in Treasury revenues was impacted mainly by atypical factors that were not registered in the previous year:

a) payment of R$14.7 billion in tax debts in arrears, of which R$9.6 billion were effected by pension funds;
b) collection of R$6.7 billion with the Contribution on Intervention in the Economic Domain (Cide), the charging of which began in January of the current year;
c) increase of R$1.9 billion in collections of royalties and special participation in petroleum and natural gas production.

In the period from January to October, National Treasury expenditures came to R$177.6 billion, for growth of 17% compared to the same period of 2001. Disbursements for purposes of coverage of outlays on personnel and social charges added up to R$64.5 billion, with growth of 14.5%, and transfers to the states and municipalities came to R$51.4 billion and were driven by the increase in the income tax inflow, registering growth of 22.9% in the period. At the same time, expenditures on current and capital outlays reached R$61.7

billion, for growth of 15.1%. This heading includes spending on activities in the area of health, which came to R$19.9 billion, with growth of 12.4% in the period; outlays under the responsibility of the Ministry of Education (MEC), with R$6 billion, registering growth of 39.5%; and outlays with FAT resources totaling R$7.2 billion, and resources from the Fund for Combating and Eradicating Poverty, with R$3.1 billion.

With regard to social security benefits, the total came to R$75 billion, or 17% more than in the same period of 2001. This result was a consequence of an increase of 11.4% in the average value of benefits paid, reflecting growth in the minimum wage as of April 2002; of adjustments in other benefits as of June 2002; and of growth of 718.8 thousand in the average quantity of benefits paid in 2002.

Up to November, regional governments turned in an accumulated primary surplus of R$12.2 billion, of which R$10.2 billion corresponded to the states and R$2 billion to the municipalities. The accumulated total is equivalent to 1.04% of GDP, compared to 1% in the same period of 2001. One factor that contributed to this result was the reduction in outlays on investments which were below the level forecast in the budget, despite the election process.

Appropriation of nominal interest indicated growth in interest and exchange rates. In this context, appropriations totaled R$96.6 billion, 8.09% of GDP from January to November 2002, compared to R$78.2 billion, 7.24% of GDP, in the same period of the previous year. Interest appropriated by the central government came to R$40 billion, 3.4% of GDP, compared to R$39.6 billion or 3.66% of GDP; that involving regional governments came to R$46.9 billion, or 3.86% of GDP, compared to R$33.2 billion, 3.06% of GDP; and interest appropriated by state enterprises closed with R$9.7 billion, or 0.83% of GDP, compared to R$5.5 billion, or 0.51% of GDP, using the same basis of comparison. The more accentuated growth registered at the level of regional governments and state enterprises was basically due to accumulated exchange depreciation in the period, which impacted renegotiated external debts (Notification MF30, Brazil Investment Bonds – BIB, Paris Club, Program of Modernization of the Sanitation Sector – PMSS). In the case of regional governments, growth is projected in interest to be appropriated in the coming months as a result of expansion in the IGP-DI, which is the index used to adjust the balance of renegotiation of a significant share of debts with the Federal Government (23.09% up to November 2002, when compared to 11.04% in the same period of 2001).

Public sector borrowing requirements (NFSP) in the nominal concept, which includes the primary result and nominal interest appropriated, totaled R$39.5 billion, or 3.27% of GDP, compared to R$31.6 billion, or 2.88% of GDP, in the same period of the previous year. With respect to the major sources of financing, R$3.4 billion originated from debts and liabilities with banks, principally growth in compulsory deposits, R$23.4 billion resulted from external financing and R$7.3 billion corresponded to growth in the monetary base. On the other hand, the securities debt registered growth of R$5.7 billion in the period.

Federal securities debt

Evaluated according to portfolio position, the federal securities debt dropped from R$674.4 billion in July to R$632.1 billion in October. The major determinant underlying this reduction was that of net redemptions of R$85.3 billion registered in the primary market.

The share of the federal securities debt indexed to the rate of exchange dropped from R$192.2 billion in July to R$149.3 billion in November, motivated by net exchange redemptions of R$55.6 billion. In the period under consideration, participation of exchange securities in total federal securities debt dropped from 28.5% to 23.6%, while participation of the preset debt moved from 7.7% to 4.4% and that referenced to the Selic rate from 53% to 57.7%.

The amortization schedule of the public debt on the market, with the exception of securitized debt, financing operations and securities registered in Cetip turned in the following results in November; R$33.1 billion, 5.6% of the total, maturing up to December 2002, R$220.3 billion, 37.3% of the total in 2003 and R$336.5 billion, 5.7% of the total, as of January 2004.

Exchange swap operations came to R$88.6 billion in November, compared to R$57.7 billion in July. The result of these operations in the period, defined as the difference between the profitability of DI and exchange rate growth, was disadvantageous to Banco Central by a margin of R$14.9 billion, on an accrual basis. Based on the cash criterion, the unfavorable result came to R$7 billion. It should be noted that R$7.9 billion out of the total of R$14.9 billion refer to provisions for negotiations of SC2 contracts, in which settlement only occurs at the maturity of each contract.

Net public sector debt

The net public sector debt came to R$869.5 billion, 57.54% of the GDP in November, compared to R$660.9 billion or 53.25% of GDP in December 2001.

With regard to the factors underlying growth of the net debt, exchange depreciation of 56.7% registered in the period is the major factor behind this growth, accounting for R$157.9 billion or 10.45% of GDP, of which R$80.6 billion or 5.34% of GDP, correspond to the exchange impact on the internal securities debt indexed to the dollar and R$77.2 billion, 5.11% of GDP, to the exchange impact on the net external debt. Acknowledgement of debts contributed with growth of R$11.8 billion, 0.78% of GDP, and privatizations, with a reduction of R$3.6 billion, 0.24% of GDP. Note should also be taken of the reduction of 9.52 p.p. in the debt, referring to nominal growth of GDP.

Despite the fluctuations registered in the debt/GDP ratio, consequent upon oscillations in the rates of the real against the dollar, simulations of the dynamics of the net public sector debt indicate a continued sustainable trajectory, particularly as a result of the previously defined level of the primary surplus.

Net debt growth

Conditioning factors

Itemization	2001		2002			
	December		November			
	R$ million	% GDP	R$ million	% GDP	R$ million	% GDP
Total net debt - balance	660 867	53.25	869 473	57.54	869 473	57.54
Flows	**Accumulated in the year**				**Month**	
Net debt - growth accumulated in the year	97 703	3.82	208 606	4.28	3 261	-1.87
Conditioning factors	97 703	7.87	208 606	13.80	3 261	0.22
PSBR	42 788	3.45	39 536	2.62	6 423	0.43
Primary	-43 655	-3.52	-57 073	-3.78	-3 170	-0.21
Nominal interest	86 443	6.97	96 609	6.39	9 593	0.63
Exchange adjustment	37 814	3.05	157 944	10.45	-1 240	-0.08
Domestic securities debt 1/	19 182	1.55	80 751	5.34	- 699	-0.05
External debt	18 633	1.50	77 193	5.11	- 541	-0.04
External debt adjustment - others 2/	- 383	-0.03	2 917	0.19	-1 762	-0.12
Acknowledgement of debt	18 465	1.49	11 846	0.78	- 161	-0.01
Privatizations	- 980	-0.08	-3 637	-0.24	0	0.00
GDP growth effect - debt		-4.05		-9.52	0	-2.08

1/ Indexed to exchange rate.
2/ Parity of the currency basket which make up the net external debt.

3.4 Conclusion

Stability in demand for banking system credit is conditioned by uncertainties of an external and internal nature as reflected in growing aversion to risk on the part of various agents. In this framework, companies tended to postpone investment decisions, as did consumers, particularly when families faced decisions on commitments to high value items. In this segment, one should highlight the importance of the added income provided to families by releases of FGTS resources and its impact on consumption and the evolution of the monetary aggregates.

In this sense, when one considers the rather weak performance of bank loans, the monetary growth expressed by the more restricted aggregates should be seen as a result of factors such as the aforementioned releases and migration of resources, a normal process in times of high financial market volatility. Recent financial market evolution also reflected the uncertainties rooted in the electoral process.

The evolution of public accounts has evinced the government's commitment to continuation of the process of fiscal consolidation that has marked recent years. In this scenario, note should be taken of the surplus fiscal results at all levels of government, in such a way that the dynamics of the net public sector debt have been maintained on a sustainable trajectory, despite fluctuations caused by exchange market pressures. Continuation of this fiscal effort, coupled with positive perceptions of the commitment to preserve stability, will aid in improving perceptions of country risk and in consolidating the downward trajectory in the debt noted in coming months.

4 – International economy

The evolution of the world economy in 2002 was marked by the uncertainties and doubts that dominated the international scenario. Several factors deserve mention including the prospects of a double-dip recession in the United States, partly driven by grave corporate scandals in the first half of the year, downward slides in the world's principal stock exchanges, rather sluggish performance in the euro zone economies, persistent economic stagnation in Japan, volatile petroleum prices caused by the uncertainties that marked the Middle East political imbroglio, and the trend in global financial markets, described as the flight to quality, reflecting growing risk aversion on the part of international capital, in detriment to capital flows to the emerging economies and, particularly, those of Latin America.

However, in the final months of the year, this rather somber outlook gave way to a somewhat brighter scenario. Despite rather contradictory indicators, the United States economy has begun a process of gradual recovery, sustained basically by continued high levels of private consumption powered by a steady decline in the real rate of interest in recent quarters. The latter factor, in turn, has further strengthened demand for consumer durables and real estate.

In contrast to this situation, the Japanese economy remains mired in stagnation. Despite signs of recovery in both the external sector and industrial output, the country still faces serious economic difficulties, including persistent deflation that has affected goods, services and financial assets and the falloff in banking credits, despite recent measures taken by monetary authorities to increase liquidity and restructure the domestic banking system.

Insofar as the euro zone countries are concerned, the intensity of the process of economic deceleration has surpassed initial expectations. In this context, growth recovery came to depend more directly on recovery in the United States economy. It should be stressed that the 50 base point reduction in the short-term interest rate adopted by the ECB in the first week of December could stimulate the euro zone economy and, consequently, reduce the degree of dependence of the world economy on the United States economic juggernaut. Parallel to this, there was very little space for implementation of more expansionary fiscal policies.

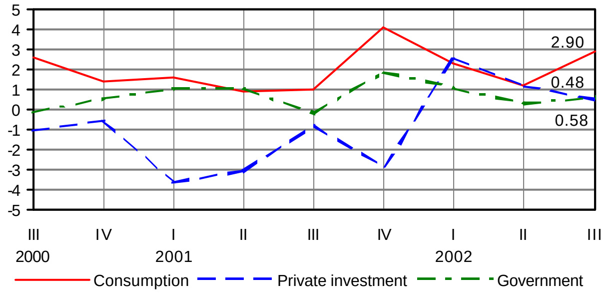
The world macroeconomic situation had a greatly different impact on the emerging economies as a result of their dependence on external financial resources. This dependence introduces elements of economic and political uncertainty and, therefore, increases perceptions of sovereign risk and feeds demand for higher earnings on the debts of these nations. In this framework, the degree of risk aversion found among international investors is more evident in the Latin American economies than in the emerging economies of Asia and Eastern Europe. At the same time, the languid performance of the Latin American economy over the course of 2002 contrasts sharply with the increased dynamics of the Asian economies and the moderate growth achieved by the countries of Eastern Europe.

4.1 United States

Private consumption, defense spending and stock replenishment were the principal factors underlying demand. Aside from this, purchases of equipment and software have shown signs of recovery at a time of only modest growth in the other components of private investment. However, the downturn in industrial output and high rates of unemployment revealed the still very slow pace at which the economy is operating. Thus, in the absence of pressures in the markets of goods and labor and considering deteriorating short-term expectations, monetary policy was utilized once again to sustain demand.

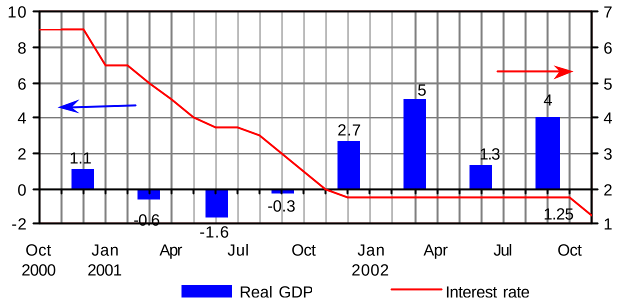
Though these factors are not sufficient to supply a clear picture of future economic trends, more recent results have apparently warded

Aggregate demand - components[1/]



Source: Bureau of Economic Analysis
1/ Contributions to percent change in real GDP. Seasonally adjusted at annual rate.

Real GDP[1/] and official interest rate[2/]



Source: Bureau of Economic Analysis and Federal Reserve
1/ Seasonally adjusted at annual rates.
2/ Target for the annual federal funds rate.

off fears of a more pessimistic scenario in the short-term that would include a double-dip recession and price deflation. This outlook is based on various factors, including maintenance of the growth pace, though clearly insufficient, and the gradual reaction of prices, albeit still quite limited.

In the third quarter of the year, the GDP result indicated real annualized growth of 4%, according to preliminary figures. Once again, the principal contribution to this result was rooted in private consumption (2.9%), followed by government procurements (0.58%) and private investment (0.48%), due basically to accumulation of stocks.

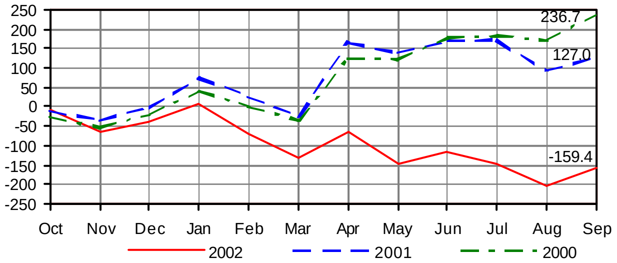
Retail sales decelerated in recent months under the impact of a downturn in automotive sales, one of the major factors undergirding recent demand. Thus, in the statistical series purged of seasonal factors, September was marked by a decline of 1.5%, followed by an October increase of 0.1%.

Orders placed with factories registered monthly growth of 1.5% in October, according to the statistical series from which seasonal factors have been eliminated. To some extent, this result reverses the declines of 2.4% and 0.4% registered in September and August, respectively. In the same sense, orders for durable goods expanded by 2.8% in October, following two consecutive months of downward movement.

Industrial and trade sector stocks increased by 0.1% in August and 0.5% in September, continuing the trajectory begun in the month of May. It should be stressed that the stock/sales ratio has not yet shown any consistent signs of recovery, suggesting that, in coming months, the stock replenishment cycle could be an important factor in sustaining demand.

In the fiscal year ended in September, the fiscal deficit came to US$159.4 billion, compared to a surplus of US$127 billion in the

Fiscal balance[1/]
Fiscal year
US$ billion

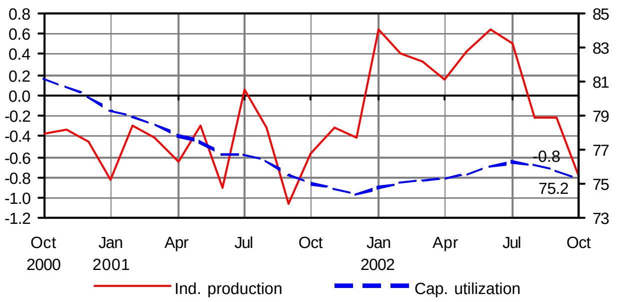


Source: Department of the Treasury
1/ Fiscal year = Oct-1 - Sep.

previous fiscal year. This result evinces the abrupt turnaround in the United States fiscal position. In October, the fiscal deficit came to US$54 billion, which was higher than the average in recent years.

Insofar as external demand is concerned, figures on the trade deficit – limited exclusively to goods – from which seasonal factors have been purged indicate a total of US$41.8 billion in September, based on exports of US$58.3 billion and imports of US$100.1 billion. For the most part, the increase in the current year's deficit reflects sharper growth in imports as a result of a gradual upturn in the level of domestic activity. With this, imports accumulated in the year up to September totaled US$857.6 billion and imports came to US$508.3 billion.

Industrial production and capacity utilization
Monthly percent change and capacity utilization

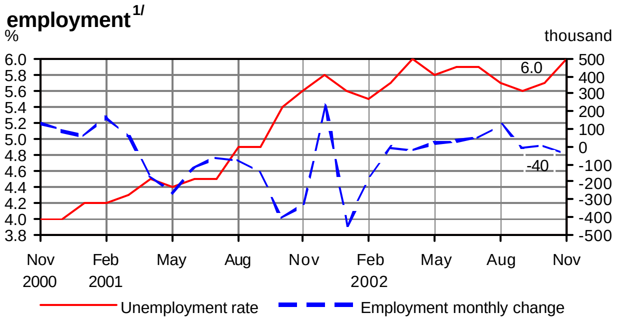


Source: Federal Reserve
1/ Seasonally adjusted.

Industrial output has registered successive declines since August, dropping by 0.2% and 0.8%, respectively in the months of September and October, according to statistical data purged of seasonal factors. Parallel to this trajectory, the level of utilization of installed capacity dropped in the last three months and closed October at 75.2%.

According to revised data, productivity gains in the third quarter of the year were high in the nonfarm and manufacturing sectors, with respective increases of 5.1% and 5.5%. In its turn, the unit cost of labor declined by 0.2% in the nonfarm sector and 1% in manufacturing, indicating some degree of leeway in the labor market.

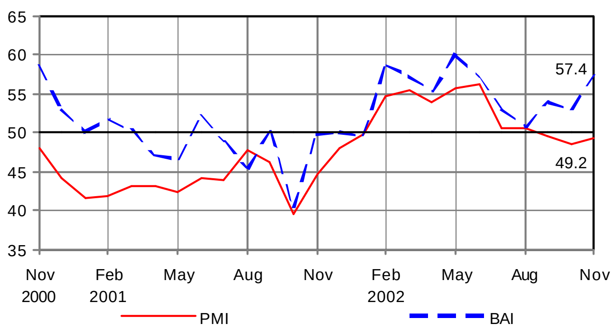
Unemployment rate and nonfarm payroll employment[1/]



Source: Bureau of Labor Statistics
1/ Seasonally adjusted.

Unemployment in the nonfarm sector increased to 6% in November after registering marginal growth to 5.7% in October. The trend toward recovery in the employment level that had begun in May of this year lasted for only four months and was partially reversed by elimination of 38 thousand positions in the last three months. At the same time, weekly hours worked showed no sign of recovery while real earnings on labor continued on a downward curve.

ISM Indicators



Source: Institute for Supply Management

As of the middle of the year, short-term expectations deteriorated rapidly, though some signs of recovery were noted in the final quarter of the year. The activity indicators released by the Institute for Supply Management (ISM) decelerated rapidly, though only that involving the manufacturing sector dropped below the point of equilibrium. In its turn, the indicator for the nonmanufacturing sector turned expansionary in September. With regard to consumer expectations, the third quarter was marked by an abrupt drop as reported by the Conference Board. Though the overall level continues quite low, November was marked by some degree of upward movement. The leading indicators performed in a rather different manner with gradual declines over the course of the period.

Despite acknowledging that its more relaxed monetary policy, coupled with productivity gains, has been one of the bulwarks of economic activity, the Federal Reserve (Fed) decided to adopt a further interest rate reduction at its November 6 meeting. The entity explained its position by stating that recent economic data suggest a more gradual recovery than previously expected. Consequently, the Open Market Committee voted unanimously to cut the fed funds rate, which had held firm at 1.75% per year since December 2001, by 50 base points to 1.25% per year.

Though inflation has been curtailed in the recent past, data for the month of November indicated that the trend toward price recovery in recent months has gained momentum, particularly in the case of producer prices. Thus, once the October increase of 1.1% in the prices of final goods is incorporated, annual inflation at the level of the producer was positive for the first time since September 2001. Though this spurt was caused mainly by localized factors, such as the 4.2% rise in energy prices provoked by rising fuel prices, the core index also registered upward movement, closing at 0.5%.

With regard to consumer prices, inflation came to 0.3% in October and an annual rate of 2%. The core consumer index increased by 0.2% in the month, with no significant signs of acceleration.

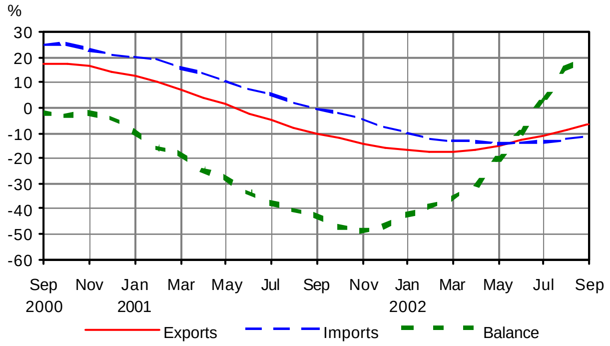
4.2 Japan

In the coming months, the positive performance achieved by the Japanese external sector and industrial output over the course of the current year will have to withstand growing uncertainties regarding world economic recovery, particularly in the United States, and falling demand for information technology intensive products. On the other hand, the country is moving in a somewhat plodding fashion toward the structural reforms required to overcome such serious domestic problems as deflation, high default levels and high levels of bank capital commitments to poor quality assets.

Insofar as demand is concerned, orders placed with factories reacted positively in the second and third quarters, reflecting the corporate investments generated by the export sector. Thus, average orders placed in the period from April to September were 1.5% greater than those registered in the previous half-year period. On the other hand, although core orders – which exclude orders classified as volatile – registered September growth of 12.7% over the August result, the government predicts a fourth quarter decline in this indicator, as a result of a falloff in private sector orders.

The index of new building starts remained stable over the course of the year, though it did decline by 6.2% in the third quarter when compared to the same period of the preceding year. Notwithstanding the 1.2% drop in available income in the period, spending on the part of wage earning families increased in real terms by 4.1% in September, when compared to September 2001 mostly as a result of consumption of cell phones, apparel and furniture. However, this increase should be analyzed in the light of the fact that consumer spending, which accounted for approximately 55% of GDP, has been hampered by wage cuts and pressures brought to bear on the banking sector by the Financial Services Entity to force institutions to register poor quality credits as losses, a measure that resulted in the bankruptcy of several borrowers.

Trade balance - Acc. change in 12 months

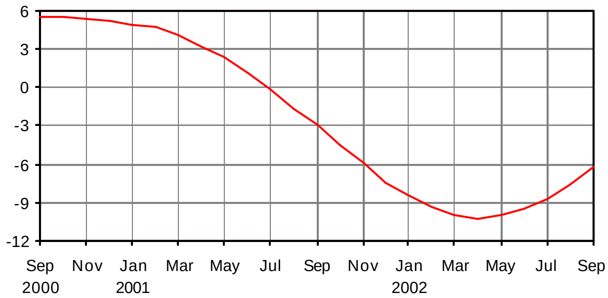


Source: Bank of Japan and Bloomberg

The dynamics of the Japanese economy over the course of the year was clearly generated by the export sector. Though foreign sales have been relatively stable in monthly terms, an analysis on the basis of either twelve month growth or a comparison of the month's result with that of the corresponding month of the preceding year points to upward movement. Using this basis of reference, one should stress that exports expanded by 14.3% in October, the eighth consecutive month of positive growth. Despite appreciation of the yen, this performance has been led by sales to Asian countries, with expansion of 28.1% when the October 2002 result is compared to that of the previous year, and a high of 95% in the trade surplus in the period.

Industrial production

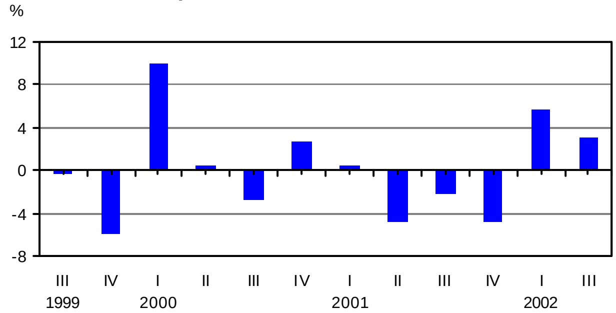
Accumulated change in 12 months



Source: Ministry of Economy, Trade and Industry

In the third quarter of the year, industrial output expanded by 2.1% when viewed against the previous period. The factors that accounted for the major share of this growth were production of cars and integrated circuits. It should be stressed that, using the same basis of analysis, forecasts point to a reduction of 1.2% in the result for the subsequent quarter. In comparison to the same period of 2001, growth reached 3.1%. However, a comparison based on twelve month accumulated growth figures indicates an upward trajectory, albeit with declining intensity. Unemployment, which had stabilized at 5.4% since May of the current year, shifted to 5.5% in October, matching the December 2001 record level.

Gross domestic product[1/]



Source: Economic Planning Agency

1/ Growth over previous quarter seasonally adjusted, annualized.

Gross product expanded by 0.7% in the third quarter, compared to the previous quarter, and reflected an annualized rate of 3%. Internal demand was the factor most responsible for this movement, particularly private consumption which expanded by 0.8%.

The economy has been operating in a process of deflation. Over the course of 2001 and 2002, annual growth of the Consumer Price Index (CPI) has been systematically below zero, with -0.9% in October. This performance demonstrates that utilization of monetary policy instruments, including near zero basic interest rates, and high levels of liquidity provided by the Bank of Japan (BoJ), have not had the desired impact on the granting of loans partly due to the fact that banks have opted to acquire government bonds. In the current year, the Wholesale Price Index (WPI) was steadily negative, though it did turn upward by 0.4% in October.

Though it has been unable to keep to its original schedule, the new financial restructuring program begun on October 30 does have the merit of recognizing that bank loans must be more efficiently structured and, consequently, reduced by 50% by the end of the 2004 fiscal year. The program is targeted at three points: (i) enhanced strictness in the classification of bad loans; (ii) segregation of good from poor quality assets, with the first grouping remaining in the accounting of banks and the second being sold to the Resolution and Collection Corporation (RCC); and (iii) reduction of the deferred tax on banking revenues from 40% to 10%, allowing banks to use the resources as an integral part of level 1 capital. In Japan, taxes on banking revenues can be postponed for up to five years at the same time in which it is permitted to include these revenues under the level 1 capital of the banks. It should be emphasized that, were the Japanese banks forced to adopt the rules applied in the United States where deferral of up to one year is permitted, all of the large Japanese banks, with the exception of the Bank of Tokyo-Mitsubishi and Sumitomo Trust, would drop below the required solvency level.

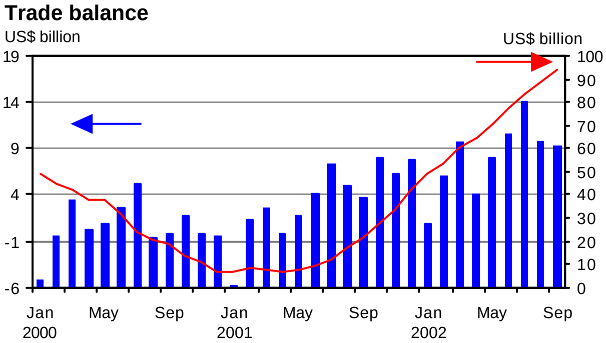
According to the Tankan survey released quarterly by BoJ, the business confidence level improved. The index for large manufacturing companies registered -14 or four points above the June figure. In the case of supply and demand conditions, the same index came to -33 or three points above the second quarter figure. These results generate some degree of relief for the Japanese economy in general, though by no means do they suggest that business conditions have improved in any lasting way. In its turn, the *Shoko Chukin*, the confidence indicator for small companies, increased to 45 in November, compared to 44 in the preceding month.

4.3 Euro zone

The outlook for the euro zone economy became somewhat pessimistic in recent months. Here, it should be stressed that business and consumer uncertainties evident in the result of various confidence indicators are mainly a result of doubts regarding recovery of the United States economy, the possibility of warfare in the Middle East and corporate instability. Taken together, these factors have tended to dampen already low level internal demand and further growth in the activity level. The need for fiscal adjustment in the three major economies of the region has contributed to unfavorable forecasts for the coming years, with adverse impacts on growth estimates for the region. Consequently, the European Commission (EC) estimates that euro zone GDP will expand by 0.8% in 2002 and 1.8% in 2003. The recessive scenario is particularly accentuated in Germany, the region's major economy, where GDP growth estimates indicate rates of 0.2% for 2002 and 1% for 2003.

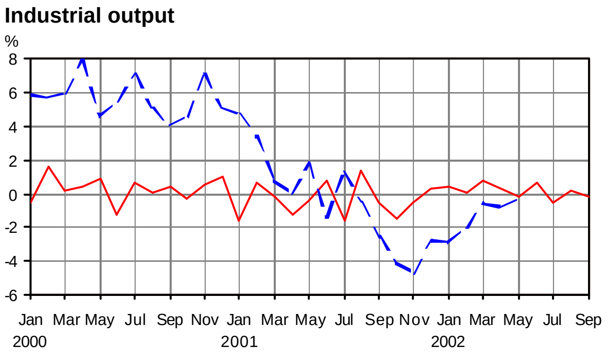
Confirmation of a public deficit equivalent to 4.1% of GDP in Portugal in 2001 was the first occurrence of a deficit higher than had been agreed upon by the countries of the region since creation of the euro on January 1999. According to the Stability and Growth Pact signed by European Union member countries in 1997, the deficit registered by the different countries cannot exceed 3% of GDP and those countries that surpass this limit will be subject to sanctions. The EC estimates that the German deficit will reach 3.8% of GDP this year and 3.1% in 2003, followed by a steady downward slide as a result of the already described fiscal efforts made by that country. According to the EC, France and Italy have questioned the pact and been somewhat reluctant to adopt the adjustments in their public accounts required to reverse the trajectory of their deficits, which are expected to come quite close to the 3% of GDP ceiling in the coming years.

Though the balance of trade result registered successive declines in August and September, the external sector of the economy has registered a positive performance. This is evident in the accumulated twelve month surplus of US$94.6 billion in September, compared to US$77.3 billion in June. Exports and



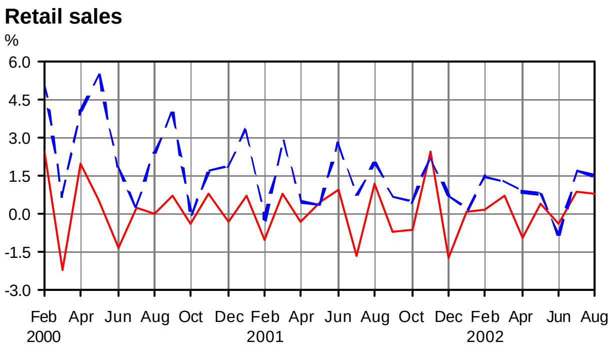
Source: Eurostat

imports registered accentuated downward movement in August as a result of seasonal factors and were able to recover the previous level in September. Foreign sales fell from US$93.7 billion in July to US$79.4 billion in August before increasing to US$87.6 billion in September. Moving in the same direction, imports dropped from US$79.5 billion in July to US$69.6 billion in August, before turning upward once again to US$78.3 billion in September. The strong upturn in import operations provoked a reduction in the trade balance surplus to a level of US$9.8 billion in August and US$9.3 billion in September, after having risen to the mark of US$14.2 billion in July.



Source: Eurostat

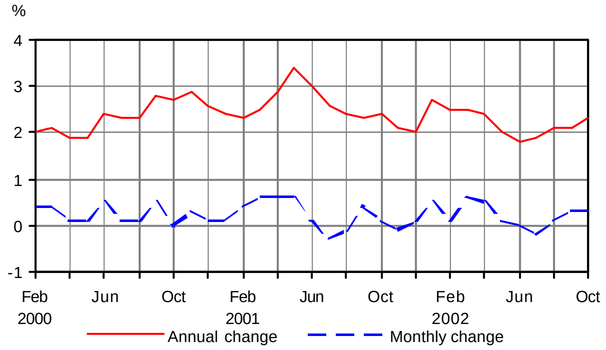
Industrial recovery continues sluggish with no significant signs of recovery, having registered a loss of 0.2% in September, following 0.2% growth in August and a decline of 0.5% in July. Annual growth figures have been slipping since September 2001, as evident in the reductions of 1.2% in August and 0.6% in September. Moving in the opposite direction, retail sales increased by 1.7% in July and 1.5% in August, when compared to the levels for the corresponding months of the previous year.



Source: Eurostat

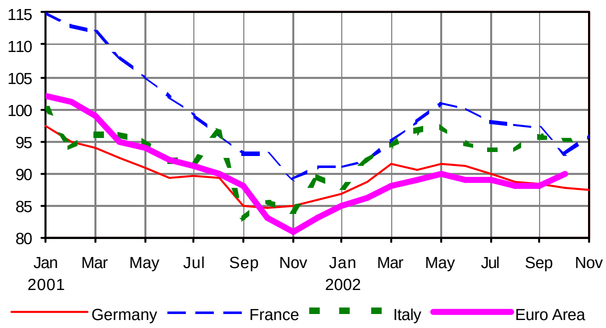
In October, annual inflation increased to 2.3% and has been above the ECB reference level of 2% since August. The index is expected to close the year between 2.2% and 2.3%. The ECB's concern with persistent inflation has been reflected in its utilization of the basic interest rate as an instrument for stimulating economic recovery. Despite this, the drop in the annual growth rate of the M3 monetary aggregate which closed October at 7%, following 7.3% in September, led the ECB to reduce short-term interest rates by 50 base points in the first week of December in order to stimulate the economy of the region.

HICP



Source: Eurostat

Business surveys



Source: IFO, Insee, Isae and European Comission

In general, business sector confidence indicators tend toward stabilization, after a steady decline since May. In Germany, the index of the Institute of Economic Research (IFO), which estimates business expectations, came to 87.3 in November, compared to 87.7 in October and 88.2 in September. In France, the index of the *Institut National de la Statistique et des Études Économiques* (Insee) closed at 96 in November, compared to 93 and 97, respectively, in the two previous months. In Italy, the indicator issued by the *Istituto di Studie e Analisi Economica* (Isae) remained relatively stable in recent months, closing September at 95.7, followed by 95.2 and 95.4 in the two subsequent months.

Consumer expectation indices showed highly distinct performances. Consequently, indicators for expectations in France and Italy pointed to positive results, in contrast to a drop in the index for Germany, slipping from 95 in September to 89 in October. In Italy, the downward trajectory of the Isae continued through October, closing the month at 109.4 and turned upward to 109.8 in November. In France, the Insee index closed at 82 in September, the lowest mark since May, and increased to 84 in the following month.

4.4 Emerging economies

4.4.1 Asia

In the case of Asian countries and, principally, those that participate more intensively in the global economy, performance was clearly impacted by the difficulties faced by the world’s more important economies in their pursuit of recovery. Preliminary estimates on the region’s annual GDP growth indicate a process of deceleration in the third quarter of the year, when compared to the previous period. Though domestic demands have partially preserved their recovery capacity, this movement was not sufficient to offset the drop in the net exports of the bloc. Parallel to this, growth in the number of bankruptcies and credit card defaults in Korea and continued unfavorable conditions in the Taiwan labor market clearly hampered recovery in those countries. More recently, several countries reduced their basic interest rates as an attempt to jumpstart the recovery process. Among these countries, Taiwan and Thailand, which reduced their rates by 25 base points, could be cited.

In South Korea, GDP expanded by 5.8% in the third quarter, compared to the same period of the previous year, and 6.4% in the second quarter. This drop was mostly caused by a lesser pace of activity in the farm sector and construction industry. In October, industrial output turned in growth of 12.7% over twelve months, compared to 3.4% in September, principally as a result of the positive performance of the export sector, particularly in the segments of automobiles and semiconductors. In November, unemployment closed at 2.7%, as against 3% in October, while growth in consumer prices in the same month, viewed under the prism of accumulated twelve month growth, totaled 2.8% compared to 3.1% in September.

South Korean exports in October totaled US$15.2 billion, while imports came to US$13.9 billion, for a trade surplus of US$1.3 billion, compared to US$1 billion in September. The current account surplus in October reached a level of US$1.4 billion, compared to US$0.5 billion in the previous month.

In Thailand, industrial output expanded by 8.8% in the twelve month period ended in October. The decline of 1 p.p. in relation to the September figure reflected the slowdown in production of goods for the export sector and a lesser degree of internal absorption of electric-electronic appliances. Accumulated twelve month growth in consumer prices came to 1.4% in October, compared to 0.4% in September. Foreign trade registered exports of US$6.3 billion and imports of US$5.8 billion in the month of October, generating a trade surplus of US$0.5 billion in the month, compared to US$0.8 billion in September.

China, by far the region’s largest economy, registered twelve month GDP growth of 8.1% in the third quarter, compared to 8% in the previous quarter. Gross Fixed Capital Formation (GFCF) continued higher than in the other countries, despite the fact that twelve month growth in the construction industry fell from 28.1% in September to 21% in October. However, residential investments increased from 26% in September to 32.5% in October. Using the same calculation criterion, industrial output expanded by 14.2% in October, compared to 13.8% in the previous month, while annual growth in consumer prices remained negative at 0.8%. Insofar as foreign trade is concerned, exports closed at US$31.2 billion, imports at US$28.7 billion and the trade surplus at US$2.5 billion in November, compared to US$4.8 billion in the previous month.

In Taiwan, twelve month GDP growth came to 4.8% in the third quarter of the year, compared to 4% in the preceding quarter, driven by growth of 8.8% in the GFCF. On the other hand, industrial production turned in expansion of 7.4% in the twelve month period ended in October. Here, it should be pointed out that the 4.3 p.p. decline in the rate compared to the previous month evinces deceleration under exports and the construction industry. In the twelve month period up to October, consumer prices dropped by 1.7% compared to 0.8% up to September, while wholesale prices increased by 2.1% and 0.5% in the same periods, respectively. The nation’s international reserves added up to US$157.6 billion in October, a level that was quite similar to the previous year.

In India, industrial output registered accumulated twelve month growth of 6.2% in October, compared to 6.1% in September. These results were driven by exports and internal consumption of nondurable consumer goods and increased capital goods output. Consumer prices registered annual growth of 4.3% in the month of September, compared to 3.9% in August. Wholesale prices registered annual growth of 3.3% in October and 3.5% in September. Exports totaled US$4 billion in September and imports came to US$5.1 billion, registering growth in the trade deficit from US$0.7 billion in August to US$1.1 billion. Indian international reserve holdings came to US$64 billion in October, compared to US$62.7 billion in September.

4.4.2 Eastern Europe

The scenario of moderate GDP growth in the euro zone countries has not had a significant impact on the other countries of the continent and, particularly, the emerging economies of Eastern Europe. These countries turned in less robust economic activity than among the emerging economies of Asia, but performed better than the countries of Latin America.

The European Commission, the executive arm of the European Union (EU), recommended that ten countries be candidates to enter the bloc in 2002 (Poland, Hungary, the Czech Republic, Slovakia, Lithuania, Latvia, Estonia, Slovenia, Cyprus and Malta) and two others in 2007 (Bulgaria and Romania). This is expected to result in considerable economic benefits for these countries since they will be incorporated into a market of 500 million people. At the same time, these countries must adapt themselves to the rigid standards to which the EU countries are subject. A date for the start of entry negotiations was not offered to Turkey, the thirteenth candidate country.

In Poland, the industrial sector turned in accumulated twelve month growth of 3.2% in October, reflecting a drop in the pace of growth, which had climbed as high as 6.6% in September. The reduction in this case was mainly due to a falloff in the construction industry. In the same month, unemployment came to 17.5% of the labor force, a figure quite close to the 17.6% September result. Growth in producer prices closed with an accumulated twelve month level of 1.7% in October, compared to 1.1% in September. On the other hand, during the same month, consumer prices turned in a twelve month accumulated growth of 1.1%, compared to 1.3% in September. Insofar as foreign trade is concerned, exports reached a level of US$3.2 billion and imports closed at US$4.2 billion in October, resulting in a US$1 billion trade deficit in the month, compared to US$0.9 billion in September. International reserves fell from a September level of US$29.3 billion to US$29.2 billion in October.

In Russia, industrial output in the twelve month period up to October expanded by 3.9%, compared to 5.5% in September. The lesser pace of growth was due to deceleration in the segments of capital goods and consumer goods, which were partially offset by continued growth in production of intermediate goods. In the industrial sector, producer prices totaled accumulated twelve month growth of 16.7% in October, as against 14.7% up to September, due to increases in the prices of fuels and ferrous and nonferrous products for metallurgical use. Twelve month growth in consumer prices came to 15% in October, the same level as in the previous month. In this case, the favorable performance of food prices offset the high registered under services. In September, external accounts registered exports of US$9.9 billion and imports of US$5.2 billion, raising the trade balance surplus from US$0.1 billion in August to US$4.7 billion. International reserves closed October at US$50.5 billion, for growth of US$1.2 billion in the month.

In Turkey, September industrial output registered twelve month growth of 10.8%, compared to 7.3% in the previous month. The highlights of this performance were the segments of machines, equipment and automobiles. In this context, October utilization of industrial capacity came to 80.6%, compared to 79.7% in September. Consumer prices turned in growth of 33.5% in the twelve month period ended in October, compared to 37.1% in September. With regard to wholesale prices, growth came to respective levels of 36.1% and 40.9%, to some extent reflecting declines in fuels prices. With regard to the trade surplus, exports added up to US$3.1 billion and imports came to US$4.2 billion in September, for a monthly decline of US$0.3 billion in the trade deficit, which closed at US$1.1 billion. International reserves totaled US$36.2 billion, a level quite similar to that of the previous month.

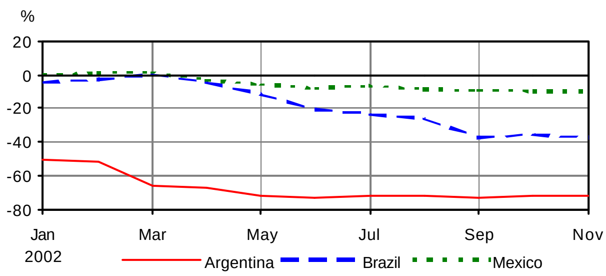
4.4.3 Latin America

The economic scenario in the region remains highly unstable, particularly as a result of the political and economic uncertainties that have dominated in Argentina, Venezuela and Uruguay, coupled with the slowdown in the pace of economic activity in the developed world, increasing world scale risk aversion and the consequent cutback in international capital flows.

In this context, the IMF estimates that the region's GDP will decline by 0.6% in 2002, compared to growth of 0.6% in 2001. The factors underlying this decline are reductions of 16% in the Argentine GDP, 11% in that of Uruguay and 6% in the Venezuelan GDP. Parallel to these results, it is estimated that the more important economies of the region – Mexico and Brazil – will achieve growth in the range of 1.5%, as a result of the still incipient recovery in the United States, which absorbs about 90% of Mexican foreign sales, and of the crisis of confidence in the Brazilian economy. In this regard, the result has been an accentuated drop in foreign capital inflows and a consequent process of depreciation of the real. Though Chile has managed to preserve its positive growth trajectory, it should be noted that the 2.2% growth rate forecast for 2002 is well below the 4.4% and 2.8% levels registered in 2000 and 2001, in that order. The Andean countries, including Colombia, Ecuador and Peru, are expected to close with moderate growth of up to 3%.

Exchange rate

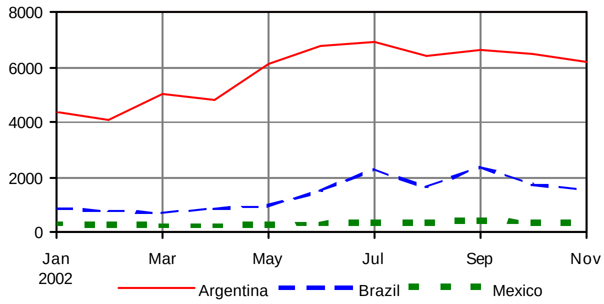
Anually percentual change[1/]



Source: Bloomberg
1/ End-of-period.

Embi+ Index

Basis points



Source: Bloomberg

Though internal demand indicators point to falling consumption, the foreign trade sector has managed to achieve positive results notwithstanding the reduction of 1.5% in the annual foreign sales of the region, as reported in the estimates issued by the Economic Commission for Latin America and the Caribbean (Cepal). With the exception of Mexico, the climate of recession and devaluation of local currencies resulted in sharply reduced imports and, consequently, trade surplus that have contributed importantly to attenuating the external vulnerabilities of the countries of the region. In this sense, the current account deficit, which had reached 2.8% of GDP in 2001, is expected to close at 1.9% of GDP in 2002, according to figures released by the IMF.

The external adjustment process has occurred in a period of declining foreign investments in the region as a result of the Argentine quagmire and growing global aversion to risk. External financing difficulties have reduced the internal supply of dollars, generating intense pressures on local currencies. Despite some degree of attenuation in the fourth quarter of the year, this process has contributed to deterioration in the perception of risk in the region.

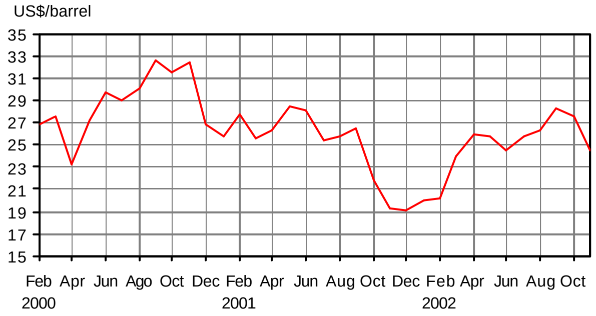
Aside from these results, depreciation of local currencies increased the risks of an inflationary upturn. According to IMF projections, inflation in the region is expected to close at 8.6% in 2002, after reaching a mark of 6.4% in the previous year, reflecting growth in the rates registered in Argentina, Brazil, Venezuela and Uruguay. The inflationary spurt led these countries to adopt more restrictive monetary policy instruments that had the effect of restricting growth in the activity level.

4.5 Petroleum

At its September 19 meeting, the Organization of Petroleum Exporting Countries (Opec) concluded that fourth quarter growth in demand was basically a result of seasonal factors, particularly considering that world economic recovery has been no better than moderate. In this context, the entity decided to maintain its output target of 21.7 million barrels per year (mbd) in order to ensure stability in the prices of crude.

In October, prices fell by almost four dollars per barrel as a consequence of increased supply and lesser production at refineries. Coupled with attenuation of concern before the possibility of a conflict in the Middle East, these factors provoked a process of liquidation of speculative positions on the petroleum futures market and aided in reducing prices. World output of petroleum expanded by 1.25 mbd in October, with the Opec countries accounting for 0.76 mbd of this total. Countries that are not Opec members produced 0.45 mbd more than in the previous month. This output level resulted mostly from increased production at Norwegian wells, following a pause for maintenance purposes in September. Evaluation of growth in global petroleum demand in relation to the previous year remained constant in October, coming to 190 thousand barrels per day in 2002 and 1,040 thousand barrels per day in 2003.

Brent type petroleum
Average in the period



Source: Bloomberg

On the spot market, the price of Brent type petroleum at the end of the period diminished from US$28.90 per barrel in September to US$25.61 per barrel in October and US$24.84 per barrel in November. The accentuated drop in prices in the quarter can, to some extent, be attributed to strong growth in supply, principally on the part of Opec countries, and some degree of attenuation of expectations of a United States attack on Iraq. Parallel to this, the factors that tend to hamper price reductions include the low levels of crude oil stocks held by the member countries of the Organization for Economic Cooperation and Development (OECD) at the start of October, and the trend toward increased demand as a result of colder than expected weather in the northern hemisphere.

In the futures market, the prices of Brent-type petroleum tended downward for subsequent delivery periods negotiated on the same date. For contracts negotiated at the end of November, price levels closed below those of previous months, due partly to lesser tensions in the Middle East as a result of Iraqi agreement to the terms of the United Nations Resolution permitting the return of weapons inspectors to that country.

4.6 Conclusion

The growth registered in available indicators is not yet sufficient to guaranty that a process of sustainable recovery in the world economy has begun. However, the results do seem to strengthen the hypothesis that the end of this year and beginning of the new year could well mark the end of the sluggish economic growth that was characteristic of 2002.

Following the 2001 world recession, accumulated stock exchange losses and the negative effects generated by accounting scandals in the United States undermined the world economy, and transformed growth of the United States economy into the key variable for the future. Continued growth in the American economy in coming months depends on steady gains in productivity levels which, in turn, would provoke a new cycle of investments capable of setting down the foundations for more sustainable growth, in contrast to the current situation which is almost entirely dependent on private consumption.

A growth upturn in the United States would also have a positive impact on world trade, since the rest of the world is highly dependent on the that country's market. However, according to the World Trade Organization (WTO), growth in world trade is expected to be lower than the median for recent years. Among the causes underlying this forecast are expectations of a poor performance in the economies of Japan and the euro zone, as well as proliferation of trade barriers during the year.

A solution to the problems of the Japanese economy still depends on broad-based and deep structural reforms, while the economies of the euro zone will have to adopt measures capable of generating productivity and efficiency gains.

The consolidation of United States economic recovery and international market normalization should dampen the current process of flight to quality that has dominated the market in moments of uncertainty and turbulence. In this context, the volume of external resources made available to the emerging countries that adopt healthy monetary and fiscal policies must be gradually rebuilt.

5 – Foreign sector

Analysis of the balance of payments clearly demonstrates that the external sector of the Brazilian economy has adapted well to the restrictions imposed by the current scarcity of financing. These adjustments have generated strong improvement in the nation's current accounts due not only to the growing trade surplus, but also to lesser outlays on services and income. It should also be stressed that the shift in the level of the rate of exchange has contributed to achieving this adjustment.

In the framework of the Financial Assistance Program (PAF), the country's agreement with the International Monetary Fund (IMF) has contributed to the adjustment process in a complementary way, particularly in offsetting the falloff in direct investment and loan inflows.

As regards 2003, consolidation of the external sector adjustment process is expected, within a context of gradual recovery in foreign capital flows to the country.

5.1 Trade in goods

Once the strong growth in the second half of 2002 is incorporated into the result, export operations increased to an accumulated total of US$55.1 billion up to November, corresponding to 2.3% more than in the same period of 2001. Obviously, this result went well beyond the expectations that had marked the start of the year. On the other hand, imports remained at a relatively stable and low level, with a total of US$43.8 billion, reflecting a decline of 15.9% using the same basis of reference. In the period from January to November, the trade surplus came to US$11.3 billion, compared to US$1.8 billion in the corresponding period of 2001.

Trade balance - FOB

US$ million

Period		Exports	Imports	Balance	Trade flow
Jan-Nov	2002	55 119	43 793	11 327	98 912
Jan-Nov	2001	53 877	52 081	1 795	105 958
% change		2.3	-15.9		-6.6

Source: MDIC/Secex

Exports by aggregate factor - FOB
Daily average - January-November

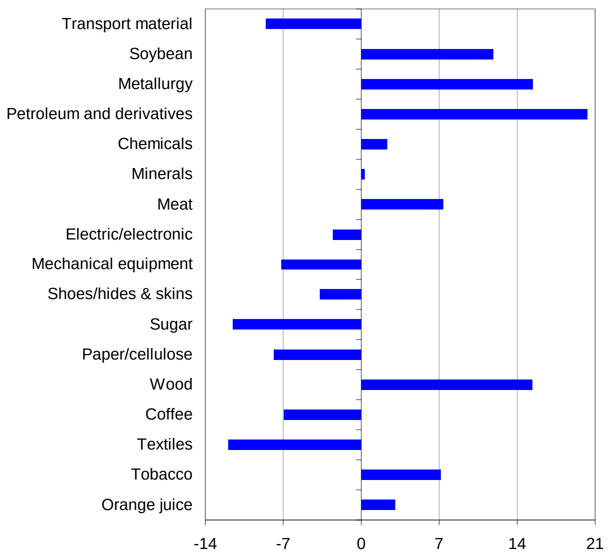
US$ million

Itemization	Accumulated		
	2001	2002	% change
Total	234.2	237.6	1.4
Primary products	62.2	67.6	8.6
Industrial products	164.7	164.1	- 0.4
Semimanufatured goods	32.9	35.2	7.2
Manufactured goods	131.8	128.9	- 2.2
Special operations	7.3	5.9	- 19.5

Source: MDIC/Secex

Note: In 2001, 230 working days; in 2002, 232.

Exports by sectors - FOB - January-November/2002
Percentual change from the same period of the last year



Source: MDIC/Secex

The strong performance of the export sector – including highly positive results with basic products, precisely at a seasonally unfavorable moment – is unprecedented in the history of Brazilian foreign trade. In the first half of 2002, average daily exports closed at US$203.7 million, increasing by 35.4% to US$275.8 million in the second half of the year up to November. With respect to daily average imports, growth in the same period came to 7.3%, moving from US$182.5 million in the first six months to US$195.8 million in the second half of the year.

Basically, export growth in the current year has been a consequence of the sales performance of basic and semimanufactured goods, with respective increases of 8.6% and 7.2%, in relation to the figures for the period from January to November 2001. In contrast to this performance, exports of manufactured goods dropped by 2.2%. It is important to note that exports recovered during the entire year and in all product categories. This conclusion is clear in growth figures for average daily external sales in the second half of the year up to November, compared to the first six months of 2002, as basic products spiraled by 70.2%, semimanufactured goods by 56.5% and manufactured products rose by 19.6%.

To some extent, growth in the second half of the year was driven by devaluation of the real in the period. This is evident in the fact that the average effective rate of exchange in the second half of the year up to October was a full 24.7% higher than the average for the first six months of the year. However, other factors indicate that the new level achieved by the export sector could be permanent. Here, it is enough to mention the new markets the country has managed to penetrate, the success of export incentive policies adopted in the past and trade missions to such countries as China and Russia without, of course, failing to mention the repercussions of the bilateral trade agreement with Mexico.

Exports to Argentina and other countries - FOB

Absolute change - Jan-Nov/2002 over Jan-Nov/2001

US$ million

Itemization	Argentina	Other	Total
Total	-2 643	3 885	1 243
Manufactured products[1/]	-2 485	2 065	- 420

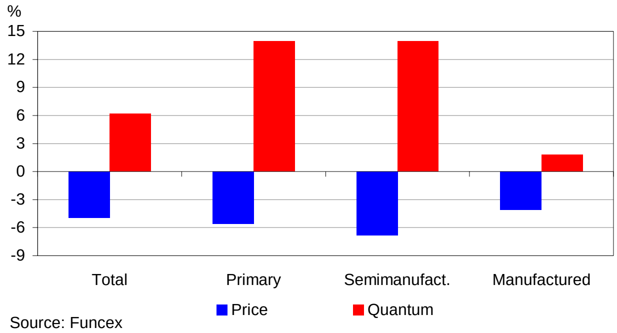
Source: MDIC/Secex

1/ Includes manufactured product reexports.

For the most part, the moderate performance of foreign sales of manufactured products was due to cutbacks in sales to Argentina, one of the major markets for these goods. In this context, in the period from January to November 2002, sales to that country plunged by US$2.6 billion, of which 94% corresponded to manufactured products. In the opposite sense, sales to other countries increased by US$3.9 billion, with manufactured products accounting for 53.1% of this total.

Exports - price and quantum index - Jan-Oct/2002

Change over the same period in 2001



Source: Funcex

In the January-November 2002 period, growth in exports resulted from volume increases in all of the aggregate factor categories. Prices dropped to historically low levels, mainly in the cases of basic and semimanufactured goods, and are not expected to exert any additional negative pressures on export revenues in coming months.

Imports by end-use category - FOB

Daily average - January-November

US$ million

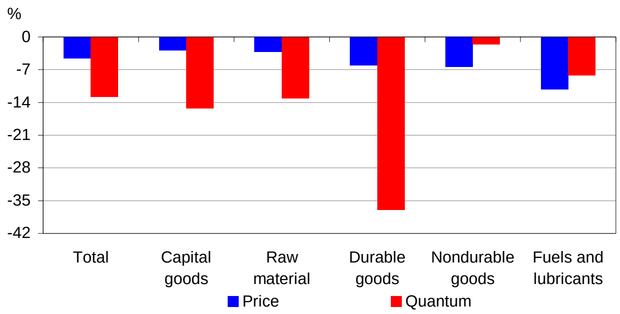
Itemization	Accumulated		
	2001	2002	% change
Total	226.4	188.8	- 16.6
Capital goods	59.7	46.8	- 21.6
Raw materials	112.1	93.7	- 16.4
Naphtha	5.5	2.5	- 54.7
Consumer goods	29.1	23.6	- 18.9
Durable	14.5	10.0	- 30.6
Passenger vehicles	5.8	3.0	- 48.9
Nondurable	14.6	13.5	- 7.3
Fuels	25.6	24.7	- 3.5
Crude petroleum	12.9	12.8	- 0.9

Source: MDIC/Secex

Note: In 2001, 230 working days; in 2002, 232.

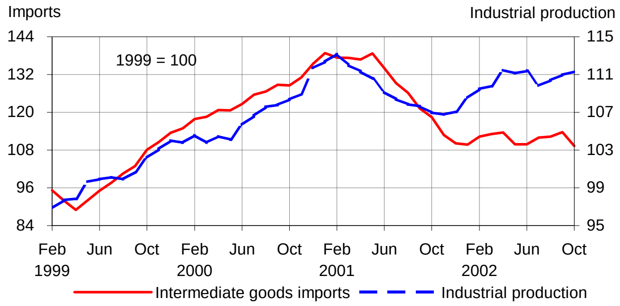
When one analyzes the total accumulated in the first eleven months of the year, compared to the corresponding period of 2001, imports declined in all of the final use categories, a performance considered fully compatible with the level of economic activity and depreciation of the rate of exchange. The sharpest decrease occurred under purchases of consumer durables, with a drop of 30.6% in the daily average. The strongest drop (48.9%) occurred in daily average imports of automobiles, which is the major item under this heading, accounting for 29.6% of the total. Foreign purchases of capital goods registered a

Imports - price and quantum index - Jan-Oct/2002
Change over the same period of 2001



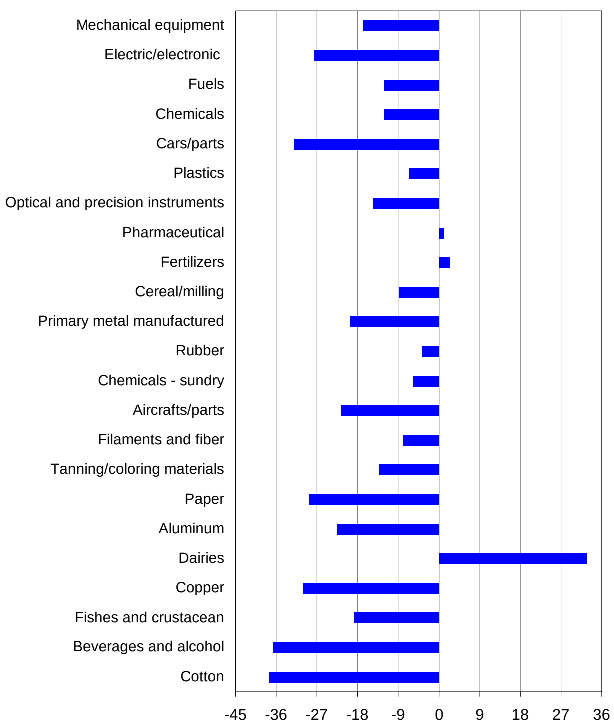
Source: Funcex

Intermediate goods imports x industrial production
Seasonally adjusted indices - 3 month moving average



Source: IBGE and Funcex

Imports by sectors - January-November/2002
Percentual change from the same period of the last year



Source: MDIC/Secex

decline of 21.6%, while those of raw materials and intermediate goods dropped by 16.4%, imports of nondurable consumer goods fell by 7.3% and purchases of fuels and lubricants slipped by 3.5%.

The second half of the year has been marked by signs of upward movement under imports, mostly as a consequence of higher petroleum prices and volumes of imports, with the exception of fuels and lubricants. In this context, average daily foreign purchases in the period from July to November were 7.3% higher than in the first half of the year, registering growth in all of the different use categories. Thus, imports of fuels and lubricants increased by 26.1%, while purchases of consumer durables (excluding automobiles) rose by 16.9%, raw materials and intermediate goods increased by 6.7%, capital goods imports grew by 1.5% and operations involving nondurable consumer goods expanded by 0.4%.

In the specific case of raw materials and intermediate goods, there have been some limited signs of recovery, though the pace has not been able to accompany the evolution of industrial output as happened in the past. The asymmetry evident in these results suggests intensification of the process of substitution of previously imported goods for domestic products, due to the structural changes that have occurred in recent years, above all, in the exchange market.

In comparison to the same period of 2001, operations with the nation's major trading partners improved in the January-November 2002 period, with the sole exception of Argentina. At the same time, this process has

Exports and imports by geographic area - FOB
January-November

US$ million

Itemization	Exports 2001	Exports 2002	Exports % change	Imports 2001	Imports 2002	Imports % change	Balance 2001	Balance 2002
Total	53 877	55 120	2.3	52 081	43 793	-15.9	1 795	11 327
Laia	11 375	8 993	-20.9	9 391	7 624	-18.8	1 984	1 368
Mercosur	6 012	2 995	-50.2	6 573	5 179	-21.2	- 561	-2 184
Argentina	4 747	2 105	-55.7	5 834	4 387	-24.8	-1 087	-2 282
Other	1 265	890	-29.6	738	792	7.3	526	98
Mexico	1 700	2 128	25.2	653	533	-18.3	1 047	1 595
Other	3 663	3 869	5.6	2 165	1 913	-11.7	1 498	1 957
USA 1/	13 145	14 186	7.9	12 234	9 807	-19.8	912	4 379
EU	13 852	13 789	-0.5	13 853	12 071	-12.9	- 1	1 718
E. Europe 2/	1 579	1 599	1.3	1 042	840	-19.4	537	759
Asia	6 441	8 055	25.1	8 409	7 462	-11.3	-1 968	593
Japan	1 831	1 932	5.5	2 889	2 207	-23.6	-1 058	- 275
South Korea	664	790	19.0	1 487	1 017	-31.6	- 823	- 228
China	1 819	2 348	29.1	1 238	1 422	14.8	581	926
Other	2 127	2 985	40.3	2 795	2 816	0.8	- 668	169
Sundry	7 485	8 498	13.5	7 153	5 989	-16.3	332	2 510

Source: MDIC/Secex

1/ Includes Puerto Rico.
2/ Albania, Bulgaria, Hungary, Poland, Slovak Republic, Czech Republic, Romania and countries of the former Soviet Union.
Note: Forty working days in both periods.

been paralleled by growing exports to new markets, particularly in Africa, Asia and the Middle East, and closer trade relations based on bilateral agreements with other countries, such as that formalized with Mexico.

Trade with the countries of Asia generated a surplus of US$593 million, compared to a US$2 billion deficit in 2001. This result was achieved on the basis of 25.1% growth in foreign sales, coupled with a drop of 11.3% in imports. Here, one should stress the 29.1% growth in sales to China, partly as a result of expanding exports of soybeans and soybean oil. It is important to note that China is now the third largest Brazilian export market and is surpassed only by the United States of America (USA) and the Netherlands. Finally, the trade deficit in operations with Japan declined by US$784 million.

As far as the Latin-American Integration Association (Laia) is concerned, the trade surplus in operations with Mexico expanded by US$548 million, as a result of 25.2% growth in exports and a decline of 18.3% in imports. Moving in precisely the opposite direction, the deficit in bilateral trade with Argentina increased by US$1.2 billion to US$2.3 billion, reflecting reductions of 55.7% in Brazilian exports and 24.8% in imports.

The largest absolute increase in the trade surplus occurred in operations with the United States, with growth of US$3.5 billion, based on 7.9% expansion under Brazilian foreign sales, mostly involving automobile engines and parts and semimanufactured steel products, coupled with a decline of 19.8% in the nation's imports.

In the case of the European Union, the trade surplus increased by US$1.7 billion, with relative stability in exports and a 12.9% drop in imports from that bloc.

5.2 Services and income

Current account

US$ billion

Itemization	2001 Jan-Nov	2001 Year	2002 Jan-Nov	2002 Dec	2002 Year[1/]	2003 Year[1/]
Current account	-21.4	-23.2	-7.5	-0.9	-8.4	-6.6
Trade balance	1.8	2.6	11.3	1.2	12.5	15.0
Exports	53.9	58.2	55.1	5.0	60.2	65.0
Imports	52.1	55.6	43.8	3.9	47.7	50.0
Services	-7.1	-7.7	-4.3	-0.6	-4.9	-5.4
Transportation	-2.8	-3.0	-1.8	-0.2	-2.0	-2.1
International travel	-1.4	-1.5	-0.5	0.0	-0.4	-0.6
Computer and information	-1.0	-1.1	-1.0	-0.1	-1.1	-1.2
Operational leasing	-1.8	-1.9	-1.4	-0.3	-1.6	-1.8
Other	-0.1	-0.4	0.3	-0.1	0.2	0.3
Income	-17.6	-19.7	-16.6	-1.7	-18.4	-18.1
Interest	-13.5	-14.9	-11.9	-1.3	-13.3	-13.1
Profits and dividends	-4.2	-5.0	-4.8	-0.4	-5.2	-5.0
Compensation of employees	0.1	0.1	0.1	0.0	0.1	0.0
Current transfers	1.5	1.6	2.2	0.3	2.4	2.0

1/ Forecast.

The sharp improvement in the current account result – decline of 65% in the deficit registered in the first eleven months of 2002, compared to the same period in 2001 – was due not only to the trade balance performance but also to lesser outlays on services and income.

Net spending on services dropped by 38.9% to US$4.3 billion. Net outlays on transportation came to US$1.8 billion, for a reduction of 36.3%. For the most part, this reduction was concentrated under freights, which dropped from US$1.2 billion to US$565 million. Net spending on international travel fell by 66.8%. Here, one should note that this heading reversed course in the period from September to November, registering net revenues of US$4 million, US$82 million and US$61 million respectively. Payment of equipment rentals generated net outflows of US$1.4 billion, a decrease of 24.9% in the period. Net outlays on communications and information remained at the level of US$985 million.

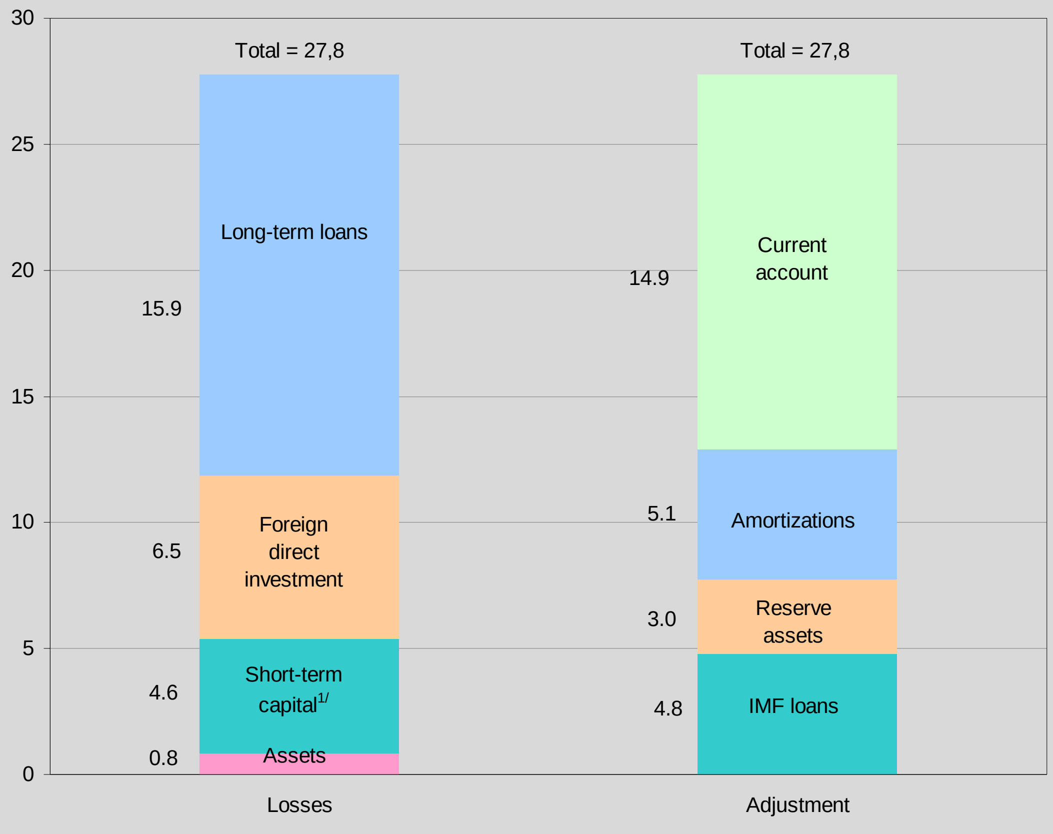
Net flows of income abroad totaled US$16.6 billion, or 5.5% less than in the first eleven months of 2001. With the external debt on a downward trajectory, net payments of interest dropped by 12% to US$11.9 billion. At the same time, net remittances of profits and dividends followed the opposite trajectory, with growth of 15.5% to an overall total of US$4.8 billion.

The trade balance result and the falloff in spending on services and income were the elements responsible for the balance of payments adjustment, in a context of diminishing external sources of financing that drove the rate of exchange to a new plateau in 2002. This process is expected to continue in 2003, with the added factor of improvement in the performance of economic activity in the period.

Balance of payments adjustment in 2002

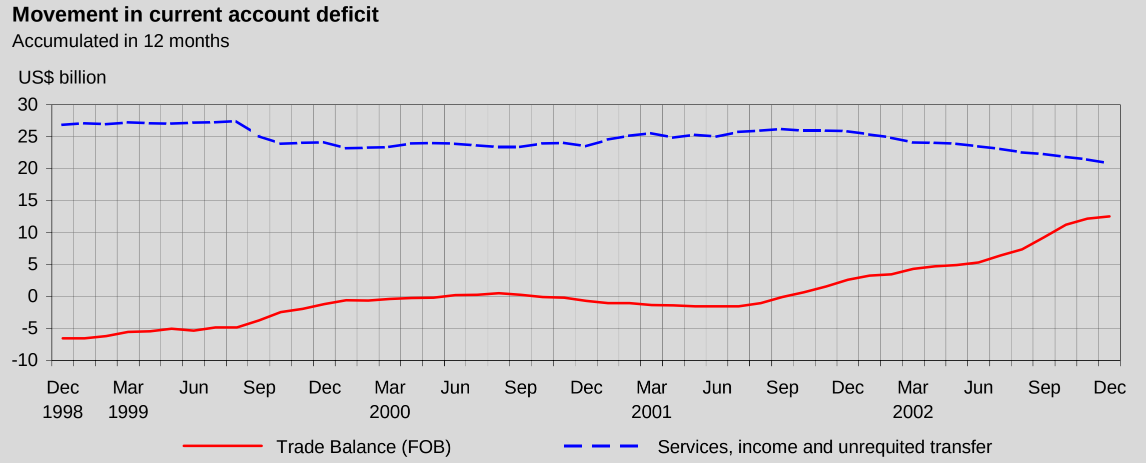
According to estimated data for the month of December, in 2002, the balance of payments registered losses in the major sources of financing and balances of resources channeled to asset formation abroad. This will cause a total reduction of US$28 billion in 2002, when compared to flows in 2001. The major share of this reduction was concentrated in long-term inflows (US$15.9 billion), principally in the form of direct loans and placements of debt securities abroad, as the rates of rolling these operations dropped sharply during the course of the year. An accentuated reduction also occurred under flows of direct foreign investments (US$6.5 billion) as well as in short-term inflows, particularly trade credit lines.

Losses and Adjustment of Balance of Payments
Variation of the main accounts between 2001 and 2002
US$ billion



1/ Includes the capital account, foreign investments in equities, short-term debt securities issued in the country and issued abroad, short-term loans, short-term trade credit, financial derivatives, non-residents deposits, other liabilities and errors and omissions.

To a great extent, the adjustment resulted from a lesser current account deficit that closed US$14.9 billion below the 2001 result, caused mostly by sharp growth in the trade balance surplus. Service imports were also adjusted and played a role of fundamental importance in the change in the level of the current account deficit. One should also note that remittances of income abroad, particularly those involving payments of interest on the external debt, have begun shifting into a downward curve, precisely as a result of the drop in the external debt.



In the framework of the adjustment process, another phenomenon that must be considered is the drop in amortizations of long-term debt, totaling. US$5.1 billion. When amortization of papers earmarked to nationalized debt, refinancing and conversion operations are excluded, the 2002 position closed at the same 2001 level, with cutbacks in payments of securities and growth in direct loans. However, it is important to note that both the nationalized debt and conversions effected in 2001 and 2002 represented anticipated settlement of commitments spread over the coming years, thus reducing future pressures on the balance of payments.

Inflows generated by sovereign bond operations and the IMF loan disbursements to Brazil provided resources sufficient to meet the commitments of the Central Government and part of overall private sector commitments. Monetary authority interventions in the exchange market were estimated at US$9 billion. Gross reserves remained constant. However, in relation to net reserves, the reduction is estimated at US$13.7 billion, considering buybacks of sovereign debt securities which exceed the limits established in the IMF agreement (US$1,023 million).

In 2003, the reduction in net reserves is estimated at US$2 billion, including Central Government debt service, disbursements from international organizations (Interamerican Development Bank/International Bank for Reconstruction and Development – IDB/IBRD) and, furthermore, the fact that US$700 million in securities issued by the Republic held at Banco Central mature in the coming year.

The performance of the balance of payments in 2002 indicates a strong probability of lesser pressures generated by Brazilian external accounts in the coming years. The net private sector external debt is clearly on a downward curve, a process that is expected to continue in 2003 due to expectations of lesser demand for new indebtedness.

Over the course of the year, constitution of Brazilian assets abroad should be considered as another instrument capable of reducing pressures in the future, since the resources targeted to constituting external available funding abroad originate in the low prices of the Brazilian debt on the secondary market and stand as a strong incentive to acquisitions of these papers. These resources are expected to return as the prices of debt securities improve or the volume of maturities of principal scheduled for coming years decreases.

These positive results become evident when one considers the downward slide in the ratio between the current account deficit and GDP, particularly at a time when the growth rate of the economy is still quite moderate. Consequently, the current account deficit should be equivalent to 1.7% of GDP at the end of 2003, compared to 4.6% at the end of 2001.

Thus, projections of continued growth in the trade surplus at a pace greater than the increase in net remittances of income and net outlays on services include forecast growth of 4.9% under imports. Parallel to this, the trade surplus projection for the coming year is based on expectations of 8% expansion in exports, mostly as a result of increased operations in new markets.

5.3 Financial account

From January to November, the financial account registered net inflows of US$6.7 billion, partly as a consequence of net inflows of US$8.5 billion against the country's IMF loan and US$15.1 billion in net direct foreign investment. However, it should be noted that, as of the end of the first half of the year, the low rate of rolling private securities, notes and commercial papers had an unfavorable impact on medium and long-term sources of financing.

Up to November, foreign portfolio investments totaled net outflows of US$4.2 billion. Stock investments turned in net inflows of US$1.2

Financial account

US$ billion

Itemization	2001 Jan-Nov	2001 Year	2002 Jan-Nov	2002 Dec	2002 Year 1/	2003 Year 1/
Financial account	27.0	28.0	6.7	2.3	9.0	-5.4
Direct investments	20.3	24.7	12.7	0.9	13.6	14.5
Abroad	1.5	2.3	-2.4	-0.1	-2.4	-1.5
In Brazil	18.8	22.5	15.1	0.9	16.0	16.0
Equity capital	15.1	18.8	15.5	0.9	16.4	16.0
Intercompany loans	3.7	3.7	-0.4	0.0	-0.4	0.0
Portfolio investments	1.0	0.1	-4.6	-0.6	-5.2	-1.2
Assets	-0.8	-0.8	-0.3	0.0	-0.3	0.0
Liabilities	1.8	0.9	-4.2	-0.6	-4.8	-1.2
Derivatives	-0.4	-0.5	-0.3	0.0	-0.3	0.0
Other investments	6.1	3.6	-1.1	1.9	0.9	-18.7
Assets	-3.1	-6.6	-3.9	0.3	-3.6	-6.0
Liabilities	9.2	10.2	2.9	1.6	4.5	-12.7

1/ Forecast.

BP medium and long-term financing sources

Selected items

US$ billion

Itemization	2001 Jan-Nov	2001 Year	2002 Jan-Nov	2002 Dec	2002 Year 1/	2003 Year 1/
Medium and long-term funds	18.0	19.9	8.2	0.5	8.7	10.4
Bonds	7.0	7.5	4.1	0.0	4.1	4.0
Notes and commercial papers	6.2	7.4	2.0	0.3	2.3	2.4
Direct loans	4.7	5.0	2.1	0.3	2.3	4.1
Short-term loans 2/	-2.7	-1.9	-5.4	-0.2	-5.5	1.0
Roll-over rates 3/						
Bonds	114%	118%	n.a.	n.a.	164%	115%
Notes and commercial papers	76%	81%	35%	30%	34%	51%
Direct loans	143%	138%	65%	60%	65%	90%

1/ Forecast.
2/ Includes direct loans and trade credits transferred by banks.
3/ Roll-over rate equals the ratio of dibursements to amortizations, excluding amortizations of securities and loans converted into direct investment.

billion up to November, though these investments registered net outflows during the period from June to October, representing a foreign capital return of US$1.3 billion. However, November turned in a net inflow of US$241 million, pointing to an interruption in the outflows of foreign investments in stocks and projecting increased net inflows in the coming year, attracted by expectations of higher growth and improved profitability levels in variable income assets.

Investments in fixed income papers resulted in net amortizations of US$5.4 billion in the first eleven months of the year, of which US$2.4 billion were registered in the September-November period. This result is explained by the low median level of rolling of notes and commercial papers. The drop in the quarter came to 15% and was the most accentuated decline of the year, resulting in net amortizations of US$1.7 billion. At the same time in which amortizations added up to US$703 million in the quarter, no new bond issues were registered. For 2003, gradual growth in the rolling of private securities is forecast to begin as of the second quarter of the year, reaching a level of 51% at the end of the year.

The rolling of medium and long-term loans came to 65% in the period from January to November. This figure is also expected to increase gradually during the course of 2003 and, particularly, as of the third quarter, when net disbursements of resources are expected to recommence.

Short-term loans, which include trade credit lines onlent through banks, also declined in the year. Funding operations remained negative and closed with accumulated net outflows of US$5.4 billion

Uses and sources

US$ billion

Itemization	2001 Jan-Nov	2001 Year	2002 Jan-Nov	2002 Dec	2002 Year[1/]	2003 Year[1/]
Uses	-52.6	-58.4	-33.7	-4.6	-38.4	-34.1
Current account	-21.4	-23.2	-7.5	-0.9	-8.4	-6.6
Amortizations ML-term[2/]	-31.2	-35.2	-26.2	-3.8	-30.0	-27.6
Securities	-16.5	-19.0	-10.5	-1.0	-11.5	-9.4
Paid	-14.4	-15.5	-8.3	-1.0	-9.3	-9.4
Nationalization debt	-3.1	-3.3	-0.3	-	-0.3	-
Refinanced	-2.2	-2.2	0.0	-	0.0	-
FDI conversions	-	-1.4	-2.3	-	-2.3	-
Suppliers' credits	-2.4	-2.8	-2.0	-0.3	-2.3	-3.1
Direct loans[3/]	-12.2	-13.3	-13.7	-2.5	-16.2	-15.2
Sources	52.6	58.4	33.7	4.6	38.4	34.1
Capital account	0.3	0.0	0.4	0.0	0.4	-
FDI	18.8	22.5	15.1	0.9	16.0	16.0
Domestic securities[4/]	2.3	2.2	1.0	0.1	1.1	1.8
ML-term disbursements[5/]	31.9	34.6	17.1	1.7	18.7	21.9
Securities	15.4	17.0	6.1	0.3	6.4	6.4
Supliers' credits	3.1	3.3	1.3	0.2	1.5	2.6
Direct loans	13.4	14.3	9.7	1.2	10.9	13.0
Brazilian assets abroad	-1.8	-4.6	-5.9	0.5	-5.4	-7.0
Loans to Bacen	6.5	6.5	8.5	2.9	11.4	-11.1
Other[6/]	-1.1	0.3	-3.5	0.0	-3.6	0.5
Reserve assets	-4.4	-3.3	1.1	-1.4	-0.3	11.9

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

up to November, of which US$3 billion occurred in the final three months of the period. A turnaround in these flows is expected in 2003 with upward movement in the volume of trade credit lines, resulting in a projected volume of net disbursements equivalent to US$1 billion.

Balance of payments financing conditions improved as a result of the performance of the current account adjustment. Direct foreign investments have provided the resources required to finance the nation's current account position with considerable leeway, and this situation is expected to last through 2003.

In 2002, placements of sovereign bonds and IMF disbursements to the country in the context of the Financial Assistance Program provided the resources required for Banco Central interventions and external debt service payments for which the monetary authority was liable. Gross reserves remained at the same level as in 2001. For 2003, the reserve position is expected to decline as a result of payments to the IMF. However, the impact on net reserves is not expected to be significant and the position at the end of the year is projected at US$13.8 billion or US$340 million below 2002 and US$8.8 billion above the minimum US$5 billion level agreed upon with the IMF.

5.4 Conclusion

The adjustment capacity demonstrated by the nation's current account position should be analyzed on the basis of its recent evolution as a proportion of GDP. This analysis indicates that the ratio dropped from 4.6% in 2001 to 1.8% in the following year, a trajectory that is expected to continue in 2003. The strongest contribution to this

Statement of international reserves

US$ billion

Itemization	2001 Year	2002 Jan-Nov	2002 Dec	2002 Year[3/]	2003 Year[3/]
Reserves position in previous period	33.0	35.9	35.6	35.9	37.0
Net Banco Central interventions	-7.2	-7.8	-1.2	-9.0	1.5
Spot and export lines	-8.2	-6.9	-0.7	-7.6	0.0
Repurchase lines	1.0	-0.8	-0.5	-1.3	1.5
Debt servicing (net)	-7.1	-6.7	-0.5	-7.2	-9.1
Interest	-3.2	-3.6	0.0	-3.6	-4.5
Credit	1.9	1.4	0.1	1.6	1.4
Debit	-5.1	-5.0	-0.1	-5.2	-5.9
Amortization	-3.9	-3.1	-0.5	-3.6	-4.7
Disbursements	7.8	5.0	0.2	5.3	6.8
Multilateral organizations	1.2	1.1	0.2	1.3	2.8
Sovereign bonds	6.7	3.9	0.0	3.9	4.0
Exceptional financing (IMF)	6.8	8.5	2.9	11.4	-11.1
Disbursement	6.8	13.0	3.0	16.0	0.0
Amortization	0.0	-4.5	-0.1	-4.6	-11.1
Others[1/]	2.6	0.6	0.0	0.6	0.0
Change in assets	2.9	-0.3	1.4	1.2	-11.9
Gross reserves position	35.9	35.6	37.0	37.0	25.1
Net reserves position - Agreement with IMF[2/]	27.8	15.6	14.2	14.2	13.8

1/ Includes pre-payment to Poland in November 2001. Includes payments/receipts in the framework of the Reciprocal Credit Agreement (CCR), fluctuations in prices of securities, exchange parities and price of gold, discounts and premiums, duty fees and release of collaterals.

2/ In order to comply with the performance criterion, in the framework of the international Monetary Fund Agreement, the calculation parameters for the net adjusted reserves - as defined in the Technical Memorandum of Understanding (TMU) of the third review of the Stand-By Agreement - should be observed. In this case, the net adjusted reserves denominated in USD take into account the parities set on dates established by the TMU to figure out the assets denominated in currencies unlike the USD, including the SRD. The same methodology is applied in the case of the gold price. Also, pursuant the TMU, the outstanding debt with the IMF should be excluded from the reserve assets (international liquidity concept), as well as the deposits in banks domiciled abroad, though headquartered in the country, and the securities issued by residents that surpass altogether US$1,023 million.The exceeding value as of October 2002 is equal to US$2,507 million.

3/ Forecast.

performance was made by the balance of trade result, though net outlays on services, including the traditionally deficit position of international travel, also turned in positive results at the end of 2002 and, therefore, played a highly important role. Even in the case of income remitted abroad, a variable considered highly rigid, the result closed below US$19 billion, confirming that the downward trajectory that began following the shift in the rate of exchange has come to an end.

This evolution was of fundamental performance, particularly in light of the cutback in sources of balance of payments financing in 2002, which was marked by drops in the inflows of direct foreign investments and loans, partly offset by IMF resources.

The adjustment in uses of resources came to approximately US$20 billion between 2001 and 2002. This change in level is expected to continue in the coming year at a pace that is consistent with gradual recovery in foreign capital flows to the country.

6 – Inflation outlook

This chapter of the Inflation Report presents the Monetary Policy Committee's (Copom) assessment of the performance of the Brazilian economy since the last Report, in September 2002, as well as its assessment of prospects for inflation through 2004. The projections presented herein are based on the assumption that the basic interest rate will remain unchanged during the period under analysis at 25.00% a year, which is the rate set by the Copom at its last meeting, held on December 17-18, and that the exchange rate will remain approximately at the same level as on the eve of that meeting (R$ 3.55). As an alternative, an inflation fan chart is also presented taking into account the future path of the basic interest rate and the exchange rate expected by market participants on December 16. It is important to note that these procedures are strictly technical. Hence, these assumptions should not be taken as forecasts of the future interest rate path.

The inflation and GDP growth forecasts presented in this Report are not meant to be restricted to point estimates. Rather, they are projected within probability intervals, reflecting the degree of uncertainty present when setting the basic interest rate. Inflation forecasts are based not only on the interest rate assumption, but also on assumptions concerning the behavior of relevant exogenous variables. The baseline scenario, which the Copom uses to make its decisions regarding interest rates, utilizes the set of assumptions considered most likely by the Copom. The Copom's forecasts that are presented in this Report are intended to enhance monetary policy transparency and its effectiveness in controlling inflation, which is its main objective.

6.1. – Determinants of inflation

The last *Report* noted a gap between production and sales: while sales registered positive results, the rate of production was stable. In this quarter, the data for industrial activity point to a slight recovery.

According to seasonally adjusted data from the IBGE, industrial production grew for the fifth consecutive month in October. The growth trend of real sales in the transformation industry indicated in the last *Report* was maintained with an increase of 9.3% between August and October, according to seasonally adjusted data from the National Industrial Confederation (CNI). In 2002, GDP is expected to grow by 1.6%.

Consumption and exports have been the main factors sustaining aggregate demand in 2002. Consumption has grown moderately in recent months, particularly purchases of low-value items. This movement will continue in the next few months as a result of ongoing factors such as the release of FGTS (Warranty Fund for Severance Pay) funds, payments related to the 13th salary, and improved expectations. The Consumer Intentions Index, measured by Fecomercio of São Paulo, rose by 5,0% in December, accumulating a 6,4% increase in the fourth quarter.: This positive performance is mainly attributed to an increase in the Future Intentions Index, which reached its highest level since March 1999. In the medium and long run, however, this growth in consumption will be moderate, given the decline in real wages and the modest growth of employment.

In 2002, the foreign trade sector played an important role in ensuring positive economic growth. This is to a certain extent an exceptional result, considering the relatively low trade openness of the Brazilian economy, and it is derived from the large improvement in the trade surplus, which is expected to be above the mark of US$ 12 billion in 2002. In relation to 2001, this represents an increase of approximately US$ 10 billion, or approximately 2% of GDP. In 2003, the trade surplus is expected to reach US$ 15 billion. Since the trade surplus will grow less in 2003, its contribution to GDP growth should be lower than observed in 2002.

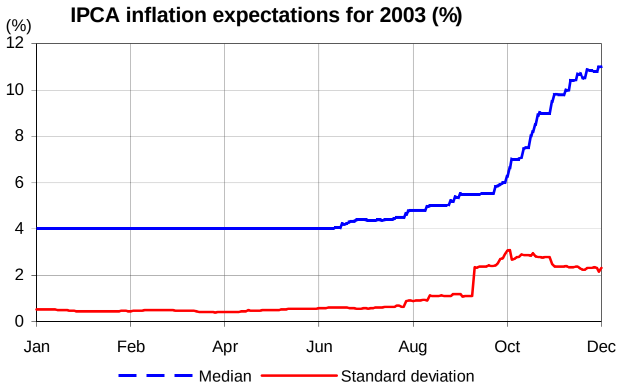
Particularly because of the positive trade balance results, the 12-month current account deficit has been falling steadily since August 2001. In September, the current account had its highest monthly surplus (US$ 1.2 billion) since 1980, when the monthly series began. Up to November, the entry of foreign direct investments in 2002 was sufficient to finance twice the current account gap accumulated over the same period (US$ 15.0 and US$ 7.5 billion, respectively).

The Quarterly National Accounts calculated by the IBGE show that investment spending dropped during the first two quarters of 2002 in relation to 2001. Despite some positive indicators more recently, such as higher production of capital goods and construction inputs, the situation is not expected to have changed in the second half of the year as a result of the current high level of uncertainty. The Index of Industrial CEOs' Confidence has not recovered from the significant drop registered in the third quarter of this year.

Regarding aggregate supply, the labor market has not been exerting pressure on corporate costs. The average seasonally adjusted open unemployment rate as measured by the IBGE hit 7.7% in October, the highest rate registered since February 2000. According to seasonally adjusted data from the IBGE, the real average income of employed personnel in the third quarter of 2002 was lower than in the previous two quarters. No salary pressures are expected in the next few months either, since most collective salary negotiations will be held in the second half of 2003.

Looking ahead, the scenario for capacity utilization is not clear. According to the Getúlio Vargas Foundation (FGV), capacity utilization stood at 80.4% in October, the highest figure in 2002. However, the average rate of utilization in 2002 is still lower than in 2001. According to seasonally adjusted data from the CNI, installed capacity utilization in the transformation industry hit 81.77% in October, the highest rate since the beginning of the data series. More detailed analyses of the series, however, show that capacity use is high in some sectors linked to exports, such as transportation and steel. Therefore, the high rate of capacity utilization may give rise to some inflationary pressure in specific sectors without pressuring costs at large.

The main cost pressure for corporations has been the deprecation of the exchange rate, which accumulated 45%, when one compares the average of the last quarter of 2002 with the same period of 2001. Given the magnitude of the recent IPCA results, the evaluation of the future exchange rate pass-through in 2003 has been reviewed since the last *Report*. If the magnitude of exchange rate pass-through does not change in the future, the exchange rate depreciation is not expected to produce direct pressure on the inflation of market prices in 2003. As for the inflation of managed prices in 2003, which are adjusted according to the IGPs (General Price Indices), this will probably be more influenced by the exchange rate depreciation observed in 2002.



The expected inflation (IPCA) for 2003 as collected by the Central Bank of Brazil's Investor Relations Group (Gerin) has increased significantly over the last three months. The median of expectations rose from 5.2% to 11% between the Copom meeting in September and the eve of the December meeting. There was also an increase in the dispersion of expectations, as the standard deviation rose from an average of 1.2 p.p. in September to 2.3 p.p. on December 6. According to the Copom's evaluation, the factors that might have led the market to increase its expectations for 2003 inflation by this large magnitude include the following: i) the evaluation that some sectors will be affected by a delayed exchange rate pass-through that would put pressure on the inflation of market prices in 2003; ii) uncertainties in relation to the conduct of monetary policy in the next federal administration; iii) inflation inertia associated with the high inflation observed in the last quarter of 2002.

In relation to the first factor, as mentioned above, the evaluation that there is no exchange rate pass-through still to be realized means that the effects of the exchange rate depreciation in 2002 will be mainly felt on managed prices in 2003. Regarding inflation inertia, the Copom believes that some pressure will indeed be felt on market prices, particularly early in 2003. However, the abnormally high inflation registered in the last quarter of 2002 can, to a large extent, be attributed to temporary phenomena such as the period between harvests, the higher international price of some commodities, preventive price adjustments, and less optimistic expectations. Some of these factors, such as the large increase registered in the price of food products and preventive price adjustments, could have a positive effect on inflation early in 2003, as they enhance the probability of a reversion in prices. It should be highlighted that although over 80% of the items that make up the IPCA were positively readjusted in November, the inflation that was registered could be better characterized as a change in relative prices between tradable and non-tradable goods. In particular, "personal services" items registered inflation of 1.70% in the last three months, compared to the 5.12% increase registered by the IPCA.

In sum, economic activity has been growing gradually and monotonically during the year, reflecting the higher domestic consumption and exports. Inflation rates increased in the last quarter of 2002 as a consequence of the exchange rate depreciation occurred during 2002 and temporary factors and has been accompanied by higher inflation expectations. The main risk factors for 2003 will be price adjustments caused by high inflation expectations and the inertial effects on market and administered prices.

6.2 – Baseline scenario: assumptions and associated risks

The Copom's forecasts are based on a set of underlying assumptions about the behavior of key economic variables. This set of assumptions and respective associated risks are part of the baseline scenario under which the Copom makes monetary policy decisions.

The main risk factor for inflation in 2003 is the possible impact of the expectations of higher inflation observed in recent months. The behavior of the exchange rate and its pass-through to prices also constitute recurrent sources of uncertainty for the projections. Finally, as has been the case in recent years (see box *Managed Prices and the Monetary Policy*), the inflation of managed prices is expected to be higher than that of market prices, pushing inflation up until 2004.

According to the baseline scenario, the average exchange rate in the last quarter of 2002 (R$ 3.68) will be more depreciated than the one anticipated for 2003 (R$ 3.55). Despite this more favorable conjuncture, the volatility of the exchange rate and of other markets continues to generate uncertainties for inflation forecasts for 2003, since the exchange rate depreciation registered in 2002 led to an upward review of the projected figures and also enhanced the uncertainties in relation to the persistence of this depreciation and to the pass-through coefficient to market prices. As explained in section 6.1, according to the estimate of the exchange rate pass-through and given the high inflation registered in the last quarter of 2002, the Copom believes that the impact of the exchange rate depreciation in 2002 has been incorporated into the inflation observed this year already, meaning that no repressed exchange rate pass-through will push inflation up in 2003.

In October, prices managed by contract and monitored prices were redefined to exclude three items: wood coal, school transportation, and domestic workers. With this new definition, prices administered by contract and monitored prices had a weight of 27.7% in the IPCA as of October, instead of 31.1% as in the old definition. According to this new definition, a 15.4% increase is anticipated for managed items in 2002 and 13.0% in 2003. The higher inflation projected for managed items in 2003 was mainly determined by the exchange rate devaluation and by a new assessment of expectations around the IGP-M, the index which determines the readjustment of a high proportion of the prices of managed items. For 2004, a 7.6% inflation rate is projected for items managed by contract and monitored items, assuming that the prices of all these items will be adjusted according to the IGP-M for that year.

A change in the Contribution for Interventions in the Economic Domain (Cide) for oil by-products constitutes the highest risk factor for the projection of managed prices. In December, the Chamber of Representatives passed a Cide increase for gasoline from R$0.50 a liter to R$0.86 a liter and for liquefied petroleum gas from R$136.70 a ton to R$250.00 a ton. The baseline scenario does not incorporate these price adjustments, which should have a direct impact of 1 p.p. on the IPCA. For this reason, the baseline scenario assumes that the projected price adjustments in reais for oil by-products result from the evolution projected for international prices and for the exchange rate. The gasoline price is projected to drop by 3.8% and cooking gas price should increase by 2.0% in the next year.

The December projections for residential electricity rates, which had a weight of 4.24% in the November IPCA, assume that electricity prices will rise by 30.3% in 2003. In relation to the last Report, the projection for electricity rates in 2003 rose by 9.6 p.p. Former projections were reviewed as a result of the exchange rate depreciation observed over the last three months and of the significantly higher projections for the IGPs, which constitute an important component in electricity rate adjustments.

The projection for the *spread* between the six-month interest rate and the Selic rate, following the specification of an error correction model, and provided that the Selic rate remains constant at 25.0% a year, begins at 300 basis points in the first quarter of 2003 and declines to -125 basis points late in that year.

As in the September *Report*, no factors that could restrict the growth of aggregate supply have been identified. For agriculture/livestock products, the underlying assumption made in the last *Reports* – that their prices will evolve according to the inflation of market prices up to the end of 2003 – was maintained. Although the baseline scenario does not incorporate this underlying assumption, the inflation of food products is likely to remain below the inflation of market prices in the first months of 2003 as a result of a reversion of the marked price hikes observed in the last quarter of 2002.

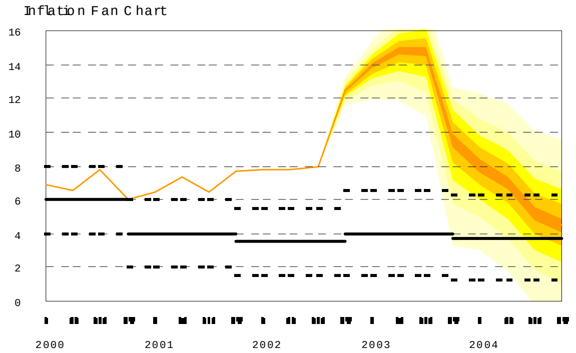
Regarding fiscal policy, it is assumed that the target of 3.88% set for the primary surplus of the consolidated public sector in 2002 and of 3.75% in coming years will be achieved.

As detailed in section 6.1, inflation expectations for the IPCA in 2003, as collected by the Central Bank of Brazil's Investor Relations Group (Gerin), have deteriorated significantly between the Copom meetings in September and December, as the median and the dispersion of expectations have increased. The forecasting models adopted by the Copom usually take these expectations into account. The Copom has built an alternative scenario that incorporates a faster decline of inflation expectations, which would drop to 8% for 2003. In addition, instead of keeping the exchange rate approximately at the level observed on the eve of the Copom meeting (US$ 1 = R$ 3.55), this scenario assumes an exchange rate of R$ 3.20. These scenarios are among the several others analyzed by the Copom. The other underlying assumptions of the baseline scenario were maintained in the alternative scenario.

6.3 – Inflation forecast

Based on the assumptions and associated risks considered by the Copom and on all the information available, the 12-month change in the IPCA was projected using a basic interest rate of 25.00% a year, as defined at the meeting held on 17-18 December 2002, and the exchange rate at R$3.55, a value close to the one registered on the eve of the Copom meeting. The inflation projection based on an alternative scenario defined by the Copom is also presented.

Forecasted 12-month IPCA-inflation with Selic interest rate constant at 25% p.a. (Baseline Scenario)



12-month IPCA inflation with 25% p.a. fixed interest rate. (Baseline Scenario)

Year	Q	Confidence Intervals 50%	30%	10%				Central Projection
2002	4	12.1	12.2	12.4	12.5	12.6	12.8	12.4
2003	1	13.1	13.5	13.8	14.0	14.3	14.6	13.9
2003	2	13.6	14.2	14.6	15.0	15.4	15.8	14.8
2003	3	13.3	13.9	14.5	15.1	15.6	16.1	14.8
2003	4	7.2	8.2	9.1	9.9	10.6	11.3	9.5
2004	1	6.0	6.9	7.6	8.4	9.1	9.8	8.0
2004	2	4.9	5.8	6.6	7.4	8.1	9.0	7.0
2004	3	3.0	4.0	4.8	5.6	6.4	7.2	5.2
2004	4	2.3	3.2	4.1	4.9	5.7	6.6	4.5

Accumulated inflation in 12 months (% p.a.). The values correspond to the ones shown in inflation fan chart.

The central path expected for inflation accumulated in 12 months rises up to the third quarter of 2003, when it hits the mark of 14.8%, and declines continually after that to 9.5% late in 2003 and 4.5% in the last quarter of 2004.

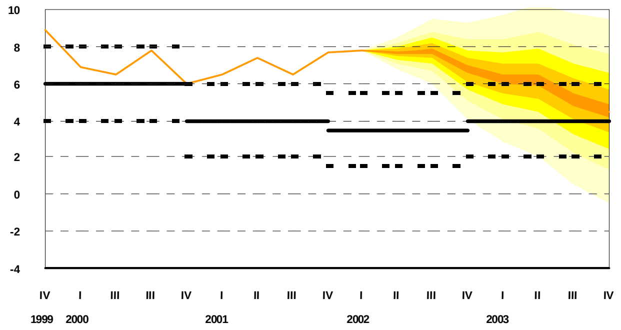
The high 12-month accumulated inflation up to the third quarter is a consequence of the inclusion in the calculation of the high inflation projected for the fourth quarter of 2002 (6.5%). The inflation estimated for the last quarter of 2003 is 1.6%, much lower than the 6.5% rate projected for the last quarter of 2002. Consequently, inflation accumulated in 12 months drops by 5.3 percentage points between the third and fourth quarters of 2003. In addition, inflation in the third quarter rises due to the concentration of managed price adjustments in this period.

It should be noted that deviation probabilities are asymmetrically distributed around the median, with greater dispersion for figures below the path associated with the baseline scenario. This asymmetry incorporates the higher weight that the Copom attributes to the fall in inflation expectations and to the appreciation of the real, as described in the alternative scenario in section 6.2, as compared to other scenarios.

Prices administered by contract and monitored prices cause the highest inflationary pressure. For 2002, 2003 and 2004, the inflation projected for managed prices is 15.4%, 13.0%, and 7.6%, respectively. Over the same period, the inflation of market prices is expected to be 11.3%, 8.2%, and 3.3%. Because of the effects associated with inflation inertia, the impacts caused by managed price adjustments, and expectations of high inflation, the inflation of market prices is only expected to drop back to figures consistent with the inflation targets after the second half of 2003.

Forecasted 12-month IPCA-inflation with interest rate constant at 18% p.a. (September Report)

Inflation Fan Chart

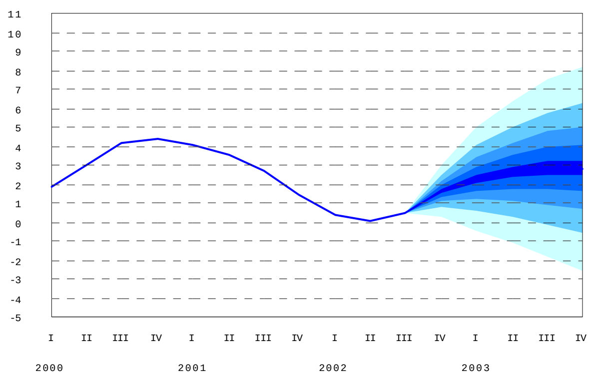


Comparing the current projection with the one made in the September *Report*, a change can be observed in the expected path. Although it is not possible to compare them directly, because the projections are based on different assumptions in terms of scenario and interest rates, it is worthwhile to comment on some issues. The central projection for 2003 rose from 4.5% in the last *Report* to 9.5% in the present *Report*.

The main causes of the higher projection for 2003 were the deterioration in expectations for next year and the inertial effects of the anticipated 6.5% inflation rate in the fourth quarter of 2002. Since the last *Report*, the projection rose by 5 percentage points. Out of this increase, 1.3 p.p. are attributable to the higher inflation of managed prices, which are now projected to increase by 13.0% versus 7.9% in the last *Report*. The remaining 3.7 percentage points are attributable to the higher projection for the inflation of market prices, which are now projected to increase by 8.2% versus 2.9% in the last *Report*.

GDP growth with 25% p.a. constant interest rate

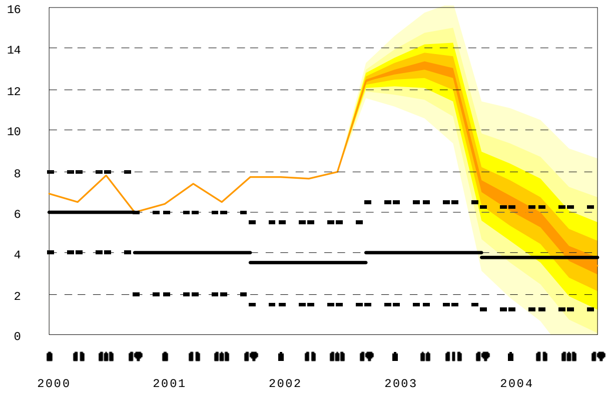
GDP Growth Fan Chart



As in previous *Reports*, this issue also presents the fan chart for output growth that was built based on the same underlying assumptions used in the baseline scenario. It should be stressed that the forecasting errors associated with GDP growth projections are considerably larger than in the case of inflation projections, both because they involve the path of two non-observable components, namely, potential output and the output gap, and because calculating output is, by definition, more complex and less precise than calculating inflation. The central projection for output growth in 2002 is approximately 1.6%, which represents an increase of 0.2 percentage points since the last Report. For 2003, growth of 2.8% has been projected.

An inflation fan chart is also shown taking into account an alternative scenario outlined by the Copom, where inflation expectations for 2003 drops more rapidly to 8% and the exchange rate becomes stable at

Forecasted 12-month IPCA-inflation with Selic interest rate at 25% p.a. (Alternative Scenario)
Inflation Fan Chart



12-month IPCA inflation with 25% p.a. fixed interest rate (Alternative Scenario)

Year	Q	Confidence Intervals 50%	30%	10%	10%	30%	50%	Central Projection
2002	4	12.1	12.2	12.4	12.5	12.6	12.8	12.4
2003	1	12.1	12.4	12.7	13.0	13.3	13.6	12.9
2003	2	12.1	12.5	13.0	13.4	13.8	14.2	13.2
2003	3	11.4	12.0	12.6	13.1	13.6	14.2	12.8
2003	4	5.6	6.3	7.0	7.6	8.2	9.0	7.3
2004	1	4.6	5.4	6.1	6.8	7.5	8.4	6.5
2004	2	3.6	4.4	5.2	6.0	6.7	7.6	5.6
2004	3	1.9	2.8	3.6	4.4	5.2	6.1	4.0
2004	4	1.2	2.1	3.0	3.8	4.6	5.5	3.4

Accumulated inflation in 12 months (% p.a.). The values correspond to the ones shown in inflation fan chart.

R$3.20, against R$3.55 in the baseline scenario. This alternative scenario is one among several others analyzed by the Copom. The remaining assumptions are the same as those spelled out in the baseline scenario. The inflation projected according to these underlying assumptions is 7.3% in 2003 and 3.4% in 2004. What this means is that a more rapid reversion of expectations associated with an appreciation of the real will play a significant role in bringing inflation down in the next year.

Monetary Policy in Brazil

Arminio Fraga Neto and Ilan Goldfajn

Governing involves managing wishes, conflicts and, many times, inconsistencies. Monetary policy is not an exception, especially in Brazil. The public wishes the maintenance of the hard-won price stability that has been sustained in recent years; however, it also wants the immediate reduction of real interest rates. It wishes a less volatile exchange rate, but it does not appreciate foreign exchange interventions that reduce Brazil's international reserves. It wishes the reduction of the external debt, but it rejects the depreciated exchange rate and the pressure this induces on prices.

In these moments of transition it is important to think about the Central Bank's role. To begin with, it is worth emphasizing that the Central Bank has only one instrument, monetary policy; therefore, it should have only one objective as a target. Currently there is a consensus in the world that this objective should be price stability. In the long run, monetary policy is unable to engineer rates of output growth higher than the economy's rate of productivity growth. Empirical evidence suggests that the most effective use of monetary policy is to ensure price stability. This stability can generate higher output growth rates by reducing uncertainties and distortions, extending decision-making horizons, and allowing for an increase in investments and productivity gains. Therefore it should be made clear that a higher sustainable growth rate with more inflation is not an option.

Even with only one objective and one instrument, it is possible to organize Central Bank actions in different ways. One of the options is to anchor the price level by returning to the fixed (or "administered") exchange rate regime, a choice which is not recommended for many reasons. Another option is to try to control a monetary aggregate, such as money held by the public or credit in the economy. However, in practice, due to the instability of the demand for these aggregates, the great majority of central banks have given up on this option. Finally, there is the use of the interest rate as an instrument to control inflation, the option preferred by the majority of central banks. In this case, a central bank can act with a higher or lower degree of transparency and commitment. In the Inflation-Targeting Regime Framework, the inflation targets for the following years are made explicit, the Central Bank's inflation projections are reported on a quarterly basis, and the reasons for the Central Bank's actions are detailed in the minutes after the decisions.

The US Fed, with the credibility acquired under the presidency of Paul Volcker and Alan Greenspan, have chosen not to adopt this framework. Other Central Banks, including in England, Canada, New Zealand, Australia, Brazil, Mexico and Chile, among others, have adopted inflation-targeting regimes.

In Brazil, since the adoption of the inflation-targeting regime, Central Bank policy has been based upon some basic principles implemented by the Monetary Policy Committee (Copom). First, the Copom begins with an evaluation of the future trend of inflation. These projections are obtained through the best available information, using both quantitative methods, including structural models, simulations and other statistical procedures, and qualitative and disaggregated methods, which require a more subjective evaluation.

Second, the Copom attempts to analyze the reasons for the differences between the inflation projection and the target, in order to react according to best international theory and practice. In order to react appropriately, it is necessary to distinguish between demand and supply shocks, and between temporary and permanent shocks. Demand shocks should be fought one-for-one. A demand contraction, for instance, should be offset by an expansionary monetary policy. In the case of supply shocks (also known as cost-shocks) the Copom has followed the traditional recommendation: the direct impact of the shock on the price level is accommodated (that is, it does not provoke any monetary policy reaction), but monetary policy attempts to counteract the secondary (or inertial) effects of the shock.

When confronted with shocks of great magnitude, as over the last 18 months, monetary policy has been adjusted in order to extend the period over which the price index converges to the inflation target. This procedure takes into account the output costs of the adjustment process that are related to the existence of inflationary inertia. According to this policy, and consistent with the design of the inflation targeting system, the Central Bank should give due consideration to the volatility of economic activity in its decision-making, but without setting aside its main objective of achieving the inflation targets.

For the Central Bank to be able to act with the necessary flexibility, without jeopardizing the credibility of its commitment to the targets, it is essential that its performance be totally transparent, so that an appropriate decision is not interpreted as an unjustified deviation from its stated goals. To meet this condition, the Copom tries to measure the primary price effect of economic shocks. The Copom then evaluates the time period necessary to eliminate the associated inflationary inertia, in view of the magnitude and of the persistence of the shock. Given this period, the Committee estimates the share of the inertia to be accommodated in the year under consideration; this share is then added to the estimate of the primary shock and incorporated into the target, for the purpose of comparison with the Copom’s inflation projection. In the case of the shocks in 2003, the Copom decided to neutralize the associated inertia over a period of two years. Adding together half the impact of the inflationary inertia and the primary shock on administered prices yields a total of 2 p.p., and increases the adjusted inflation target in 2003 to a rate of around 6%. Thus, the BCB does not aim to achieve its target at any cost, but considers the nature and persistence of the shocks, and the associated costs on the level of economic activity.

Based on this framework and on the basic principles adopted, it is interesting to evaluate the performance of the inflation-targeting regime in Brazil since its implementation in mid-1999. Table I shows that in the period of the inflation-targeting regime the volatility of both inflation and GDP growth (quarter in relation to the previous quarter) have declined (to 0.4 from 0.9 and to 1.5 from 3.2, respectively). Likewise, on average, GDP growth increased (to 2.4% from 2.0%) and inflation and interest rates fell (to 7.1% from 10.3% and to 18% from 35.4%, respectively).

As a consequence of their influence on inflation expectations, the inflation targets themselves played an important role in achieving this result by reducing inflationary inertia to one third of the previous level (to 0.2 from 0.6). Another improvement is the increased capacity of the economy to absorb exchange rate fluctuations, which have been required to achieve external adjustment. This has depended to a great extent on the success of monetary policy in fighting the inflationary effects of exchange rate depreciation. Table II shows that in the last years only 14-16% of the exchange rate depreciation was passed through to prices.

These results indicate that the Inflation-Targeting Regime has been successfully fulfilling its role. During the entire period that followed the adoption of the regime, the BCB has been loyal to its commitments, using the flexibility allowed by the regime, while trying not to lose control over inflation expectations. Until the worsening of the confidence crisis that began in the middle of this year, inflation expectations remained within the tolerance intervals of the targets for future inflation (see graph I that shows the expectations of inflation for 12 months ahead and the respective inflation target calculated as a weighted average). More recently, however, inflation expectations have surpassed acceptable levels for the first time, denoting a high degree of uncertainty in regard to the future commitment to inflation control. This situation cannot be maintained without an answer, or we will once again experience the painful, frustrating and socially unfair times of high inflation.

The BCB provided an answer in the last extraordinary meeting of the Copom by increasing the basic interest rate by 3 p.p. Adding to this effort was the contribution of the elected President and his team by reaffirming their campaign commitment to conduct a responsible macroeconomic policy, including low inflation. Thus, as these commitments solidify, we believe that the confidence crisis, which already shows signs of reversion, will be eliminated.

Graph I
12-Month Ahead Expected Inflation and Inflation Target
2000:01 - 2002:10 (% p.a.)

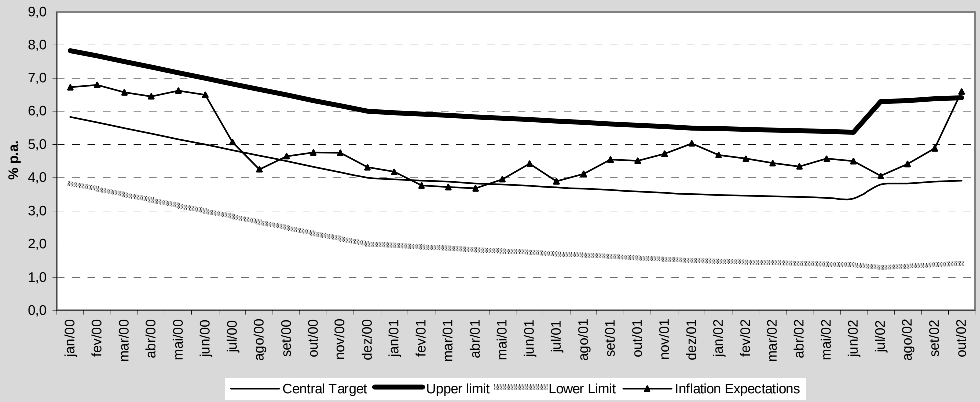


Table I
Before and After the Inflation-Targeting Regime

	Before (1994:4 - 1999:2)	Before (1996:1 – 1999:2) shorter sample	After (1999:3 – 2002:2)
Volatilities - Variation Coefficient (standard deviation/average, quarterly data)			
Inflation	0.9	0.8	0.4
GDP Growth (seasonally adj.)	3.2	2.5	1.5
Interest Rate	0.4	0.2	0.1
Average (annualized)			
Inflation	10.3	5.8	7.1
GDP Growth (seasonally adj.)	2.0	2.0	2.4
Interest Rate	35.4	28.2	18.0
Inflationary Inertia (monthly data)*			
Inflation (t-1) – significant	0.6		0.2

Sample: 1995:08 - 2002:06 (equation also includes the exchange rate change in the previous 12 months and the employment rate)
Source: Minella, Freitas, Goldfajn, and Muinhos (2002), "Inflation-Targeting in Brazil: Lessons and Challenges"

Table II
Exchange rate Pass-Through in 12 months to Administered Prices, to Free Prices and to the IPCA (Real Plan)

Model	Administered Prices	Free Prices	IPCA
Structural Model and Information regarding Administered Prices	25%	12%	16%
Modelo VAR	20%	8%	14%

Source: Minella, Freitas, Goldfajn, and Muinhos (2002), "Inflation-Targeting in Brazil: Lessons and Challenges"

Medium-Size Macroeconomic Model for the Brazilian Economy *

Marcelo Kfoury Muinhos and Sergio Afonso Lago Alves**

1. Introduction

Small-scale macroeconomic models are very useful for forecasting the short run, but they are not very useful for anchoring the key variables in the long run. They are not able to answer questions about the macro equilibrium of the economy, nor to establish fiscal or external constraints. Larger macroeconomic models work better in providing information about the interaction of stabilization and growth in the medium run. Questions concerning technology, investment, labor markets and the current account balance are better addressed by a more comprehensive model. Micro-founded models are also able to present long run properties consistent with economic agents' optimal behavior. On the other hand Keynesian models are important because they can be used to simultaneously determine the equilibrium levels of output, employment, inflation, current account, rate of investment and fiscal balance. However, in Keynesian models the long-run equilibrium of some key variables such as the interest rate and exchange rate are not endogenously determined.

Many Central Banks have built micro founded structural models. Examples include the Bank of Canada's QPM, the Bank of England's MM (*Macroeconomic Model*) and also the IMF's Multimod. Among the models in the Keynesian paradigm, one example is the Financial Programming model of the International Monetary Fund, which uses the monetarist approach to the balance of payments. This model was used in the creation of an entire generation of IMF programs and is still being applied. The World Bank has a line of two-gap growth models (domestic saving and external saving) called RMSM-X. The Central Bank of Chile has built a Keynesian model very similar to the one presented in this paper. The major difference between the models is in the derivation of the steady-state equilibrium. In the Chilean model, consumption is divided into durable and non-durable goods, which is a future goal for our model. In Brazil, IPEA has set up a Keynesian macroeconomic model, based on the national accounts, especially the balance of payments and the fiscal budget. A quarterly version of this model has been released recently.

The main contributions of our model, compared to other macroeconomic models developed in the Central Bank of Brazil, are:

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* We would like to thank Gil Riella for his outstand help in running the model in Matlab. Flávia Mourão Graminho, Eduardo Loyo and Andrew Levin also helped us in the estimations and with suggestions. The views expressed in this work are those of the authors and do not reflect those of the Banco Central do Brasil or its members.

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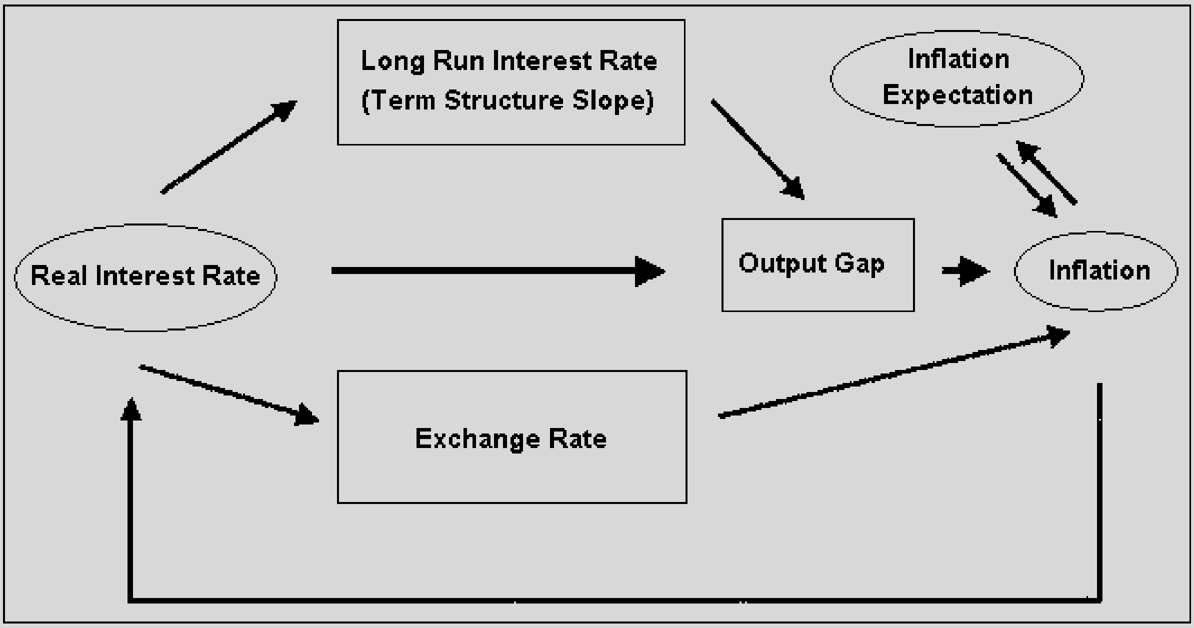
- Aggregate demand is calculated by estimating: (1) family consumption, investment in (2) machinery and (3) construction, (4) net exports, (5) government spending, (6) government taxes, (7) changes in inventories;
- The model uses a Phillips curve that includes dummies for the structural break in the pass-through coefficient in 1999 and a proxy for labor productivity (unit labor cost);
- Potential output is estimated by a Cobb-Douglas production function;
- The model includes a partial calibrated-estimated Uncovered-Interest-Parity (UIP) equation, together with an equation for the risk premium, to which responses for changes in fiscal and external conditions are added;[1]
- The model includes ad-hoc steady-state conditions for the current account deficit and the primary fiscal surplus.

2. Diagrams of The Transmission Mechanisms and Equilibrium Conditions

In order to compare the monetary transmission mechanisms of the medium-scale and the small-scale models, it is necessary to explain the mechanisms in the latter model, as shown in Figure 1..

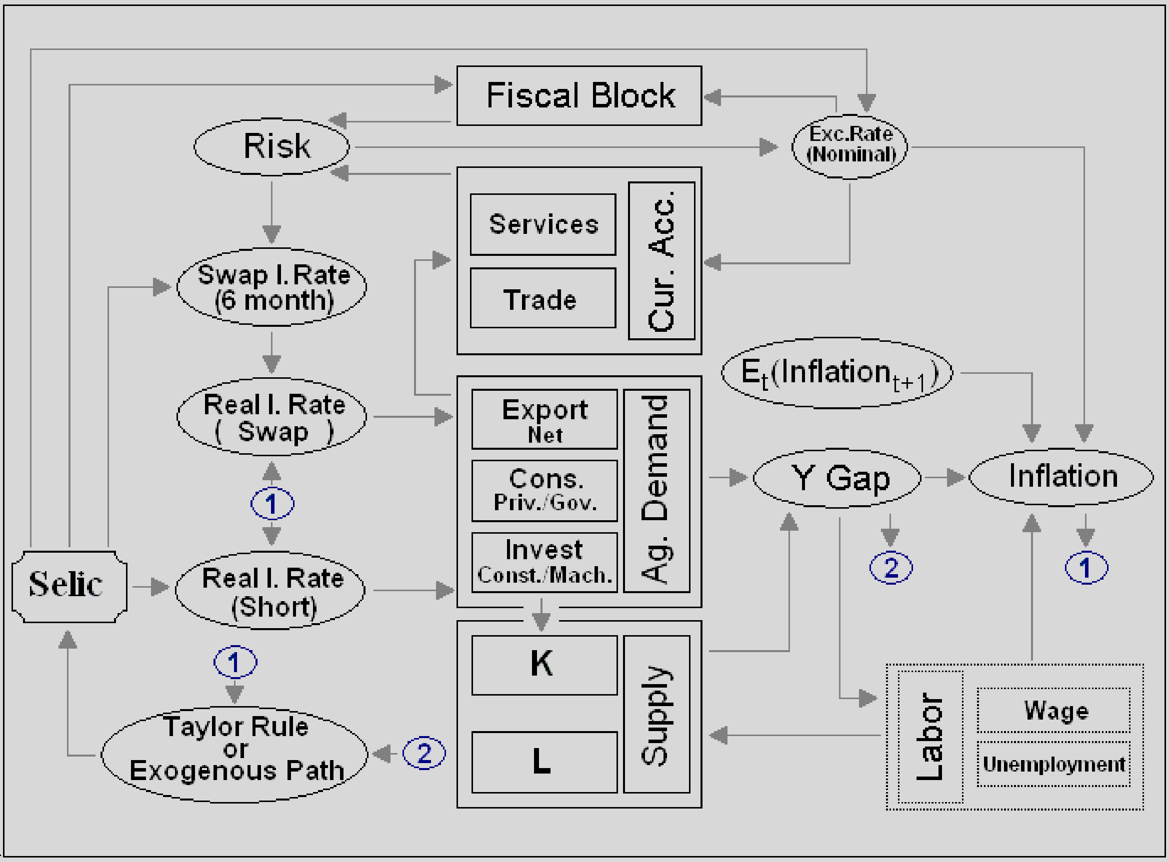
Figure 1 ***Small Model Transmition Mechanism***



The model includes the traditional channel, the output gap, and a second channel, the exchange rate. The IS curve shows that an increase in the real interest rate will negatively affect the output gap, directly and indirectly via the term structure of interest rates. A more negative output gap will decrease inflation via the Phillips curve. By the UIP non-arbitrage condition, an increase in the interest rate causes an appreciation of the exchange rate in the spot market, and, via the Phillips curve, a decrease in imported prices will generate lower inflation.

The two monetary transmission mechanisms described for the small model also occur in the medium model, shown in Figure 2[2]. But now it is possible to distinguish between supply and demand effects. An increase in the interest rates will affect household consumption and investment in construction and machinery through the term structure, generating a decrease in aggregate demand. A higher interest rate will cause an exchange rate appreciation and a decrease in net exports, decreasing aggregate demand. On the supply side, the effects of a higher interest rate will take more time to occur, because a lower level of investment will cause a decrease in the growth rate of the capital stock, affecting potential output growth. The decrease in aggregate demand leads to a drop in inflation through a more negative output gap. But this drop would be partially offset by the decrease in potential output growth.

Figure 2 ***Medium Model Transmition Mechanism***



The exchange rate mechanism is still available in the medium size model. But now the fiscal and external variables also affect the exchange rate via the risk premium. An increase in the interest rate that worsens the fiscal accounts will generate an increase in the risk premium and a devaluation of the exchange rate that might offset the aggregate demand channel. The current account deficit also affects the risk premium and consequently, the exchange rate and inflation. Rapid GDP growth may cause an increase in inflation via the output gap and also via a worsening of the trade balance.

The absence of micro-founded behavior equations does not allow us to find endogenous steady state values for variables such as the interest rate or exchange rate. The UIP derived equation, for instance, presents an error correction mechanism that drives the system to the long run equilibrium steady-state exchange rate, defined as the exchange rate that leads to an ad-hoc long-run current account/GDP ratio. This ratio, in turn, is consistent with a steady-state ratio of external liabilities/GDP. For the interest rate, the use of the Taylor rule assures a long-run equilibrium compatible with the inflation target and a neutral output gap.

3 Simulations

The model is simulated in a Matlab/Simulink environment until 2100:4, but we only show the first 30 years of results for simplicity. Our closure rule is an ad-hoc end-point for the current account/ GDP ratio, which brings us to a long-run equilibrium value for the real exchange rate. The current account surplus was set at 0% for the last period of the simulation. The primary fiscal surplus follows an exogenous vanishing path to the long run. We also assumed that world and domestic growth converge in the long run.

The paper is about to be released as a Working Paper of Central Bank of Brazil, and contain a more detailed description of the equations and of the hypothesis used in the modeling process. There is also an estimation process for the latent variables of the supply side, as the full employment capacity utilization and unemployment rate. Simulations include forecasting under different Taylor Rule specifications and impulse responses for shocks on interest rate, risk premium and administered prices.

1 Muinhos, Alves and Riella (2002) already have similar equations for UIP and Risk premium.

2 Although the main blocks of the medium model are represented in Figure 2, there are some interactions between variables not shown in the figure in order to obtain a clean representation of the model. Nevertheless, the model equations are commented in the paper about to be released as a working paper of Central Bank of Brazil. As this is still a work in progress, our blocks are subject to future improvements.

Managed Prices and Monetary Policy*

In recent years, prices managed by contract or monitored prices have posted much higher increases than so-called market prices, putting pressure on the consumer price index (IPCA) that is used in Brazil's inflation targeting regime. Between January 1999, the year in which the exchange rate was floated and the inflation targeting regime was adopted, and October 2002, the headline IPCA rose by 33.0%, while managed prices rose by 61.2%.

Broadly speaking, prices managed by contract or monitored prices (henceforth, managed prices) are those prices that are relatively insensitive to supply and demand, although they are not necessarily directly regulated by the government. Also included in this category are prices that despite being determined by supply and demand require the authorization or prior notification of some governmental agency. The set of items with managed prices includes taxes and fees (the IPVA (automobile tax), the IPTU (property tax), and the water and sewage taxes), public utilities whose rates are regulated or authorized by the government through regulatory or inspection agencies (telephone, electricity, health insurance, toll agencies), oil by-products whose market is being liberalized but whose prices are set by state enterprise, and items whose prices can be considered virtually free (fuel alcohol and airline tickets).

At first glance, the larger rise in managed prices versus market prices might seem to be a realignment of the relative prices of these two groups that simply reverses a previous change in the opposite direction. However, when examining a longer sample, for example since January 1995 as has been done here, the results also indicate a higher increase in managed prices. This can be seen in the chart below, which shows the changes in the headline IPCA and the main components of managed prices between 1995 and October 2002.

Evolution of the main managed prices

Items	1995-1998	1999-2002*	1995-2002*
IPCA	**43.46**	**32.98**	**90.78**
Managed Prices	**88.00**	**61.19**	**203.04**
Urban bus transportation	97.82	53.23	203.12
Gasoline	51.50	113.30	223.14
Residential electricity	89.60	86.77	254.11
Domestic worker	85.70	40.94	161.73
Fixed telephone lines	309.66	48.83	509.70
Health insurance	126.63	27.46	188.85
Water and sewage tax	84.45	45.95	169.21
Cooking gas	121.24	149.67	425.37

Source: IBGE

* Up to October/02

* For more details see Figueiredo and Ferreira (2002), "Preços Administrados e a Inflação no Brasil". Working Paper Series, Banco Central do Brasil, nº 59.

Various factors have determined the path of managed price inflation over this period. One of these has been the process of tariff realignment and elimination of cross-subsidies in privatized sectors, such as the telephone and electricity industries.

A second factor has been the rise of international oil prices and the devaluation of the exchange rate, which have both played an important role in determining the behavior of the domestic prices of oil by-products. The prices of gasoline, cooking gas (liquefied petroleum gas), diesel oil, and fuel oil represent, as a set, about 5.7% of the IPCA (October 2002), and about 20.6% of the total group of managed prices. In addition, changes in the prices of these items have an indirect bearing on other managed prices, such as on transportation and electricity.

A third factor that has influenced the evolution of managed prices has been the effect of the exchange rate's depreciation on Brazil's general price indices. Repeated devaluations have resulted in a higher growth of general price indices relative to consumer indices, leading those managed prices with contracts indexed to general indices to rise above market prices. Moreover, the impact of changes in the exchange rate on managed prices tends to be different from the impact on market prices both in terms of magnitude and of price gap. Regarding the magnitude, given managed prices' lower elasticity of demand, the pass-through to managed prices tends to be higher than to market prices, even though the exchange rate has a similar bearing on the cost structure of the two groups of goods. As for the gap of the pass-through to managed prices, it will depend on the contracts involved, which in the case of electricity or telephony cannot be less than one year. In the case of oil by-products, prices can be adjusted as a result of changes in the exchange rate within the same month according to the methodology implemented in early 2002.

A fourth factor that should be mentioned is the strong inertial component of managed prices, which is responsible for a higher degree of inflation persistence in these prices *vis-à-vis* market prices during the process of disinflation and in the face of shocks. As indicated by Bogdanski, Freitas, Goldfajn and Tombini (2001)[1] , many managed prices in Brazil are chiefly inertial because their adjustments are governed by contracts linked to the past behavior of general price indices. Therefore, these prices tend to be somewhat persistent, as is more evident during a process of disinflation such as the one experienced in Brazil between 1995 and 1998.

The bearing of various factors on the behavior of managed prices can be better illustrated through the following regression between the ratio of the inflation of managed prices and of market prices, and some of the factors described above:[2]

$$\left(\frac{\Delta I_{adm}}{\Delta I_{liv}}\right)_t = -0.004 + 0{,}053\Delta e_{t-1} + 0.038\Delta e_{t-3} + 0.581\Delta igp_{t-5} + 0.021\Delta p_{t-1} + 0.021\Delta p_{t-2} + 0.020\Delta p_{t-3} + 0.026 d_t + \varepsilon_t$$

(-1.998) (1.729) (1.937) (4.257) (2.169) (2.233) (2.068) (6.699)

$R^2 \rightarrow$ 0,774 $R^2_{adj} \rightarrow$ 0,723 $SER \rightarrow$ 0,006 $DW \rightarrow$ 1,863

where:

$\frac{\Delta I_{adm}}{\Delta I_{liv}}$ = ratio between the monthly change of managed prices and market prices;

Δe = monthly change of the nominal exchange rate;

Δigp = monthly inflation as measured by the IGP-DI;

Δp = monthly change of the international oil price;

d = seasonal dummy for the month of July, when most managed prices are adjusted[3]

ε = error

It can be seen that all the coefficients display the expected signs, showing that the proposed factors truly contribute toward a scenario where the growth rates of managed prices are higher than those of market prices.

Among the factors analyzed here, the IGP-DI appears be the most relevant for the behavior of the ratio of the inflation of managed prices to the inflation of market prices. In addition to being the most significant coefficient (except for the dummy), it is also the one with the largest magnitude. Even after adding the effects of the exchange rate or of the oil price in the different price gaps (0.091 and 0.062, respectively), figures that are considerably lower than the coefficient on the IGP-DI are obtained.

Once the differences between the behavior of market prices and managed prices are identified, one can analyze the response of the Central Bank to these differences. For this purpose, we estimated the following Taylor rule, which relates interest rates to the inflation of market prices, to the inflation of managed prices, and to the interest rate set in the previous period.[4]

$$i_t = 0.034 + 0.757 i_{t-1} + (1 - 0.757)\left[0.636\left(liv_{t-1} - \pi^*_{t-1}\right) + 0.498\left(adm_{t-1} - \pi^*_{t-1}\right)\right] + \varepsilon_t$$

$$(4.809) \quad (23.075) \qquad\qquad (2.262) \qquad\qquad (2.229)$$

$$R^2 \rightarrow 0.962 \qquad R^2_{adj} \rightarrow 0.959 \qquad SER \rightarrow 0.005$$

where:

i = nominal interest rate (Selic rate)

liv = inflation of market prices accumulated over the past 12 months

π^* = inflation target for the past 12 months

adm = inflation of managed prices accumulated over the past 12 months

By analyzing the results, it is possible to conclude that monetary policy reacts more strongly to changes in market prices than to changes in managed prices. However, the underlying assumption that the coefficients are equal cannot be rejected.

One might consider that changes in interest rates in reaction to managed price inflation would not be fully effective, since these prices are less sensitive to changes in supply and demand. However, the Central Bank should neutralize the secondary effects of managed price shocks. Although the Monetary Authority is not supposed to respond to the primary effects of the shock, it should prevent the propagation of its effects, since they could affect the general level of prices in the economy. For this reason, a shock to managed prices leads the Central Bank to react by raising the Selic rate for the purpose of inhibiting the secondary effects of this shock.

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1 Bogdanski, Joel, Paulo S. de Freitas, Ilan Goldfajn and Alexandre A. Tombini (2001), “Inflation Targeting in Brazil: Shocks, Backward-looking Prices and IMF Conditionality”. *Working Paper Series*, Central Bank of Brazil, n. 24.

2 The monthly changes mentioned below refer to the log difference of the variables. The sample covers the period between April 1999 and June 2002.

3 In fact, most managed prices are adjusted between June and August. The *dummy* in July would capture this effect.

4 The Taylor rule estimated above should not be strictly interpreted as a reaction function of the Central Bank. For this purpose, using expected future inflation in the Taylor rule would be a more appropriate procedure. However, the series of expectations and inflation forecasts, separated by market prices and managed prices, are more recent, and this fact jeopardizes the estimation. For an analysis of the reaction function of the Central Bank based on future inflation, see Minella, André, Paulo S. de Freitas, Ilan Goldfajn and Marcelo K. Muinhos (2002), “Inflation Targeting in Brazil: Lessons and Challenges”. *Working Paper Series*, Central Bank of Brazil, n. 53.

Annex

Minutes of the 75th Meeting of Banco Central do Brasil Monetary Policy Committee (Copom)

Date: September 17 and 18, 2002
Place: Central Bank's Headquarters 8th floor Meeting room (on September 17) and 20th floor (on September 18) -Brasília - DF

Called to Order: 3:40 PM on September 17 and 11:49 AM on September 18
Adjourned: 7:20 PM on September 17 and 1:37 PM on September 18

In attendance:
Members of the Board
Arminio Fraga Neto - Governor
Beny Parnes
Carlos Eduardo de Freitas
Edison Bernardes dos Santos
Ilan Goldfajn
Luiz Fernando Figueiredo

Department Heads (all present on August 20)
Altamir Lopes – Economic Department (DEPEC)
Carlos Yoshitaka Urata - International Reserve Operations Department (DEPIN)
José Antônio Marciano - Department of Banking Operations and Payment System (DEBAN)
Marcelo Kfoury Muinhos - Research Department (DEPEP)
Sérgio Goldenstein - Open Market Operations Department (DEMAB)

Other participants (all present on August 21)
Antônio Carlos Monteiro - Executive Secretary
José Pedro Ramos Fachada Martins da Silva - Advisor to the Board
Alexandre Pundek Rocha - Advisor to the Board
João Borges - Press Secretary (ASIMP)
Tarsila Segalla Afanasieff – Investor Relations Group

The Board analyzed the recent performance of, and prospects for, the Brazilian and international economies under the monetary policy framework, designed to comply with the inflation targets established by the government.

Economic Activity

The recently released economic indicators related to retail activity and external trade, show favorable signs. Domestically, the results are a consequence of the measures implemented with the objective of normalizing the foreign exchange market (IMF agreement among others), and a reflex of the effects of the Time in Service Guarantee Fund (FGTS) extraordinary disbursements initiated in June. The positive performance of international sales is closely related to the exchange rate stimulus.

Preliminary data from São Paulo State's Federation of Commerce (Fecomércio-SP) indicate an expansion of 4.1% in real turnover of retail commerce in the metropolitan region of São Paulo in August, not considering the seasonal factors. The higher increases were observed in sales of non-durable consumer goods and construction materials. The monthly growth of 1.7% of Usecheque consultations, released by São Paulo Trade Association (ACSP), pointed in the same direction.

Vehicle sales also reacted in August, stimulated in part by the sales promotions, taking advantage of the reduction of the Industrialized Products Tax (IPI), which momentarily altered the sales mix in favor of more expensive vehicles. This movement, however, should not be considered a trend as yet, since the vehicle concessionaires registered, in August, an expansion in cash sales. Credit sales, which normally are more significant in relation to more expensive durable consumer goods, are not progressing due to the unfavorable credit conditions and consumer caution (as registered by the credit sales consultations to the Service Protection Service - SPC - from the ACSP, which declined 3.5% in August) and the retraction in the volume of new concessions to private individuals by the financial system.

Another positive piece of information from commerce refers to the consumers confidence level recuperation as related to the economic conditions. Consumers Intentions Index (IIC) grew 9.6% in September, reaching 100.4 in a scale from 0 to 200, the best result since May 2001. The result was due to the perception of improvement of current and future conditions.

Defaults have declined significantly in August, possibly due to the continuity of the use of part of the values released from FGTS resources to pay off debts. According to ACSP, the maintenance of the reinstatement registers at much higher levels than the previous average permitted the decline of the default rate to 4.7% in August from 7.2% in July and in the year. In the financial market, the default decline could be verified by the reduction of returned checks to 4.3% in August from 4.7% in July due to insufficient funds in relation to the total of cleared checks.

As regards the credit market, the default of the credit portfolio with freely allocated resources fell 0.2 p.p. in August, reaching 7.8% of the portfolio, the lowest value since last November. The implementation of more conservative credit policies by the financial institutions, such as the reduction of individual limits, credit line cutoffs for certain clients and additional guarantee requests, also contributed to the default decline.

This higher selectivity in the credit offer has diminished the volume of new concessions, making the balance of these operations decline. Credit operations inventory with legal entities contracted by free established rates fell 3.8% in the month, reaching R$132.0 billion. The volume of resources with internal funding declined 1.9% and those with external funding declined 7.2%, reflecting the exchange rate appreciation of 11.85% in the month.

The volume of credit to private individuals totaled R$76.2 billion, rising 0.4% in August. The daily average concessions grew 0.5%, while the new concessions flow declined 3.9% in the month, due to the lower number of business days in August in comparison to July. The relative stability of the balance of this segment continued to be influenced by debt liquidations from Income Tax (IR) returns and FGTS reimbursements, besides the deteriorating credit conditions in the last months.

Industrial activity maintained in July the same production level observed in the previous month, according to the seasonally adjusted indexes from the Brazilian Institute of Geography and Statistics (IBGE). The result confirmed the lower production level in comparison to the first months of the year, but is still considered favorable, since the increase of industrial stocks and the lowering of entrepreneur expectancy levels, registered in the same period, which could mean a decline of the industrial activity in the month.

This leveling off of industrial production in the last months interrupted the stronger recovery trend that had been occurring since the beginning of the year. However, taking into account the turbulences that negatively affected the entrepreneurs and consumers confidence in June and July, the recent results are favorable, since they have exceeded the expectations outlined by some previous variables that had indicated a fall in production.

In July, the National Confederation of Industries (CNI) statistics confirmed the idea that the activity level in the industrial sector is showing a tendency to be self- sustaining. For the second consecutive month industrial sales grew, 0.9% in comparison to June, and the installed capacity utilization level was 0.85% above that registered in the previous month, both in seasonally adjusted series.

In the labor market, the average rate of open unemployment, measured by IBGE, remained stable at 7.5% in July. This result was due to equivalent percentage growth rates in the number of employed workers and in the Economically Active Population (PEA). Regarding the formal work environment, according to the Ministry of Labor and Employment, there was a 0.2% growth in July and a 3.2% growth accumulated over twelve months.

In relation to the external sector, the commercial surplus of US$1.6 billion registered in August was the highest since May 1990, and has accumulated US$7.4 billion in twelve months. The current account deficit in twelve months, reached US$16.7 billion, up to July. This was the lowest result for this kind of comparison since July 1996.

The trade balance totaled a surplus of US$931.0 million up to the 15th day of September, as exports registered another increase in the daily average, reaching US$284.0 million, in comparison to US$224.0 million in the year. The US$190.0 million daily imports average in September is almost at the same level observed in the January to August period. Thus, the surplus for the year reached US$6.3 billion, in comparison to US$0.8 billion occurred in the same period in 2001. Exports reached US$39.9 billion while the imports totaled US$33.6 billion, falling 4.4% and 18.0%, respectively, in comparison with the values registered in the same period in 2001.

This trade balance result reversion reveals the importance of deeper modifications in the economic structure, such as imports substitution and higher exports profitability, which is enabling the diversification of the trade products and the entry into new markets. Some current factors, such as the depreciation of the Real and the level of deceleration of the economic activity, have also contributed to this scenario.

In summary, the activity level indicators show signs of retail commerce recuperation, which have shown sales growth, reduction in default levels and consumers confidence recuperation. The industrial activity, however, remains stable and reflects the stocks' adjustment process.

External Environment

The international scenario continues very unstable, with a corresponding reflection in the various segments of the international financial market by increased volatility. The accumulated losses in the stock exchanges in the last two years and the impact provoked by the accounting scandals of big U.S. corporations increased the fragility of the global economy. More recently, the expectations concerning a possible attack on Iraq have contributed to the uneasiness in the oil market, and prices returned to the level of US$30 per barrel. In this framework of instability and risk aversion, financing conditions have worsened for emerging economies, also affected by the decline in international trade.

In the United States, macroeconomic indicators continue to show contradictory signs, reinforcing the uncertainties about the sustainability of the economic recovery. The business confidence indicators remain positive, although having presented a new decline in August. Consumers confidence indices also worsened in the last surveys, reflecting the recent falls in the stock market and the unemployment rates, which remain high, in spite of the fall to 5.7% in August, compared to 5.9% in July. Retail sales increased by 0.8% in August, stimulated by the favorable vehicle purchase financing conditions. Factory orders increased by 4.7% in July, the largest expansion since October 2001, led by durable goods orders, particularly transport equipment and industrial machinery. Inflationary pressures remain weak but budget deficit increase, that may reach 1.5% of GDP in the fiscal year ending in September, is a cause for concern.

In Japan, the good performance of the external trade has contributed to reduce pessimistic expectations. The growth of Asian countries has boosted Japanese exports, especially of finished goods, in spite of the yen appreciation. Factory orders declined by 8.5% compared to those of July 2001 and the beginning of new constructions declined by 6.7%, also compared annually. The accumulated variation over 12 months of industrial production reached 3.3%, maintaining an upward trend, but at a declining rate.

Economic growth is slower in the Euro area, in line with the expected fragility of global recovery. Domestic demand remains retracted, as shown by retail sales, which declined by 0.9% in the 12-month accumulated figure up to June. Industrial production does not show any reaction, with negative annual variations since September 2001.

Unemployment rate remained stable at 8.3% in July. In spite of the euro appreciation, the trade balance accumulated in the 12 months up to June continued to grow, with higher exports and imports. The main confidence indicators registered a decline in the expectations of both consumers and businesses. The estimates for the growth/variation of prices in August indicate an annual rate of 2.1%, above the ceiling of the European Central Bank (ECB).

Regarding Argentina, recession and demand contraction have been responsible for restraining price increases, leading the inflation rates to decline in the past three months, but administered prices have not yet been readjusted since the floating of the peso, at the beginning of the year. The trade balance registered a US$2.2 billion surplus in July, still reflecting on the whole the contraction of imports.

Regarding the Mexican economy, the Economic Activity Global Indicator has been showing a downward trend, in spite of the positive variations in the second quarter of 2002, reflecting the increase of the link with the U.S. economic performance in the past years. About 90% of the exports go to the U.S., coming from the "*maquiladora*s". The Mexican GDP grew by 2.1% in the second quarter, led by the growths of 2.5% in the industrial sector and of 2.2% in services.

Prices

Inflation remained high in August, mainly reflecting the effects of the between harvest period in agriculture and the impacts of the recent exchange rate depreciation. Nevertheless, the consumer price indices showed smaller variation in comparison to the previous month, mainly due to the end of the impacts of the recent readjustments in monitored prices.

The Consumer Price Index - Extended (IPCA) increased by 0.65% in August, accumulating variations of 4.85% year-to-date and 7.46% over 12 months. The monthly result was influenced by a 1.94% rise in food and beverage prices, due to the exchange rate depreciation and the between harvest period. The French roll was the product with the highest individual contribution to the result of the month, corresponding to 0,14 p.p. in the IPCA rate. Still in the food and beverage group, the increases in prices of cattle and chicken meat, soy oil and milk, should be highlighted. The decline in the monthly variation in comparison to July (1.19%) was due to the smaller variation of monitored prices (0.22% as against 2.52% in the previous month). In August, despite the rises in airline fares and in water and sewage tariffs, smaller increases in the tariffs of telephone and electricity and in housekeepers' wages were registered, whilst the prices of gasoline, alcohol and bottled gas have declined.

The effects of the exchange rate depreciation and between harvest period were stronger in the General Price Index – Domestic Supply, due to their impact on wholesale prices of agricultural and industrial goods. The monthly variation increased to 2.36% in August from 2.05% in July, accumulating 8.75% in the year and 11.76% in 12 months. The Wholesale Price Index - Domestic Supply (IPA-DI) rose by 3.32% in the month, reflecting the increases of 5.48% in agricultural prices and of 2.5% in industrial prices. The Consumer Price Index (IPC) followed the IPCA deceleration, due to the smaller pressure of monitored prices. The IPC rose by 0.76% and the IPC-core increased 0.65%.

The maintenance of the pressures derived from the recent exchange rate depreciation and from the continuity of the increase of food prices should be the main factors to influence the indices in September. Nevertheless, the rates of the main price indices should continue decelerating, if the effect of the reduction of the bottled gas price in September and the prospect of smaller increases in food prices, in the next few months, are considered.

Monetary Market and Open Market Operations

During the week after Copom's August meeting, the interest rate curve steepened significantly. Subsequently, this curve fluctuated as a result of the internal and external environment. On September 17, the spread between the 1-year interest rate and the Over-Selic target reached 710 bps from 765 bps in August 20.

Between August 21 and September 17 the foreign exchange instruments rollover reached 90%. For the rollover of US$0.3 billion in National Treasury Notes – D Series (NTN-D) and US$1.3 billion exchange rate swaps maturing on September 1 and 2 respectively, the equivalent of US$1.5 billion exchange rate swaps was placed, of which 72% due on 2002 and 28% on 2003. For the rollover of US$0.5 billion in National Treasury Notes – D Series (NTN-D) and US$1.5 billion exchange rate swaps maturing on September 11, the reference value of the swap contract reached US$1.8 billion, of which 80% due on 2003 and 20% on 2002.

The National Treasury carried out four National Treasury Bills (LTN) and National Treasury Financial Bills (LFT) auctions. Securities maturing in 2002 were auctioned in the first two, with a 500 thousand securities total offer limit for each one. In the other two auctions the National Treasury altered its strategy, by offering just LTN maturing in November 2002 and January 2003 and by raising the limit to a million securities. The total operation amounted to R$2.9 billion, of which R$2.0 billion were in LTN redeeming in 2002 and another RS$0.9 billion in LTN redeeming in 2003.

In the same period, aiming to reduce LFT price volatility, Banco Central carried out ten selling auctions of LFT due on August 2003, which could be settled by delivering LFT maturing in 2004 and 2006. Furthermore, the purchaser had the choice of contracting forward operations maturing in December 2002, up to the limit of 20% of the purchased LFT. Those operations totaled R$3.9 billion. With the same objective, Banco Central carried out ten redeeming auctions of LFT with several maturities between 2002 and 2003. In these operations the equivalent of R$5.6 billion of LFT were taken from the market, of which R$5.2 billion were due on 2003.

Throughout the 19 working day period between August 22 and September 17, BCB intervened in the open market by withdrawing and providing liquidity at yields of 17.9% and 18.0% p.a., and average daily volumes of R$32.4 billion and R$4.5 billion, respectively. The tenures oscillated from one to two working days. There were also three selling operations of long-term securities with repurchase agreement, with a total financial value of R$8.3 billion and an average tenure of 21 working days.

Regarding the financial settlements between August 22 and September 17, the monetary impact was expansionary by R$16.7 billion, mainly as a result of the net redemptions of R$6.7 billion of LTN, R$6.0 billion of LFT and R$3.8 of exchange rate indexed securities.

In August, the domestic federal securitized debt declined by R$51.6 billion (7.7%). The exchange rate indexed securities stock declined by R$31.9 billion, basically due to the 11.85% appreciation of the Real in the period.

Assessment of Inflation Trends

The identified shocks and theirs impacts were assessed according to newly available information. The scenario considered in the simulations encompasses the following assumptions:

1. For the year 2002, an increase of 3.3% in the price of gasoline is expected, representing a higher value than the one forecasted in the last Copom meeting (-0.8%). This revision is a consequence of the pass-through of the international petroleum price increase and the new exchange rate level to the gasoline consumer price. For bottled gas, a growth of approximately 25% in 2002 is maintained, as forecasted at the last Copom meeting, since the 12% reduction of the bottled gas price at the refineries in August had already been considered in the forecasts.

2. For the readjustment of the residential electricity tariffs, an increase of 20.6% in 2002 is projected, of which 16.2% has already occurred between January and August. The value projected in September is slightly higher than the one projected in August. For the next few months, a readjustment of 3.8% is forecasted. The electricity readjustment forecast for 2003 remained at 20.7%.

3. Regarding the set of prices administered by contracts and monitored, with a 31.5% weight in the IPCA in August, the inflation forecast in 2002 grew by 0.5 p.p. in relation to the last Copom meeting. For the year 2002 as a whole, an increase of 9.3% in the prices administered by contracts and monitored is projected, in comparison to 8.8% in August and 8.9% in July. The increase of the projection is due to the exchange rate pass-through and the revision of the gasoline forecast. For 2003, the inflation forecast for the prices administered by contracts and monitored is 7.9%, while in August this forecast was 7.6%. The increase in the projection for 2003 is a consequence of the exchange rate depreciation and the revision of the expectations regarding the IGP-M, which influence the forecasts of some prices administered by contracts and monitored, especially those linked to transport.

4. The forecast of the 6-month spread over the Selic rate, based on an error correction model specification. Maintaining constant the Selic rate in 18.0% p.a., the 6-month spread projection starts at 510 bp. in the third quarter of 2002, and, afterwards, declines up to the end of 2003.

The monthly inflation rate measured by the IPCA reached 0.65% in August, in comparison to 1.19% in July. The core inflation of the IPCA, calculated under the symmetric trimmed-mean method, grew to 0.65% in August from 0.51% in July. In the last twelve months, this core registered a variation of 7.17%. In turn, the core inflation of the Consumer Price Index - Brazil (IPC-BR), calculated under the symmetric trimmed-mean method, increased to 0.65% in August from 0.40% in July. In twelve months, this core registered a variation of 6.69%. The core inflation calculated by excluding prices administered by contracts and household food registered a variation of 0.38% in August and 6.10% in twelve months.

The IPCA variation in twelve months has been showing a declining trend since May and registered 7.46% in August, a value below the ones observed in July (7.51%) and June (7.66%). In these twelve months, the free market prices contributed to inflation with 4.35 p.p., while the prices administered by contracts and monitored contributed with 3.11 p.p.

Regarding fiscal policy, the hypothesis assumed is to achieve a 3.88% primary surplus for the consolidated public sector this year. For the following years the target is 3.75%. The remaining assumptions established in the previous meeting were maintained.

From the simulation exercises with several specifications of the structural model, it has been concluded that the maintenance of the interest rate at 18.0% p.a. and the exchange rate at the same level as on the eve of the Copom meeting (R$3.20) lead to an inflation rate considerably above the upper limit of the tolerance interval in 2002 and above the target center in 2003.

Monetary Policy Guidelines

Indicators of production continue to show the loss of dynamism of the economic activity. According to the IBGE, the seasonally adjusted series of the industrial production remained almost stable in July, compared to June. A 0.4% increase was registered in the year, up to July. Seasonally adjusted data from CNI corroborate these results, showing relative stability in employment (0.01% decline), in the hours worked in production (0.19% fall) and in the payroll (0.12% increase), between June and July.

Contrasting with the indicators of production, those related to sales have registered positive results. The monthly variation of the industrial sales was 0.9% in July, according to the CNI, and the real turnover of the retail commerce in the city of São Paulo increased by 4.12% in August, according to preliminary data of the Fecomércio (seasonally adjusted series). At the end of the second quarter, also according to the CNI, there were excessive inventories of finished goods in the manufacturing industry, with the corresponding indicator leveling close to 53, above the reference-value of 50, which represents the adequate level for those inventories. Considering the sales and production results of July, inventories of finished goods are tending to the levels considered adequate by businessmen, favoring the recovery of industrial activity in the medium-term. Other factors that tend to favor industry in the medium-term are the liberation of balances of the Time in Service Guarantee Fund (FGTS) and the 9.6% increase of the Consumer Intentions Index in September. One highlights that the sub-item “future intentions index” reached 108.6 in that month, whilst the reference-value of 100 indicates stability. However, the slow growth of credit, the high interest rates and the instability of the financial market tend to inhibit the recovery of economic growth.

The more recent data about the performance of the foreign sector accounts show that the Balance of Payments has fast adjusted to the adverse conditions of the international market, characterized by the reduction of world economic growth, and by the reduction of foreign financing. However, the magnitude of the Balance of Payments adjustment has not been sufficient to avoid the pressure on the exchange rate caused by the reduction of international financing and by the uncertainties still present in the market, related to the future management of the macroeconomic policy in the country.

The inflation expectations surveyed by the Investor Relations Group (Gerin) of the Banco Central do Brasil increased since the Copom’s meeting of August, noticeably for 2003. For 2002, the expectations reached 6.6%, from 6.4%. As for 2003, the inflation expectations were revised by 0.6 p.p., reaching 5.2% from 4.6%. The most important factors to explain such revisions are the accentuated exchange rate depreciation and the recent price increases of oil by-products in the international markets.

Copom also increased the projections of inflation for 2002 and 2003, partly due to the revision of the readjustments of administered prices, to 9.3% from 8.8% this year, and to 7.9% from 7.6% in the coming year. According to the models used by the Banco Central, the behavior of the free prices inflation up to August is compatible with the exchange rate depreciation observed in the period. However, taking into account the size of the exchange rate depreciation registered during the year, its pass-through coefficient to prices may increase. Especially in the case of growth recovery, the possibility of a higher pass-through increases. However, in such a context of recovery of the activity level and of better expectations it would be reasonable to expect an exchange rate appreciation. Notwithstanding, Copom considered adequate to add an exchange rate pass-through not yet accounted for in the projection of inflation for the next year.

There was a reduction of the discounts of federal securities, and a positive evolution of the financial funds industry, in the financial market. However, the uncertainties persisted. The *real* depreciated by 2.3% since the Copom’s meeting of August and the country risk measured by the Embi+ continued at high levels. This scenario of uncertainties reflects not only an adverse international environment, but also remaining doubts of some economic agents about the coherence of the macroeconomic policy in the coming years. Thus, in spite of the projected inflation for 2003 being below the target (adjusted for the shocks of the administered and monitored prices and for part of the inertia), the Copom understands that the maintenance of the volatility in the financial markets increases the risk related to the confirmation of this projection.

In the light of these facts, the Copom unanimously decided to maintain the target for the Selic interest rate at 18% p.a.

At the close of the meeting, it was announced that the Committee would meet again on October 22, 2002, for technical presentations and, on the following day, in order to discuss the monetary policy guidelines, as set in the Communiqué 8911, of Oct.3.2001.

Minutes of the 76th Meeting of Banco Central do Brasil Monetary Policy Committee (Copom)

Date: October 14, 2002
Place: Central Bank's Headquarters 20th floor - Brasília - DF

Called to Order: 1:10 PM
Adjourned: 2:25 PM

In attendance:
Members of the Board
Arminio Fraga Neto - Governor
Beny Parnes
Carlos Eduardo de Freitas
Edison Bernardes dos Santos
Ilan Goldfajn
Luiz Fernando Figueiredo
Sérgio Darcy da Silva Alves
Tereza Cristina Gross Togni

Department Head
Paulo Springer de Freitas - Research Department (DEPEP)

The Board analyzed the recent performance and prospects for the Brazilian and international economies under the monetary policy framework, which is designed to comply with the inflation targets established by the Government.

Monetary Policy Guidelines

Several price indices released recently have shown a rise in inflation caused mainly by exchange rate depreciation. The IPCA recorded 0.72% in September, higher than the value expected by the Copom and the 0.65% variation observed in August. This increase was a consequence of the inflation of free prices, with an increase of 1.05%. In contrast, there was ~~a~~ deflation of the administered and monitored prices (0.01%), due to the reduction of 7.6% of the consumer price of bottled gas.

The indicators of core-inflation have reflected this rise in the IPCA. Measured under the trimmed-mean method, the core increased to 0.78% in September from 0.65% in August, while the core calculated excluding administered and monitored prices and food items increased to 0.61% from 0.38%, in the same period.

Preliminary data related to other price indices have also indicated a rise in inflation in October. According to IPC-Fipe, the inflation increased to 0.81% in the four-week period ended in the first week of October, from 0.73% in the four-week period ended in the third week of September and, regarding the IPC-M, the inflation registered in the first ten days of October increased to 0.49% from 0.42%.

Since the Copom meeting in September, the trend of several economic indicators has changed inflation expectations for 2002 and 2003. According to the Investor Relation Group (Gerin), the median of the market expectations for the IPCA in 2003 rose to 5.9% from 5.2% since the September 16.

The inflation forecast of the Copom for 2003 was also increased. The Copom had been basing its projections on a basic scenario in which the transition to the future government would occur without exaggerated or prolonged turbulences. The higher degree of uncertainty observed in the last months has lowered the probability of the materialization of this basic scenario. In fact, at the Copom meeting in September, the inflation forecasts were made based on an exchange rate of R$3.20/US$ and an inflation expectation (collected by Gerin) of 5.2% for 2003. Neither assumptions have been occurring.

Between the last two Copom meetings, an additional depreciation of the *Real,* with the dollar reaching figures around R$3.90, and a rise in inflation expectations to 5.9% (surveyed by Gerin) for 2003 were observed. The IPCA projection was increased considerably, as a consequence. Despite the increase in the estimated primary shocks of administered and monitored prices, and the impact of inflation inertia of 2002 on the 2003 inflation, the projected inflation for 2003 is above the target adjusted to these factors.

The increase in inflation - actual and forecasted - in the last months implies that, if the target for Selic-rate were maintained at 18% p.a., the real interest rate - *ex-ante* and *ex-post* - would be reduced significantly, which could stimulate the pass-through of exchange rate depreciation and the propagation of price adjustments.

The rise of inflation projection over the adjusted target rate for 2003 recommends a tighter monetary policy, even if the primary cause of inflation were not related to an increase in demand, but rather to the effects of a significant exchange rate depreciation on domestic prices. A tighter monetary policy reduces the exchange rate pass-through to prices and improves inflation expectations. In this way, the conditions to restore sustainable growth – i.e., non-inflationary – would be in place as early as next year.

The calling of a Copom extraordinary meeting had the objective of not postponing decisions that seem to be natural for the BCB committed to inflation targeting in a more adverse scenario.

The members of Copom emphasized that, in spite of the relevance of recent exchange rate depreciation to the rise in inflation expectations, the monetary policy continues to be calibrated exclusively to maintain inflation in a trajectory within the targeted range; therefore, the monetary policy does not aim at targeting the exchange rate level. This does not mean that a reversion of the depreciation of the exchange rate in excess would not have meaningful consequences to the inflation trend and, consequently, to the monetary policy management. Obviously, an exchange rate appreciation, resulting from the restoration of confidence in future economic policy management, would reduce pressures over prices and improve the inflation expectations.

Thus, the Copom unanimously decided to increase the target for the Selic interest rate to 21% p.a. from 18% p.a.

At the close of the meeting, it was announced that the Committee would meet again on October 22, 2002, for technical presentations and, on the following day, in order to discuss the monetary policy guidelines, as set in the Communiqué 8911, of October 3, 2001.

Minutes of the 77th Meeting of Banco Central do Brasil Monetary Policy Committee (Copom)

Date: October 22 and 23, 2002
Place: Central Bank's Headquarters meeting room of the 8th floor (on October 22) and 20th floor (on October 23) - Brasília - DF

Called to Order: 3:30 PM on October 22 and 11:30 AM on October 23
Adjourned: 7:00 PM on October 22 and 1:00 PM on October 23

In attendance:
Members of the Board
Arminio Fraga Neto - Governor
Beny Parnes
Carlos Eduardo de Freitas
Edison Bernardes dos Santos
Ilan Goldfajn
Luiz Fernando Figueiredo
Sergio Darcy da Silva Alves
Tereza Cristina Grossi Togni

Department Heads (all present on August 20)
Altamir Lopes – Economic Department (DEPEC)
Daso Maranhão Coimbra – International Reserve Operations Department (DEPIN)
Luiz Fernando Cardoso Maciel - Department of Banking Operations and Payment System (DEBAN)
Marcelo Kfoury Muinhos - Research Department (DEPEP)
Sérgio Goldenstein - Open Market Operations Department (DEMAB)

Other participants (all present on August 21)
Antônio Carlos Monteiro - Executive Secretary
José Pedro Ramos Fachada Martins da Silva - Advisor to the Board
Alexandre Pundek Rocha - Advisor to the Board
João Borges - Press Secretary (ASIMP)
Tarsila Segalla Afanasieff – Investor Relations Group

The Board analyzed the recent performance of, and prospects for, the Brazilian and international economies under the monetary policy framework, designed to comply with the inflation targets established by the government.

Economic Activity

Economic indicators continue to show stability in the level of activity, maintaining the trend outlined since May. This behavior is related to the presence of factors which have opposing effects on the economy in the last months. On the one hand, the increase of uncertainty, derived from the electoral process, and the consequent turbulence in the financial market have affected the performance of the sales of goods with higher value added and, most of all, investment outlays. On the other hand, the positive results of retail commerce – mainly associated to the nonscheduled disbursements of the Time in Service Guarantee Fund (FGTS), to the increase of employment level, and to the earnings from agriculture this year – and the favorable performance of the trade balance have contributed to sustain the activity level.

According to the São Paulo State's Federation of Commerce (Fecomércio), preliminary seasonally adjusted data point to a 2.4% increase of the real turnover in the São Paulo's Metropolitan Region in September. The highest increases were observed in the sales of semi and non-durable consumption goods, and of construction materials. A countrywide survey carried out by the Brazilian Institute of Geography and Statistics (IBGE) also shows a trend of recovery of the retail sector in the last months. It should be noted that, according to Fecomércio data, even automobile sales, whose performance has been negative during the year, increased for the second consecutive month in September, still benefiting from sales promotions and from the reduction of Industrialized Products Tax (IPI). Furthermore, it should observed that the higher level of sales occurred mainly due to the increase of cash payments, in a similar way to August.

The number of enquiries to the Credit Protection Service (SPC) and to the Usecheque of the São Paulo Trade Association (ACSP) in the first fortnight of October, in comparison to the same period of 2001, increased by 7.7% and 1.9%, respectively, indicating the continuity of the expansionist movement of sales in the retail commerce.

In spite of the positive results of commerce, the scenario of uncertainties and the exchange rate volatility persist as determinants of the current economic scenario, according to the consumer expectations. As a consequence, the Consumers Intentions Index (ICC), released by the Fecomércio, declined 4.6%, mainly due to a decline of 8.4% in the indicator related to the current conditions of the economy. The future intentions indicator retracted by a smaller proportion, 2.2%.

Still regarding the determinants of the retail commerce, the nonperforming loans increased by 6.7% in September, in comparison to 4.7% in the previous month, according to the ACSP survey. It should be noted that this result was more a consequence of the decline in the number of enquiries in June, the month used as reference to calculate the indicator, rather than from the rise of new net registrations. On the contrary, the cancelled registrations, thanks to the normalization of the debtors' situation, remained well above the year's average, still reflecting the stimulus of debt redemptions, due to the payments of the FGTS. The proportion of returned checks due to insufficient funds in relation to the cleared ones continued to decline in September, reaching 4.3%, in comparison to the 5.5% peak-value of this series, registered in March 2002.

The default of the credit portfolio with freely allocated resources of the financial institutions declined by 0.3 p.p. in September, reaching 7.9% of the (total) portfolio, the lowest value since November past year, also reflecting the more selective decisions of the banks in their credit operations in the last months.

The outstanding credit operations contracted by corporations with freely established rates increased by 7.1% in the month, reaching R$ 141 billion. The volume of resources with domestic funding increased by 5.5% and those with external resources increased by 10.1%, reflecting the 21% exchange rate depreciation in the month. The volume of credit to private individuals totaled R$77.3 billion, rising by 1.5% in September.

Industrial activity increased by 0.3% in August, according to the seasonally adjusted data of the Brazilian Institute of Geography and Statistics (IBGE). This result was mainly due to the 2.1% expansion of the mineral extractive production, since the manufacturing industry registered an expansion of 0.1%. In the last three months production levels stayed practically static, reflecting, in general terms, the increase in the production of intermediate goods, particularly petroleum and gas, and the favorable performance of export segments that have offset the contraction of production of capital and consumer durable goods.

In August, data from the National Confederation of Industries (CNI) showed an expansion of the industrial sales for the third consecutive month. Nevertheless, the stability of the utilization level of installed capacity in the last four months denotes that this sales growth was mainly due to the reduction of industry inventories.

In the labor market, the average rate of open unemployment, measured by the IBGE, increased to 7.5%, in September, from 7.3%, in August. It is worth noting that the growth in the unemployment rate this year, in comparison to last year, is due to the 4% increase of the Economically Active Population (PEA), in comparison to the average of the same period in 2001, and the increase of 2.7% in the number of employed workers, using the same basis of comparison. Regarding legally registered employment, according to the Ministry of Labor, there was a 0.7% growth in September and a 3.1% growth accumulated in the year, which means the creation of 987 thousand new jobs.

The current account of the Balance of Payments registered a surplus of US$ 1.2 billion in September of 2002, the best monthly result ever registered. This performance reflects, in part, the US$ 2.5 billion record trade surplus. The performance of services and the income accounts also contributed to this result, with net remittances of US$ 1.5 billion, below the US$ 1.9 billion monthly average in the year, up to August.

In the first three weeks of October, the trade balance surplus totaled US$ 1.1 billion, with average daily exports of US$ 269 million, in comparison to US$ 233 million for the year. The average daily imports in October, US$ 187 million, is 0.7% below the average observed year-to-date, considering the period from January to October 20. As a result, the accumulated surplus reached US$ 9 billion in 2002, in comparison to the US$ 1.3 billion in the same period of 2001. Exports reached US$ 47.3 billion and imports US$ 38.3 billion, declining by 0.3% and 17.1%, respectively, in comparison to the same period of 2001.

In summary, economic activity stayed relatively steady in the third quarter of the year, despite the volatility observed in the financial market. In spite of the inventory adjustments that occurred in August and September, the continuing uncertainties of the current scenario may restrain recovery movements in the short term.

External Environment

In spite of the recent improvement in the international financial markets, concerns about the financial health of the largest banks and of large European corporations maintain risk aversion and the volatility in the global market. The prospects of recovery of the world economy worsened with the release of the latest economic indicators, reinforcing expectations that a new cycle of recession is on its way. The terrorist attack in Indonesia contributed to increase these worries, and they may affect economic growth in the Southeast Asian countries. The tension in the oil market remains due to the possibility of an attack by the United States on Iraq.

The macroeconomic indicators continue to show contradictory signs in the United States, casting doubt on the capacity of the economy to recover.

The businessmen expectation indicators show diverging trends, with an increase in the services indicator and a drop in manufacturing production. Consistent with these results, the index of leading indicators of the *Conference Board* declined slightly by 0.2% in September, the fourth consecutive month of decline, a fact that had not been repeated since the beginning of the recession of 1990/91. Industrial production declined for the second consecutive month, and the level of utilization of installed capacity, in September, was the lowest, since May. The trade deficit – goods and services - reached US$38.5 billion in August, accumulating a US$ 387 billion negative result in 12 months.

In Japan, industrial production has been increasing slightly, positively influenced by the exports sector, although domestic demand continues to be poor. However, the unemployment rate continues static at a high relative level, 5.4% in August, and the chronic problems, such as deflation and the fragility of the banking credit, continue without solution.

The economy of the Euro area does not register consistent signs of recovery either. Retail sales increased in July and industrial production increased by 0.6% in August. However, the main indicators of confidence indicated a declining expectation of both consumers and businessmen. The unemployment rate remained stable at 8.3% in August, and the annual inflation, measured through the Harmonized Consumer Price Index, reached 2.1% in September, above the ceiling of 2% defined by the European Central Bank (ECB).

Prices

The inflation rate in September indicated an increase in prices, especially in free prices, mainly as a consequence of the evolution of the exchange rate. The Consumer Price Index - Extended (IPCA) increased by 0.72%, compared to the 0.65% increase in August, accumulating a 5.6% variation in the year and a 7.9% variation in 12 months. In the General Price Index - Demand Supply (IGP-DI), the effects of the exchange rate depreciation and off-season period were stronger due to the impact of the agricultural and industrial prices on the Wholesale Price Index (IPA).

The monthly result of the Consumer Price Index - Extended (IPCA) was influenced by a 1.96% rise in food and beverage prices, mainly due to the influence of the behavior of the exchange rate on soy oil and wheat and meat by-product prices. The increase in non-food product prices showed an acceleration, with a variation of 0.37%, contrasting with the 0.29% increase last month. The price increase in this group also bears evidence of the influence of the exchange rate variation: electro electronic devices, personal hygiene and cleaning materials. The products with monitored prices presented a monthly variation of -0.01%, compared with a 0.22% increase in August, as a result of the 7.61% decline in the prices of bottled gas, which offset the price increases with a smaller impact in many other items, such as water and sewage, electricity and posting services.

In the IGP-DI, the Wholesale Price Index - Demand Supply (IPA-DI) rose by 3.84% in the month, reflecting the increases of 5.86% in agricultural prices and 3.04% in industrial prices. Among the agricultural components, the increase in the prices of wheat, corn, rice, coffee, soy, cotton, poultry and cattle for slaughter should be highlighted. Among the industry components, the upward movement in prices affected mainly the metallurgical and mechanical segments, paper and cardboard, textiles, chemical and food products.

In October the exchange rate depreciation in all likelihood will continue to be the main source of inflationary pressure on prices, a factor which associated to the increase of monitored prices – (mainly, as a result of the increase of fares of urban transport in Rio and the increase of airline fares)- plus the height of the off-season period, especially considering the delay in the rainy season, will imply in the maintenance of inflation rates at high levels.

Monetary Market and Open Market Operations

On September 17, on the eve of the release of Copom's decision in that month's meeting, the spread between the Over-Selic target and the 1-year interest rate was of 710 p.b. Afterwards, the 1-year spread reached 1,182 b.p., on October 11. After the release of the minutes of the nonscheduled Copom meeting, on October 16, the spread fell to 976 b.p.. The interest rates continued to show a declining trend due to the reduction of the uncertainties regarding the political-economic scenario in 2003 and the spread reached 787 b.p. on October 22.

A total of US$6.6 billion in securities and exchange rate swaps matured between September 18 and October 22, and the rollover rate reached 37%. Due to the lower demand for exchange rate hedge and the high rates proposed, the Banco Central decided not to rollover the US$150 million maturing on September 20, and the US$1.5 billion maturing on the 25th of the same month. Regarding the US$1.3 billion maturity on October 1, the rollover rate reached only 20%, with a maximum limit previously set at 70%. Banco Central did not set a ceiling for the rollover of US$3.6 billion due on October 17, when the reference value of the contracted swaps reached US$2.2 billion (59% of the maturities).

In the same period, the National Treasury carried out three auctions of National Treasury Bills (LTN), in which the total offer was limited to 500 thousand securities per event, distributed between LTN maturing in November or December 2002, and LTN maturing in January 2003. Only lower tenure securities were placed, amounting to R$1.5 billion. Due to the increase of the demand for National Treasury Financial Bills (LFT) in October, the National Treasury resumed selling these securities in the weekly auctions, which had not occurred since the beginning of August. On October 8, 500 thousand securities maturing in December 2002 were offered. In the following week, when the National Treasury auctioned only LFT, the first offer of 500 thousand securities was not enough to cover the demand, thus the National Treasury made a new offer of 1 million securities. The offer increased to 2 million securities on October 22. On all these occasions LFT were placed, and regarding the auctions on October 15 and 22, when securities maturing in 2002 and 2003 were offered, those with lower tenure were sold with premium. The financial result of the LFT placement reached R$5.8 billion, of which R$2.9 billion will mature in 2003.

A high increase of the demand for National Treasury Note-C Series (NTN-C) with three-year tenure was also observed, leading the National Treasury to offer these securities more frequently. Five auctions were carried out, totaling R$4.5 billion.

Aiming at reducing the volatility of LFT prices, Banco Central carried out twelve selling auctions of LFT maturing in 2003, with a total value of R$3.1 billion, allowing the settlement to be carried out with LFT and LFT-B maturing between 2004 and 2006. A further thirteen auctions were carried out to repurchase R$4.7 billion of LFT maturing in 2003.

Banco Central do Brasil intervened in the open market, withdrawing and providing one day liquidity, during the twenty-four working days between September 19 and October 22. The rates were, respectively, 17.90% and 18.00% to withdraw and provide liquidity, up to October 14. After the increase of the Over-Selic interest rate target, these rates increased to, respectively, 20.90% and 21.00%. The average daily volumes in the actions to reduce or increase liquidity were of R$33.7 billion and R$4.3 billion, respectively. The Banco Central also carried out two long-term selling operations with repurchase agreement, with a total financial value of R$6.9 billion and an average tenure of approximately 24 working days.

Considering the financial settlements between September 19 and October 22, there was an expansionist monetary impact of R$31.1 billion, basically due to the net redemptions of R$17.6 billion in LFT and of R$15.0 billion in exchange rate-linked securities.

In September, despite the net redemption of securities totaling R$17.9 billion, the domestic federal securitized debt increased by R$36.0 billion (5.8%), mainly due to the exchange rate depreciation.

Assessment of Inflation Trends

The identified shocks and their impacts were assessed according to newly available information. The scenario considered in the simulations encompasses the following assumptions:

1. There is a high level of uncertainty about the trend of future prices of petroleum by-products. In the last Copom meeting many alternative scenarios were analyzed. A conservative scenario forecasts gasoline price increases of approximately 9% for the rest of 2002 and a further 9% in

2003. The price of bottled gas is forecast to increase 16.6% in the last quarter and a further 16.6% increase is estimated for 2003. The revision of the readjustments for the petroleum by-products is a result of the pass-though occurred due to the increase in the international petroleum price that took place in the last months and to the exchange rate variation that has happened since the last readjustments. As always, in the event of changes to these parameters, the forecasts will be reviewed.

2. For the readjustment of the residential electricity tariffs, an increase of 21.2% in 2002 is projected, of which 3.8% still to occur from October to December. The value projected in October is slightly higher than the one projected in September. For 2003, the forecast for the readjustment of the electricity tariffs increased to 25% in October from 21% in September, as a consequence of the exchange rate depreciation.

3. Regarding the set of prices administered by contracts and monitored, whose weighting represented 31.3% in the IPCA in September, the inflation forecast for 2002 grew by 2.4 p.p. in relation to the last Copom meeting, to 11.6%. The latter increase in the projection is due to the exchange rate pass-through. For 2003, the inflation forecast for the prices administered by contracts and monitored is 12.1%, therefore, above the 7.9% forecast in September. The revision of the projection for 2003 is a consequence of the exchange rate depreciation and the increase in the IGP-M projection for 2003, which incorporates the forecasts of some relevant readjustments of prices administered by contracts and monitored.

4. The estimate of the 6-month spread over the Selic rate is based on an error correction model specification. Maintaining the Selic rate constant at 21.0% p.a., the projection for the 6-month spread starts at 640 p.b. in the fourth quarter of 2002, declining afterwards, to reach -90 p.b. at the end of 2003.

The monthly inflation rate measured by the IPCA reached 0.72% in September, a higher value in comparison to 0.65% in August. The core inflation of the IPCA, calculated under the symmetric trimmed-mean method, grew to 0.78% in September from 0.65% in August. In the last twelve months, this core registered a variation of 7.40%. In its turn, the core inflation of the Consumer Price Index - Brazil (IPC-BR), calculated under the symmetric trimmed-mean method, increased to 0.67% in September from 0.65% in August. In twelve months, this core registered a variation of 6.87%. The core inflation calculated by excluding prices administered by contracts and household food prices registered a variation of 0.61% in September, an accumulated variation of 6.49% over twelve months.

The accumulated IPCA variation over twelve months, which had been presenting a declining trend since May, registered 7.93% in September, a value above the ones observed in the last four months. In these twelve months, the free market prices contributed to the inflation with 4.95 p.p., while the prices administered by contracts and monitored contributed with 2.98 p.p.

Regarding the fiscal policy, the hypothesis assumed is to achieve a 3.88% primary surplus for the consolidated public sector this year and 3.75% for the coming years. The other related assumptions established in the previous meeting were maintained.

From the simulation exercises with several specifications of the structural model, it has been concluded that the maintenance of the interest rate at 21.0% p.a. and the exchange rate at the same level as on the eve of the Copom meeting (R$3.90) indicates an inflation rate considerably above the upper limit of the tolerance interval in 2002 and around the upper limit of the target in 2003.

Monetary Policy Guidelines

The economic indicators have been reinforcing the scenario shown in September, of growing sales and stable industrial production. Preliminary seasonally adjusted data of the Fecomercio shows a 2.4% increase of the real turnover of the retail commerce in São Paulo in September, the second consecutive monthly increase. The enquiries to the SPC and Usecheque increased by 3.5%, compared to August. According to seasonally adjusted data of the IBGE, the real payroll increased by 1.15% between June and July. For August, the available data refers to industrial activity, surveyed by the CNI, and they show that, compared to July, the employment level remained stable and the payroll declined by 0.6%. Since the positive evolution of the earnings is inclined to be more closely related to the growing levels of occupation, rather than to the increase of their average earnings, an eventual increase of consumption should find itself concentrated in the non-durable goods sector, as has been happening.

The industrial production measured by the IBGE grew by 0.27% between July and August (seasonally adjusted data), confirming the prospects of stability previously outlined by the Copom. The different rates between sales and production levels led to a decline of the inventory levels. According to the CNI, the index that measures the desirable inventory levels of final products in the manufacturing reached 51.7 between the second and third quarters of this year, in comparison to 55.9, the highest value of this series, which started in 1999. According to this index, data above 50 signify higher than desired inventories. In spite of the low level of utilization of the production capacity and the salary stability, the cost rises derived from the exchange rate depreciation should exert pressure on inflation, even if the current level of consumption is maintained.

The strong exchange rate depreciation and the slow growth of the economy have been causing a fast adjustment in the current account of the Balance of Payments. The 12-month accumulated deficit has been declining since July 2001, reaching US$ 13 billion in September, after surpluses in two consecutive months. The improvement of the current account, which registered the highest surplus (US$1.22 billion) in the last ten years in September, is attributed mainly to the good performance of the trade balance, whose 12-month accumulated result reached US$ 9.2 billion in September, from US$ 3 billion at the beginning of this year. A deficit of up to US$ 11 billion for the current account is projected for 2002, and a trade surplus of the same amount. For next year, a US$ 9 billion deficit for the current account is projected, and a US$ 15 billion surplus for the trade balance. The exchange rate, however, continues under pressure. Since the Copom meeting of September, the US$ quotation increased to approximately R$3.90 from R$ 3.20, reflecting an environment that is risk averse and a decline of confidence not only in relation to Brazil, but also to the industrialized countries.

The confidence crisis derived from the uncertainties concerning the future guidance of the economic policy reduced credits to Brazil. Furthermore, the scandals related to big US corporations, the crises observed in emerging markets, the prospects of another war in the Gulf and the reduction of the likelihood of recovery of the US and European economies have been reducing the market's tolerance to risk. A series of indicators have been showing the increase in the risk perception, to levels comparable to those observed during the Russian crisis. The high correlation between the Embi+ Brazil and S& P 500 indices show that the increase of the country risk registered in the last months is partially due to the higher risk aversion observed in the international financial markets.

In the last week there was a stabilization and recovery in the financial market. After a depreciation of about 18% between the September meeting and the extraordinary meeting called in October, the *real* remained relatively stable, at around R$ 3.90, until Copom's more recent monthly meeting. Furthermore, the country-risk measured by the Embi+ registered a declining trend in the period (2251 b.p. and 1987 b.p. on October 11 and 21, respectively), and one observed a higher demand for public securities in the domestic market, with lower offered discounts.

The inflation expectations surveyed by the Investor Relations Group (Gerin) of the Banco Central do Brasil for 2003 increased during the last month. Since the Copom meeting of September, the expectations' median rose to 5.9% from 5.2% on the eve of the extraordinary meeting of October, and reached 7.0% on the eve of the more recent meeting. There was also an increase in the dispersion of expectations, with the standard deviation reaching 2.7 p.p. on October 21 from an average of 1.2 p.p. in September. The increase of the inflation measured by other indices, as the 2.81% registered on the 2nd preliminary result of the IGP-M of October, contributed to the increase of inflation expectations.

The Copom also made an upward readjustment in the inflation projections for 2002 and 2003. The exchange rate depreciation was the main factor responsible for this revision. The exchange rate depreciation has direct impacts, increasing free and administered prices, and indirect ones, elevating the inflation expectations and the effects of inertia. Amongst the goods whose prices are administered by contracts and monitored, the projected increases for gasoline and bottled gas is noticeable. Since the meeting of September, the projected inflation for all the administered by contracts and monitored prices in 2003 increased to 12.1% from 7.9%. The new projections point to an IPCA increase around the adjusted target for 2003.

At this point, it is worth reinforcing the understanding regarding some basic principles that have guided Copom's actions since the adoption of the inflation target regime. First, the Copom acts by starting with an evaluation of the future trend of inflation. These projections are obtained through the best available information, both quantitative, processed by structural models, simulations and other statistical procedures, and qualitative and disaggregated, which require a more subjective evaluation.

Second, the Copom tries to analyze the cause of eventual differences between the projection and the target, in order to react in accordance with the recommendations of the best international theory and practices on this matter. It is necessary, at this point, to distinguish between demand and supply shocks, and permanent and temporary shocks. Demand shocks should be offset by a policy with an inverse sign to the shock. In the case of a supply shock (also known as a cost-shock) the traditional recommendation has been followed: the direct impact on the price level is accommodated (that is, it does not provoke reaction of the monetary policy), but the secondary (or inertial) effects of the shock are fought. The monetary policy has been adjusted in order to extend the period of convergence of the price index to the inflation target when confronted with shocks of great magnitude, as in the last 18 months. This procedure takes into account the costs (in terms of the product) of the adjustment process, linked to the existence of inflationary inertia. Such a policy indicates that, according to the conception of the targets system, Banco Central should give due consideration to the volatility of the activity level in its decision-making, but without setting aside its main objective of achieving the inflation targets.

For the Banco Central to be able to act with the necessary flexibility, without losing credibility in its commitment to the targets, it is essential that its performance be totally transparent. To meet this condition, the Copom created a methodology (detailed in the Inflation Report of June 2002) to measure the primary effect of the shocks and the impact of the inertia inherited from the previous period. Furthermore, in view of the magnitude and of the persistence of the shock, the Copom evaluates the time period necessary to eliminate the inflationary inertia. Given this period, one estimates the part of the inertia to be tolerated in the year under consideration and, added to which the estimate of the primary shock, is incorporated in the target, for the purpose of comparison with Copom's target projection. For example, for next year, the sum of half the impact of the inflationary inertia and of the primary shock of administered prices totals 2 p.p., and increases the adjusted inflation target to a rate of around 6%. In this case, the monetary policy has been set to neutralize the effect of the inertia over two years, assuring, in the absence of other shocks, a gradual convergence of the inflation to the intended target.

The Copom maintains its assessment that the increases of inflation and its expectations for 2003, derived from the accentuated exchange rate depreciation, recommend the setting of the target for the Selic interest rate at 21% p.a., as decided in the nonscheduled meeting of October 14.

In the light of these facts, the Copom unanimously decided to maintain the target for the Selic interest rate at 21% p.a.

At the close of the meeting, it was announced that the Committee would meet again on November 19, 2002, for technical presentations and, on the following day, in order to discuss the monetary policy guidelines, as set in the Communiqué 8911, of Oct 03, 2001.

Minutes of the 78th Meeting of Banco Central do Brasil Monetary Policy Committee (Copom)

Date: November 19 and 20, 2002
Place: Central Bank's Headquarters meeting room of the 8th floor (on November 19) and 20th floor (on November 20) -Brasília - DF

Called to Order: 3:30 PM on November 19 and 12:00 PM on November 20
Adjourned: 7:00 PM on November 19 and 1:30 PM on November 20

In attendance:
Members of the Board
Arminio Fraga Neto - Governor
Beny Parnes
Carlos Eduardo de Freitas
Edison Bernardes dos Santos
Ilan Goldfajn
Luiz Fernando Figueiredo
Sergio Darcy da Silva Alves

Department Heads (all present on November 19)
Altamir Lopes – Economic Department (DEPEC)
Renato Jansson Rosek – International Reserve Operations Department (DEPIN)
José Antonio Marciano - Department of Banking Operations and Payment System (DEBAN)
Marcelo Kfoury Muinhos - Research Department (DEPEP)
João Henrique de Paula Freitas Simão - Open Market Operations Department (DEMAB)

Other participants (all present on November 20)
Hélio Jose Ferreira - Executive Secretary
Alexandre Pundek Rocha - Advisor to the Board
José Pedro Ramos Fachada Martins da Silva - Advisor to the Board
João dos Reis Borges Muniz - Press Secretary (ASIMP)
Fabia Aparecida de Carvalho – Manager of the Investor Relations Group

The Board analyzed the recent performance of, and prospects for, the Brazilian and international economies under the monetary policy framework, designed to comply with the inflation targets established by the government.

Economic Activity

The indicators of the level of activity showed a recovery between the third and fourth quarters. Part of this behavior was due to a continuation of the effects of disbursements from the Time in Service Guarantee Fund (FGTS) on the consumption of semi and non-durable goods, to the increase in earnings in the agricultural sector, and to the acceleration of export growth, as well as of the import-substitution process. More recently, there was an improvement in consumer confidence, and the demand for durable goods was boosted by sectoral promotions.

In retail commerce, preliminary seasonally adjusted data from São Paulo State's Federation of Commerce (Fecomércio-SP) point to a 0.1% increase in the retail sector's real revenues in the Metropolitan region of São Paulo in October. The largest increases were observed in the sales of semi and non-durable consumption goods, and cars. October sales grew 4.1% compared to the same month of 2001. The national survey carried out by the Brazilian Institute of Geography and Statistics (IBGE) also showed a recovery of retail sales in recent months.

The improved performance of car sales registered by the Fecomércio-SP is confirmed by data from the National Federation of Auto Distributors (Fenabrave), which registered a 9.2% increase in sales in September, in the seasonally adjusted series. Car dealers' sales increased a further 2.5% in October, as a result of the promotions started by the reduction of the Industrialized Products Tax (IPI) on vehicles.

The favorable performance of the retail sector appears set to continue, considering the factors affecting expectations and defaults. Consumer confidence improved in November, according to a survey of the Fecomércio-SP. The Federation's Consumer Intentions Index (ICC) increased by 5.95% to reach 101.7 points on a scale ranging from 0 to 200. The increase in the ICC resulted from an improvement in consumers' expectations about the future, which brought the level of the future intentions index close to the series' peak. The perception of an improvement in the political scenario was the main factor underlying this result, together with a decline in concerns about higher unemployment. With respect to current intentions, the increase was more modest and the index still remains at a low level (81.2), consistent with the perception that the current economic situation remains unfavorable.

Regarding defaults, the São Paulo Trade Association's (ACSP) Usecheque indicator decreased to 4.4% in October from 6.7% in September. It should be highlighted that this decline resulted from both a smaller number of new default registrations and the maintenance of a high number of cancelled default registrations. The number of returned checks due to insufficient funds as a share of cleared checks continued to decline, falling to 4.6% in October, compared to the peak of 5.5% in this series registered in March 2002.

The default rate in financial institutions' credit portfolio of freely allocated resources remained steady in October at 7.9%, the lowest value since November of last year. The declining trend in defaults, especially on credits to individuals, is due to banks' selectivity in providing credit in recent months, as well as to the use of disbursements from the Time in Service Guarantee Fund (FGTS), which were freed because of an agreement to settle liabilities. The average interest rate on fixed income credit operations increased 2 p.p. in October, following the increase of the Selic target by the same amount.

Outstanding credit operations contracted by corporations with freely established rates declined 3.5% in the last month to R$137 billion. The volume of resources with domestic and external funding decreased 1.9% and 6.3%, respectively, despite the growth of 2.1% in the operations of Anticipated Exchange Rate Contracts (ACC), which are determined by the demands of agricultural business. The volume of credit to private individuals totaled R$77 billion, rising by 0.3% in October. Due to the different number of working days, 23 in October compared to 21 in September, the total accumulated disbursements increased by 7.1% in the last month, whereas the daily average of new concessions declined by 4.3%.

The behavior of general investment indicators continued to show a declining trend, reflecting the carryover effect of the election process on new investment decisions. However, the production of material used in civil construction registered an improvement for the second consecutive month.

Industrial production increased by 0.9% in September on a seasonally adjusted basis, according to data from the Brazilian Institute of Geography and Statistics (IBGE), mainly due to a 1.4% expansion in the transformation industry, while the mineral extraction industry registered a decline of 2.8%. The performance of the metal-mechanical industry, stimulated by the automobile sector, was a key component of the positive result. The transportation material group, in which vehicle production, metallurgy and mechanics have a heavy weight, registered increases of 8.1%, 1.5% and 2.1%, respectively, on a seasonally adjusted basis. The large increase in vehicle sales in August and September favored the stock adjustments in the sector and the expansion of production. This result was also repeated in October, as mentioned before. The furniture sector was also important in the September results, posting an increase of 8.6%. This sector has also shown a significant expansion in recent months stimulated among other factors by an increase in exports. Another important contribution to industrial performance in recent months has been the growth of sales to the agricultural sector - especially agricultural machines and fertilizers.

Data from the National Confederation of Industries (CNI) on the performance of the industrial sector in September showed an increase in industrial sales for the fourth consecutive month on a seasonally adjusted basis. This increase was due mostly to external sales. According to CNI, between the second and the third quarters of 2002 stocks of raw materials increased slightly, while stocks of final goods fell significantly relative to the levels desired by businesses. This reduction in the stocks of final goods helps to explain the difference between the expansion of industrial sales and industrial production in the third quarter of the year.

In the labor market, the average open unemployment rate measured by the IBGE increased to 7.5% in September, from 7.3% in August, as a result of a 0.2% fall in the number of employed workers and a 0.1% increase in the Economically Active Population (PEA). According to the Ministry of Labor, in September legally registered employment grew by 0.7% from the previous month on a seasonally adjusted basis, and by 3.7% over the past 12 months.

With respect to the external accounts, from November 1 to the 17 the trade balance surplus totaled US$816 million, with average daily exports of US$273 million, in comparison to US$238 million for the year. November's average daily imports of US$192 million are 1.7% higher than the average observed year-to-date, considering the period from January to November 17. As a result, the accumulated trade surplus in the year-to-date reached US$10.9 billion, in comparison to the US$1.7 billion in the same period of 2001. Exports reached US$52.7 billion, 2% higher than in the same period of 2001, while imports reached US$41.8 billion, 16.2% below the corresponding figure last year.

In summary, economic activity is showing signs of increasing dynamism, associated with the growth in sales of consumer goods with lower unit values since the beginning of the second half of the year – and attributable, among other factors, to the extraordinary resources coming from the FGTS, to the expansion of exports and import substitution, to sales directed to the agricultural sector and to the recent increase in sales of durable goods, especially vehicles. Going forward, the adjustment in stocks observed in the industrial sector, the relatively low level of defaults, and the recovery in both consumer and business confidence are elements that should contribute to a continuation of this process of recovery.

External Environment

The international economic scenario has changed little in recent weeks and remains adverse for emerging economies. Capital flows are still being influenced by risk aversion and the high volatility of financial asset prices, which has resulted in part from weaker-than-expected corporate results. Expectations for a recovery of the global economy have declined due to the release of the latest economic indicators, which have strengthened forecasts that a new recessionary period may be in course, particularly after the terrorist attack in Indonesia and with the possibility of a United States attack on Iraq.

In the United States, macroeconomic indicators are still sending contradictory signals, increasing concerns regarding prospects for an economic recovery. At its last meeting, the Federal Reserve decreased the basic interest rate by 50 points, to 1.25% p.a., and withdrew the downward bias, signaling that the easing cycle may have ended. On this point it should be highlighted that there is increasing concern among academics about the imminence of a deflationary cycle that would make monetary policy ineffectual in stimulating the economy. The FED's recent actions indicate that it may believe that recent outcomes are much more the result of very large productivity gains than excessive weakness in demand, justifying its recent monetary easing. Indicators of business and consumer confidence registered large declines in recent months, reflecting increasing uncertainties over the prolonged cycle of financial market losses and the labor market slow down, and increased fears regarding new terrorist attacks and the imminent military action against Iraq.

In Japan, the recovery of GDP growth was verified in the third quarter. However, a new deceleration is expected in the final months of the year. The uncertainty regarding global economic growth and the drop in demand for information technology-intensive goods has impacted Japan's export performance in recent months, transferring to internal demand the burden of sustaining economic activity. The unemployment rate has stabilized at a high level (5.4% from August to October) and the country is still waiting for the implementation of structural reforms to overcome deflation and the fragility of the banking system.

The performance of economic activity in the countries of the euro area has been worse than the results observed in the USA, causing forecasts for a more broad-based recovery to be abandoned.

The economic situation in Germany appears worse than in the other countries of the region, including in the areas of economic activity, the fiscal accounts and the results of the banking system, and due to the country's importance, it has been influencing the euro area's overall results and investor expectations. The maintenance of the basic interest rate of the region indicated the European Central Bank's (ECB) concern with inflation, which stood at an annual rate of 2.3% in October, the third month that inflation has remained above the ECB's target of 2.0% p.a.. This decision about the interest rate, in turn, contributed to the continuity of the euro's appreciation, with the exchange rate once again surpassing US dollar parity in recent days.

Prices

The inflation rate showed a significant acceleration in October, mainly reflecting the evolution of the exchange rate. The Consumer Price Index - Extended (IPCA) increased by 1.31%, accumulating a 6.98% increase in the year to October and a 8.45% variation in 12 months. Due to the impact of agricultural and industrial prices on wholesale prices, the effects of the exchange rate depreciation, recent increases in the international prices of some commodities, and the impact of the off-season period on agricultural prices were even more notable in the General Price Index - Demand Supply (IGP-DI). The monthly variation in the IGP-DI increased to 4.21% in October, from 2.64% in September, accumulating an increase of 16.3% in the year to October and 17.4% in 12 months.

The significant rise of the IPCA was due to the continuation of increases in free prices and to the impact of hikes in some monitored prices. The increase in free prices was responsible for 0.98 percentage points of the monthly variation and was mainly a consequence of pressure from food prices linked to the exchange rate, such as cattle meat, French roll, chicken, soy oil and rice. Among non-food products, prices of electronic devices, clothing, cigarettes, furniture and personal hygiene products posted the largest increases. Monitored prices contributed 0.33 percentage points to the monthly variation of the IPCA, reflecting increases in the prices of alcohol, gasoline, airline fares, health insurance and urban transportation in Rio de Janeiro.

Within the IGP-DI, the Wholesale Price Index –(IPA) rose 6.02% in October as a result of an 8.65% increase in agricultural prices and a 4.96% in industrial prices. Among the agricultural components, increases in the prices of soy, coffee beans, cattle meat, eggs, rice, poultry, wheat and corn were most notable. In the industrial components, price hikes were most notable mainly in metallurgical products, mineral extracting, electrical parts, paper, cardboard, chemical and food products. The National Civil Construction Index (INCC), also a sub-index of the IGP-DI, rose 1.13% in October, primarily reflecting a 1.79% increase in the costs of building materials such as steel, tile, cement, ironware and wood.

The exchange rate depreciation in recent months will continue to produce strong pressure on prices. This fact, combined with the impact of increases occurring in administered prices like fuel (gasoline, diesel and bottled gas) and electric energy (in Rio de Janeiro), will put upward pressure on consumer price indices again in November, with the possibility of a reversal only from the following month on.

Monetary Market and Open Market Operations

The spread between the Over Selic target and the 1-year interest rate, which stood at 787 b.p. on October 22, increased to 1,139 b.p. on November 13, its highest level since the October Copom meeting, before declining to 1,045 b.p. at the end of the period on November 19. The increase in the slope of the yield curve was caused by the rise in inflationary pressure and uncertainties about the exchange rate and the country's risk behavior, amongst other factors.

Between October 23 and November 19, Banco Central carried out ten auctions of Fx swaps contracts for the rollover of US$6.1 billion of Fx-linked securities and Fx swaps. The rollover of these instruments reached 82% or US$5.0 billion, with maturities on newly issued swaps ranging between 1 month and two years.

In the same period, the National Treasury carried out four auctions, placing R$21.1 billion in LFTs with an average tenor of 128 days. LTNs were offered at just one of these auctions. The attractiveness of the yield on LFTs maturing in the beginning of 2003, and the stabilization of the price discount for LFTs across all maturities due to the Banco Central's exchange and repurchase program, explain the increase in demand for these securities noted since October. On the other hand, concerns about a possible increase in the Selic rate target reduced interest in fixed income securities, resulting in no placements of LTNs in the period. Placements of NTN-Cs reached R$4.1 billion.

Continuing the program to reduce LFT price volatility, the Banco Central carried out ten selling auctions of securities maturing in 2003, allowing settlement to be carried out with LFTs and LFT-Bs maturing from 2004 to 2006. In addition, Banco Central carried out nine purchase auctions of LFTs maturing in 2003. The former auctions totaled R$1.1 billion, while the latter withdrew the equivalent of R$0.3 billion in securities from the market. In both cases, decreasing interest in the auctions has been observed, consistent with the already mentioned increase in market interest for LFTs.

Banco Central do Brasil intervened in the open market on a daily basis between October 24 and November 19, withdrawing and providing one day liquidity at respective yields of 20.90% p.a.

and 21.00% p.a. The average daily volumes of the auctions to reduce and increase liquidity were R$40.2 billion and R$4.2 billion, respectively.

The financial settlements between October 24 and November 19 had an expansionary monetary impact of R$3.0 billion, resulting from net placements of LFTs (R$14.0 billion) and NTN-Cs (R$6.2 billion) and net redemptions of LTNs (R$13.6 billion) and exchange rate indexed securities (R$9.7 billion).

In October, the domestic federal securitized debt declined by R$26.7 billion (4.1%), due mainly to the appreciation of the exchange rate and the net redemption of R$27.1 billion in securities.

Assessment of Inflation Trends

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

As mentioned in previous releases, the forecasts for the price readjustments of petroleum by-products are based on the changes in international petroleum prices and the exchange rate since the last readjustment. Because of the exchange rate appreciation that has occurred since the price readjustment announced in the beginning of November and the decrease in the international price of petroleum and its by-products, there was a downward revision to the forecasted values for 2003. For gasoline, a decrease of about 1.5% was forecast, in comparison to the increase of 9% forecast at the last Copom meeting. For bottled gas, the price is forecast to increase by approximately 6%, a much smaller increase than was projected at the ordinary meeting in October. For the last two months of 2002, the prices of gasoline and bottled gas are projected to remain stable, based on the values announced by Petrobras on November 1st.

Regarding electricity tariffs, an increase of 20% is forecasted for 2002, of which 17.2% already occurred between January and October. This value is lower than the forecast at the last meeting and this revision is a result of the exchange rate appreciation observed in the period. The projection of the electricity readjustment for 2003 increased to 27% in November from 25% in October, as a consequence of the increase in the projections for the IGP-M index, which has a significant impact on the readjustments of electricity prices.

The set of prices administered by contracts and monitored was redefined, and now excludes charcoal, school transportation and housekeepers' wages. Considering the new definition, the weight of the prices administered by contracts and monitored in the IPCA stood at 27.7% in October, instead of 31.1%. According to this new definition, the forecasts for these prices came to 13.4% and 12.1% for 2002 and 2003, respectively, in comparison to the 12.0% and 12.7%

projected previously. The lower 2003 projection for the inflation of the prices administered by contracts and monitored is due mainly to the new projection for petroleum by-products.

The forecast for the spread of the 6-month interest rate over the Selic rate, which utilizes a model specification based on the error correction method of estimation, and which assumes the maintenance of the Selic rate at a constant 21.0% p.a., starts at 490 b.p. in the fourth quarter of 2002, and, afterwards, shows a declining trend up to -100 b.p. at the end of 2003.

The monthly inflation rate measured by the IPCA reached 1.31% in October, higher than the 0.72% increase in September and above the projection at the October Copom meeting. Core inflation of the IPCA, calculated under the symmetric trimmed-mean method, remained at 0.78% in October. In the last twelve months, core prices registered an increase of 7.62%. In its turn, the core inflation of the Consumer Price Index - Brazil (IPC-BR), calculated under the symmetric trimmed-mean method, increased to 0.97% in October, from 0.67% in September. In twelve months, core prices of the IPC-BR registered an increase of 7.30%. Core inflation calculated by excluding prices administered by contracts and household food prices registered a variation of 0.74% in October, and an accumulated variation of 6.75% over twelve months.

The accumulated IPCA variation over twelve months, which had been presenting a declining trend from May to August, registered increases in September (7.93%) and October (8.44%). In these twelve months, free market prices contributed 5.47 p.p. to inflation, while prices administered by contracts and monitored contributed 2.98 p.p.

Regarding fiscal policy, it was assumed that the consolidated public sector achieves a 3.88% of GDP primary surplus for this year and 3.75% for the coming years. The other related assumptions established in the previous meeting were maintained.

From the simulation exercises with several specifications of the structural model, it has been concluded that the maintenance of the interest rate at 21.0% p.a. and the exchange rate at the same level as on the eve of the Copom meeting (R$3.55) indicates an inflation rate above the upper limit of the tolerance interval in 2002 and 2003.

Monetary Policy Guidelines

Economic activity has started to show signs of recovery, led by the increase in consumption and net exports observed in recent months. Preliminary data from Fecomércio show that the Sao Paulo retail sector's real revenues remained basically stable in October (seasonally-adjusted data), but were up 12.5% relative to October 2001. Reflecting in part the proximity of year-end festivities and the improvement of expectations about the future government, in November the IIC increased by almost 6% in relation to the previous month, mainly due to an increase in its future intentions component. According to seasonally adjusted data from CNI, real industrial sales have been rising since May, and in the most recent monthly comparison for September increased by 1.7%.

The monthly change in industrial production measured by IBGE has been positive since June. In the last three months, the growth rate has increased, rising to 0.9% in September from 0.13% in July (seasonally-adjusted data). In line with the industrial production results, the Pimes survey, carried out by the IBGE, shows an increase of 1.3% in industrial employment in September in relation to August, the highest monthly growth rate since the start of the series in December 2000. As mentioned in the Minutes of the Copom’s October meeting, the increase in industrial production in September may be explained by the reaction of industry to the increase in demand and the reduction of inventories, which fell from 53.1 to 48.5 between the second and third quarters of 2002. For the inventory index, figures above 50 correspond to inventories greater than the level desired by the firms.

The current account of the balance of payments continues to adjust as a consequence of the steep exchange rate depreciation. The projected deficit for 2002 is below US$9 billion. This forecast is due mainly to a projected trade surplus of US$12.5 billion for 2002. For 2003, the projected current account deficit is even lower, at US$8 billion, while the projected trade surplus is US$15 billion. The improvement in the balance of payments and in expectations for the future conduct of economic policy since the Copom’s last meeting allowed the dollar to fall from R$3.90 to R$3.55 in the period. The appreciation of the real was limited to some degree by the risk aversion prevailing in international markets.

Since the October Copom meeting, there have been other positive results in the financial markets aside from the appreciation of the real. Country-risk measured by the Embi+ declined from 1,987 b.p to 1,655 b.p. between October 21 and November 18. Discounts on the prices of public securities diminished. Public securities were placed with greater ease, and finally, in October the mutual fund industry posted its best results in terms of financial inflows since January 2002.

However, there was deterioration in inflation expectations for 2003. The median of inflation expectations for 2003 surveyed by the Investor Relations Group of the Banco Central do Brasil rose to 7.0% in October from 5.2% in September and it reached 9.8% on the eve of the most recent meeting. This increase was driven by a number of factors which include: i) a reaction to the deep depreciation of the exchange rate, which reached R$3.96/US$ in October; ii) the disclosure of indices – IGP, IPC-FIPE and IPCA - showing increased inflation in October and November; iii) questions related to the future conduct of monetary policy; and iv) a greater risk of margin recovery and pass-through of the exchange rate depreciation to prices in an environment of economic recovery.

The Copom has also has also made an upward adjustment to its inflation projections for 2002 and 2003, mainly due to the increase in inflation expectations in the economy. However, Copom's forecasts are meaningfully below the median of market expectations. As there was a reduction in the forecast for the readjustment of administered prices for 2003, to 12.1% from 12.7%, the higher IPCA forecast is due to a higher forecast for inflation in free prices. It is important to highlight that although the inflation forecasts of nearly 100 financial and non-financial institutions surveyed by the Investor Relations Group are a relevant parameter for price formation in the economy, they are not the only source of information used by the Copom to evaluate inflation expectations in the Brazilian economy. Among other factors that were evaluated it should be noted that the October industrial survey of the Getúlio Vargas Foundation (FGV), found that 48% of firms are willing to raise their prices. Also, recent collective wage adjustments were taken into account.

The Copom focuses on the concept of an adjusted inflation target, in which the target of 4% set for 2003 is adjusted by adding the primary impact of administered price shocks, and half the impact of inflationary inertia inherited from 2002. The adjusted target for 2003 has not changed since October (around 6%). The current inflation forecast is above this value. In summary, in light of the increase in inflation expectations for 2003, as well as the risk of higher passthrough of the exchange rate depreciation to prices, and the fact that the inflation forecast is above the adjusted target, the Copom decided, unanimously, to increase the target for the Selic rate to 22% p.a., with no bias.

At the close of the meeting, it was announced that the Committee would meet again on December 17, 2002, for technical presentations and, on the following day, in order to discuss the monetary policy guidelines, as set in Communiqué 8911, of Oct 03, 2001.

Acronyms

ac	12m accumulated in 12 months
ACC	Anticipated Exchange Rate Contracts
BM&F	Mercantile and Futures Exchange
bp	Base Points
CDI	Interbank Futures Contract
CETIP	Center for Financial Custody and Settlement of Private Securities
CNI	National Confederation of Industries
CPMF	Provisory Contribution on Financial Transactions

CSLL	Social Contribution on Net Profit
DI	Interbank Deposit
Fecomércio	Federation of Commerce of the State of São Paulo
Fenabrave	National Federation of Automotive Vehicles Distribution
FED	Federal Reserve System
FOMC	Federal Open Market Committee
FRA	Forward Rate Agreement
GDP	Gross Domestic Product
IBGE	Brazilian Institute of Geography and Statistics
IF	Financial Institution
IGP-DI	General Price Index – Domestic Supply
IIC	Consumer Intentions Index
INCC	National Civil Construction Index
IPA	Wholesale Price Index
IPC	Consumer Price Index
IPCA	Consumer Price Index – Extended
IPCH	Consumer Price Index – Harmonized
IPP	Producer Price Index
IR	Income Tax
IRF-M	Market Fixed Income Index
IRRF	Withholding Income Tax
LFT	National Treasury Letters (floating)
LFT-B	National Treasury Letters - B series (selic rate)
LTN	National Treasury Letters (fixed rate)
NAPM	National Association of Purchasing Managers
NBCE	Central Bank Note - E Series (exchange rate variation)
NTN-C	National Treasury Note - C Series (price index)
NTN-D	National Treasury Note – D Series (exchange rate)
p.a.	per annum
PEA	Economically Active Population
Pimes	Monthly Industrial Survey on Employment and Salary
p.m.	per month
pp	percentage point
Selic	Central Bank’s Custody and Settlement Center
SPC	Credit Protection Service
STN	National Treasury Secretariat
ytd	year-to-date

Economic policy measures

Measure related to the financial system and credit market

Circular 3,147, 9.4.2002 – altered the factor applicable to assets weighted by risk for cooperative banks and credit cooperatives. This factor is applied to funding operations weighted by the respective credit risk and specifies a share of the net worth required to cover the risk of financial institution funding and lending operations:

I – cooperative banks: from 0.13 to 0.11;

II – central credit cooperatives: from 0.20 to 0.13;

III – individual credit cooperatives affiliated to central credit cooperatives: from 0.20 to 0.15.

Circular 3,150, 9.11.2002 – defined criteria for accounting recording and evaluation of derivative financial instruments associated to funding or lending operations. Just as in the case of derivative contracts in general, these instruments are to be evaluated at market value. However, upward or downward value movements consequent upon marking-to-market may be ignored, provided that:

I – separate trading or settlement of the operation associated to the instrument is not permitted;

II – in the hypothesis of anticipated settlement of the associated operation, the operation is to take place at contracted value;

III – the derivative financial instrument may be contracted for the same time period and with the same counterpart as the associated operation.

Resolution 3,019, 9.19.2002 – set the Long-Term Interest Rate at 10% per year (TJLP) to remain in effect in the final quarter of 2002, based on the inflation target calculated pro rata for the coming twelve months, equivalent to 3.875% per year plus the risk premium of 6.125%.

Resolution 3,022, 9.19.2002 – deals with issue of certificates of deposit as guaranties, related to exchange securities. Issue of these certificates was permitted to investment banks and multiple banks with investment portfolios and are to be backed by exchange securities received as guaranties of loans granted to companies. These certificates should contain information on the corresponding securities, including the name of the issuers and their value, and can be used to provide greater liquidity to the corporate papers of various sectors of the economy, including the crop/livestock sector.

Circular 3,152, 9.20.2002 – determined conditions for issue of Real Estate Credit Bills (LCI). These papers may be issued by commercial banks, multiple banks with real estate portfolios, Caixa Econômica Federal, real estate credit companies, savings and loan associations and mortgage companies, in order to back real estate credits guarantied by mortgages or by chattel mortgages of the property in question. The minimum period for redemption is as follows, as of the date of issue and depending on the system of LCI updating:

I – 36 months, if updated monthly according to a price index;
II – 12 months, when updated annually according to a price index;
III – 60 days in all other cases.

Circular 3,153, 9.25.2002 – altered rules regarding Banco Central discount window operations in the context of the new system of payments. It was determined that intraday rediscount operations, based on purchases of securities with a resale commitment, that await settlement at the end of the period of operation of the Reserve Transfer System will be automatically converted into one business day operations, involving the same papers as the intraday operation.

Circular 3,156, 10.11.2002 – altered the factor applicable to operations with gold and those referenced to exchange rate variations, for purposes of calculating required net worth and the exposure limit in gold and assets and liabilities indexed to exchange. The aforementioned factor was raised to 1.0, noting that, according to the terms of Circular 3,155, dated 10.7.2002, it had already been raised previously from 0.5 to 0.75. This factor is a component of the calculation of the required net worth of financial institutions for covering the risks consequent upon their operations. Thus, the institutions were required to set aside a larger volume of their own capital resources to cover operations marked by market risk consequent upon exchange rate variations. With regard to the change in the exposure limit, it refers to the net exposure between put and call positions indexed to exchange and is verified by Banco Central on a daily basis. This limit was reduced from 60% to 30% of the reference assets (net worth calculated for purposes of operational limits).

Circular 3,157, 10.11.2002 – altered the rates and value of the deduction related to additional reserve requirements on the deposits received by financial institutions. The additional rates were increased from 3% to 8% for demand deposits and time deposits, and from 5% to 10% for savings deposits. The volume deposited corresponds to the sum of these amounts, deducting a fixed amount that was altered from R$30 million to R$100 million. The calculation base refers to the arithmetic median of the amount subject to deposit, as calculated over a period of one week. The additional requirement must be complied with in cash on the business days of the second week after the closing of the calculation period, with earnings based on the Selic rate.

Resolution 3,024, 10.24.2002 – altered and consolidated the rules regulating the Credit Guaranty Fund (FGC). This is a civil nonprofit association governed by private law and has the objective of providing credit guaranties against the associated institutions up to a maximum value of R$20,000.00 (twenty thousand reals) per depositor. Among the changes in the rules, one should cite the following: alteration of the calculation base of monthly contributions, on which the 0.025% rate is levied; this calculation base was shifted to the monthly average of the daily balances of the liabilities that received the guaranty and no longer the final balances of the cited heading in the previous months balance sheet. It was also determined that arrears on these payments would be subject to a fine corresponding to 2% of the value of the contribution, plus updating according to the Selic rate. Aside from this, the new regulations extended the guaranty to the credits held by other financial system institutions, as well as to the credits of persons connected to the institutions issuing the papers covered by the guaranty.

Resolution 3,034, 10.29.2002 – altered and consolidated the rules disciplining investment of the resources of reserves, provisions and funds of insurance companies, capitalization companies and open complementary pension funds. The regulations appended to this resolution determine that the resources of these entities must be allocated to the segments of fixed income, variable income and real estate and define the percentages of investment in each of these modalities in order to attain the degree of diversification required for purposes of client security. The period of adaptation to these rules was set at up to 12.31.2002.

Resolution 3,039, 10.30.2002 – permitted financial institutions to formalize agreements aimed at clearing and settling liabilities in the framework of the National Financial System (SFN). These agreements may include any and all operations carried out within the financial system now or in the past or that may come to be carried out in the future and may be formalized among financial institutions and individual persons or legal entities independently of whether they are or are not part of the SFN. It is prohibited for any of the parties involved to operate as intermediaries of third party operations. The contract should stipulate the conditions and methodology for calculating, clearing and settling liabilities, including the period after which one of the parties may come to be considered in default.

Resolution 3,040, 11.28.2002 – treats of the requirements and procedures for the constitution, operating authorization, transfer of stock control, company reorganization and cancellation of operating authorization of financial institutions, which are acts that depend on approval of Banco Central. With regard to the requirements for constitution of financial institutions, the following documents should be submitted for Banco Central analysis, covering the first three years of activity: economic-financial feasibility study of the project; business plan, including definition of the major products and services, and a document that defines corporate standards of governance. Once the formal acts of constitution are approved, the next step is operating authorization. At this stage, the origin of the resources to be used in the enterprise must be corroborated. Cancellation of the operating authorization may be adopted in certain cases, such as the practice of acts that are not consistent with the entity's status as a member institution of the financial system.

Resolution 3,041, 11.28.2002 – defined conditions for the exercise of positions defined in the bylaws of financial institutions. The election or nomination of the occupants of such positions should be submitted to Banco Central for approval within a maximum of fifteen days of the election or nomination, with the exception of positions in federal public financial institutions, chosen according to the legislation in effect.

Resolution 3,042, 11.28.2002 – deals with investment of the resources of the reserves, provisions and funds of insurance companies specialized in health insurance. In general, the resources of these entities must be invested in compliance with the conditions set down in Resolution 3,034, dated 10.29.2002. Furthermore, jurisdiction over questions related to health insurance pertains to the National Council of Supplementary Health (Consu) and the National Supplementary Health Agency (ANS).

Resolution 3,049, 11.28.2002 – in the context of the program that determines the conditions governing credits to the public sector, the limit on the overall value of operations contracted with municipalities as of 11.27.2002 was raised to R$200,000,000.00 (two hundred million reals), when such are contracted on the basis of the terms of Resolution 2,827, dated 3.30.2001. This additional amount depends on compliance with the rules set down in Complementary Law 101, dated 5.4.2000, to be determined in consultation with the Ministry of Finance's Secretariat of the National Treasury.

Resolution 3,050, 12.2.2002 – in order to meet crop/livestock sector demand up to the end of the year, additional allocations of up to R$790,000,000.00 (seven hundred and ninety million reals) were authorized for the Program of Modernization of the Farm Tractor and Associated Implements and Harvester Fleet (Moderfrota), to be invested by December 20,2002.

Fiscal policy measures

Provisional Measure 70, 10.1.2002 – disciplines participation of foreign capital in journalistic and sound and image broadcasting as treated in paragraph 4 of article 222 of the Federal Constitution. The most important topics in this Provisional Measure are as follows:

I – the participation of foreigners or Brazilians who have been naturalized for less than ten years in the capital stock of journalistic and broadcasting companies may not exceed thirty percent of the total capital and voting capital of such companies and is to be exercised indirectly through a legal entity constituted under the terms of Brazilian legislation and headquartered in the country;

II – by the final day of each year, journalistic companies should submit to the entities charged with commercial registration or the office of civil records of legal entities a declaration of the composition of their capital stock, including nominations of Brazilians born in the country or naturalized for more than ten years who hold title directly or indirectly to at least seventy percent of the total capital and voting capital;

III – any agreement among partners, stock or quota holders or any act, contract or other type of agreement that directly or indirectly grants or has the objective of granting participation in the total capital or voting capital of journalistic or broadcasting companies at percentage levels above thirty percent or that have the purpose of establishing such partners both legally and in fact as holding positions of equality or superiority in relation to partners born in Brazil or naturalized for more than ten years will be considered null and void.

Provisional Measure 75, 10.24.2002 – determines new periods of time for payment of debts in arrears, with amnesty in relation to fines and interest as determined in Provisional Measure 66, dated 8.29.2002.

The new measure, which represents an additional effort to expend government collections, extended the period granted to legal entities for payment of taxes and federal contributions in arrears, with amnesty from fines and interest, to November 29. The period had previously been concluded on September 30. The companies that withdraw suits now before the courts will have an equal opportunity to pay off their debt by the new date specified, according to the same criteria determined in MP 66.

It was also determined that, up to the new date specified, pension funds would be permitted to effect a single payment – with amnesty from fines and interest – of those amounts involving debts related to contributions to PIS/Pasep and Cofins, matured by July 31 of this year and levied on income related to revenues on real estate rentals and sales, when such are to be used in effecting payments of retirement benefits, pensions, savings and redemptions; and to the positive results found to exist in the re-evaluation of the real estate investment portfolio. According to MP 66, the funds are exempt from these deposits as of August.

MP 75 also permits reintegration into the Fiscal Recovery Program (Refis) of those companies that had been excluded from the program for administrative reasons. At the same time, this instrument grants companies included under the Simplified System of Tax Payments (Simples) to pay their debts in arrears in up to 60 monthly payments, including debts with the INSS. This had previously not been permitted to these companies.

According to this MP 75, individual persons and legal entities will be entitled to pay their debts with the Federal Revenue Secretariat in up to 60 months. Previously, the maximum period granted for installment payments was 30 months.

Decree 4,489, 12.28.2002 – regulated article 5 of Complementary Law 105, dated 1.10.2002, which deals with the information that should be provided to the Federal Revenue Secretariat by financial institutions, in regard to the overall amount operated monthly by each user of their services. According to the decree, the amount operated monthly is understood as follows:

I – in demand deposits and time deposits, including savings accounts, the sum of the amounts credited in the month;

II – in payments effected in currency or check, the sum of the amounts entered against such payments in the month;

III – in issues of payment orders or similar documents, the sum of the entries against such issues in the month;

IV – in redemptions against demand and time deposits, including savings deposits, the sum of the entries tied to such redemptions in the month;

V – in credit contracts and operations involving the discounting of commercial invoices, promissory notes or other types of credit instruments, the sum of the amounts entered as credit and the sum of the amounts entered as debit in the month in each account that records user operations;

VI – in acquisitions and sales of fixed or variable income papers:

a) in spot market operations, the sum of the acquisitions and the sum of the sales carried out in the month;

b) in option market operations, the sum of the premiums received and the sum of the premiums paid in the month, notified in segregated form, and related to all of the options contracts, including those involving flexible options;

c) in futures market operations, the sum of the daily adjustments in the month, related to all user contracts; and

d) in swap operations, the sum of the payments and the sum of the amounts received in the month, in segregated form, related to all user contracts;

VII – in investments in investment funds, the sum of the entries of investments in the month, on an individualized fund-by-fund basis;

VIII – in foreign currency acquisitions, the sum of the purchases made in the month by the user in national currency;

IX – in conversions of foreign currency into national currency, the sum of the sales effected in the month by the user in national currency;

X – in transfers of foreign currency and other amounts abroad, the sum in national currency of the amounts transferred by users in the month, including all modalities, independently of the exchange market in which they operate;

XI – in acquisitions or sales of gold, financial asset, the sum of the acquisitions and the sum of the sales made by the user in the month;

XII – in credit card operations, the sum of the payments effected by those holding credit cards and the sum of the payments effected to accredited establishments in the month;

XIII – in leasing operations, the sum of the payments effected by lessees in the month involving each contract.

In providing such information, financial instruments may ignore the information related to each modality of financial operation in which the overall amount registered in the month is less than the following limits:

I – for natural persons, R$5,000.00;

II – for legal entities, R$10,000.00.

Measures related to external sector

STN Directive 452, 9.16.2002 – Authorized issue of NTN-I in the amount of R$59,170,067.87 (fifty nine million, one hundred and seventy thousand and sixty seven reals and eighty seven “centavos”), referenced to 8.15.2002, to be utilized in interest rate equalization payments in the financing of Brazilian exports of goods and services based on the terms of the Export Financing Program (Proex).

Decree 4,383, 9.23.2002 – Treats of the execution of Economic Complementation Agreement 53, between Brazil and Mexico on 7.3.2002. Approves the list of merchandise benefited by preferences that correspond to percentage reductions in the import tariff.

Decree 4,396, 9.27.2002 – Altered the rate of the Industrialized Products Tax (IPI) on the products cited (capital goods in general).

Camex Resolution 23, 9.30.2002 (Ex tariff) – Altered the ad valorem rates of the Import Tax on capital goods, informatics and telecommunications goods and components of the integrated systems specified therein to 4% up to 6.30.2004. In the latter case, the tax treatment specified applies only when dealing with imports of the totality of the components specified in each system to be used as a whole in the productive activity of the importer.

MAPA Directive 459, 10.9.2002 – Deals with the volume of the import tariff quota on sugar ascribed by the Government of the United States of America to Brazil, for shipment in the 2002/2003 period.

Bacen Circular 3,156, 10.11.2002 – Altered the "F" factor applicable to operations with gold and assets and liabilities referenced to exchange variation, as determined in the PLE formula included in Regulations (Annex IV) to Resolution 2,099, dated 1994, and later altered, as well as the exposure limit in gold and assets and liabilities referenced to exchange, as treated in Resolution 2,606, dated 1999. Revokes Circular 3,155, dated 10.7.2002.

Decree 4,418, 10.11.2002 – Approved the new Bylaws of the National Bank of Economic and Social Development (BNDES), permitting the institution to finance direct Brazilian investments abroad.

MF Directive 350, 10.16.2002 – Deals with procedures for controlling the origin of the resources invested in foreign trade operations and combating fraudulent utilization of such procedures by persons.

Provisional Measure 75, 10.24.2002 – Altered federal tax legislation and adopted other measures. Complements Provisional Measure 66, dated 8.30.2002, involving the mini tax reform, and absorbs provisions of Provisional Measure 38, dated 5.15.2002, which became null and void since it was not voted within the determined period of time. Encompasses alterations in customs legislation, penalties and the charging of antidumping rights and countervailing duties.

Resolution 3,026, 10.25.2002 – Instituted a line of credit based on resources from the Coffee Economy Defense Fund (Funcafé), to be used in covering the current expenditures of the coffee crop in the 2002/2003 agricultural period.

Resolution 3,027, 10.24.2002 – Treats of alterations in the operational conditions of the credit line to be used in financing coffee stocks from the 2000/2001 and 2001/2002 harvests, based on resources from the Coffee Economy Defense Fund (Funcafé).

Circular 3,158, 10.25.2002 – With regard to the case of Argentina, altered the Regulations on Export Exchange and the Regulations on the Reciprocal Payments and Credit Agreement (CCR). Increases the value of the payment instruments to be processed through CCR involving imports of merchandise originating in and coming from Argentina to up to US$200,000.00. Permits processing of payment instruments through the CCR when such result from renegotiation of credits referring to Brazilian exports to Argentina, related to its trade debts, with no distinction as to the nature of the exports and the parties involved.

Decree 4,441, 10.25.2002 – Altered the Industrialized Products Tax (IPI) rate on the products listed therein (alcohol-powered passenger cars, capital goods in general, thermoelectric plants powered by gas).

Communiqué 10,325, 10.25.2002 – Announced procedures for providing information on credits apt for renegotiation and involving Brazilian exports to Argentina. The purpose of this instrument is to facilitate execution of the provision in article 3 of Bacen Circular 3,158, dated 10.25.2002.

Circular 3,160, 10.30.2002 – As of 12.10.2002, permitted processing of payment instruments with terms of more than 360 days on the basis of the Reciprocal Payments and Credit Agreement.

Camex Resolution 27, dated 10.29.2002 (Ex tariff) - Altered the *ad valorem* rates of the Import Tax on capital goods (BK), informatics and integrated systems to 4% up to 12.31.2004. In the latter case, the tax treatment specified applies only when dealing with imports of the totality of the components specified in each system to be used as a whole in the productive activity of the importer.

Decree 4,458, 11.5.2002 – Treats of execution of Economic Complementation Agreement 55 among Brazil, Argentina, Paraguay, Uruguay and Mexico, dated 9.27.2002. The Agreement was signed with the objective of establishing the basis for free trade in the automotive sector and fostering integration and productive complementarity of their respective automotive sectors.

Circular 3,162, 11.6.2002 – Treats of foreign currency purchase and sale operations carried out by Banco Central do Brasil on the interbank exchange market for future settlement, based on the exchange rate stated in the bulletin "Fechamento Ptax".

Bacen Communiqué 10,379, 11.6.2002 – Extends the periods stated in Communiqué 10,325, dated 12.25.2002, to 11.20.2002, which deals with the procedures to be followed in providing information on credits apt for renegotiation involving Brazilian exports to Argentina (CCR).

Secex Directive 11, 11.19.2002 – Stipulated that the Sales Records (RV) used in exports of unprocessed coffee in beans may have shipments foreseen for up to the end of the fifth month subsequent to that of negotiation. Should the operations be tied to a Rural Product Bill (CPR), shipment may be permitted up to the eleventh month subsequent to that of negotiation.

Brazil-European Community Textile and Apparel Agreement, published in the DOU dated 11.11.2002 – Treats of improvements in market access on the part of both parties, involving textile and apparel products.

Secex Circular 49, dated 11.6.2002 (United States General System of Preferences) – Announced that, according to the terms of a Notice published in the Federal Register on 11.1.2002, United States authorities have initiated the annual review process of the USA SGP. In the context of this review, interested Brazilian exporters may submit petitions to the office of the United States Trade Representative (USTR) for inclusion of products in the USA SGP and/or for obtaining waivers from the limits of competitiveness foreseen in that system of preferences.

Law 10,548, 11.13.2002 – Converted Provisional Measure 41, dated 2002, into law. Alters Law 10,147, dated 12.21.2000, which deals with the levying of the contribution to the Programs of Social Integration and Formation of Civil Service Assets (PIS/Pasep) and the Contribution to Social Security Financing (Cofins), in operations involving sales of the products specified therein (pharmaceutical products) and adopts other measures.

Resolution 3,048, 11.29.2002 – Treats of alterations in the operating conditions of the line of credit to be used in financing coffee stocks from the 2000/2001 and 2001/2002 harvest, based on resources from the Coffee Economy Defense Fund (Funcafé).

Appendix

Banco Central do Brasil Management

Members of the Monetary Policy Committee (Copom)

Banco Central do Brasil Management

Board

Armínio Fraga Neto
Governor

Carlos Eduardo de Freitas
Deputy Governor

Beny Parnes
Deputy Governor

Edison Bernardes dos Santos
Deputy Governor

Ilan Goldfajn
Deputy Governor

Luiz Fernando Figueiredo
Deputy Governor

Sérgio Darcy da Silva Alves
Deputy Governor

Tereza Cristina Grossi Togni
Deputy Governor

Members of the Monetary Policy Committee (Copom)

Voting members

Armínio Fraga Neto
Governor

Carlos Eduardo de Freitas
Deputy Governor

Beny Parnes
Deputy Governor

Edison Bernardes dos Santos
Deputy Governor

Ilan Goldfajn
Deputy Governor

Luiz Fernando Figueiredo
Deputy Governor

Sérgio Darcy da Silva Alves
Deputy Governor

Tereza Cristina Grossi Togni
Deputy Governor

Non-voting members

Altamir Lopes
Head of the Department of Economics (Depec)

Daso Maranhão Coimbra
Head of the Department of International Reserve Operations (Depin)

José Antonio Marciano
Head of the Department of Banking Operations and Payments Sistem (Deban)

Marcelo Kfoury Muinhos
Head of the Research Department (Depep)

Sérgio Goldenstein
Head of the Department of Open Market Operations (Demab)

Acronyms

Abimaq	Brazilian Association of Machinery and Equipment Industry
ac.12m.	In accumulated terms for 12 months
ac.a.	In accumulated terms for the year
ACC	Anticipated Exchange Rate Contracts
ACSP	São Paulo Trade Association
ADR	American Depositary Receipts
AIE	Energy International Agency
	and Intermunicipal Transportation Services and Communications
Aneel	National Electric Energy Agency
Anefac	National Association of Finance, Administration and Accounting Executives
Anfavea	National Association of Automotive Vehicle Manufacturers
ANP	National Petroleum Agency
BAI	Business Activity Index
Banacci	Grupo Financiero Banamex - Accival
Banxico	Bank of Mexico
BIB	Brazil Investment Bonds –
BIS	Bank for International Settlements
BIT	Informatics and Telecommunication Goods
BM&F	Commodities & Futures Exchange
BNDES	National Bank of Economic and Social Development
BNDESpar	BNDES Participações S.A.
BoJ	Bank of Japan
Bovespa	São Paulo Stock Exchange
Cadin	Information File on Outstanding Credits of the Federal Public Sector
Caged	General Reference File of the Employed and Unemployed
Camex	Chamber of Foreign Trade
CBEE	Brazilian Emergency Energy Marketing Company
CBO	Congressional Budget Office
CCR	Reciprocal Payments and Credits Agreement
CDB	Bank Deposit Certificates
CDE	Energy Development Account
CDI	Interbank Deposits Certificate
CDL	Net Domestic Credit
CEF	Federal Savings Bank
Cepal	Economic Commission for Latin America and the Caribbean
Cetes	Treasury Certificates

Cetip	Center of Financial Liquidation and Custody of Securities
CFT-E	Treasury Financial Certificates
CGPC	Council of Complementary Social Security Management
Cide	Contribution on Intervention in the Economic Domain
CIP	Interbank Chamber of Payments
CIR	Currency System
CMN	National Monetary Council
CNI	National Confederation of Industry
Cofins	Contribution to Social Security Financing
Compe	Central Clearance System of Checks and Other Papers
Copom	Monetary Policy Committee
Cosif	Accounting Plan of National Financial System Institutions
CPI	Consumer Price Index
CPMF	Provisional Contribution on Operations or Transmission of Values and Credits and Rigths of a Financial Nature
CSLL	Social Contribution on the Profits of Legal Entities
CSN	National Steel Company
CVM	Securities and Exchange Commission
CVRD	Vale do Rio Doce Company
Demab	Department of Open Market Operations
Depec	Department of Economics
DI	Deposits among financial institutions
Diset	Board of Sectoral Studies
DJIA	Dow Jones Industrial Average
DLSP	Net public sector debt
DOC	Credit documents
DOU	Federal Official Gazette
DRU	Disencunberment of Federal Government Funds
DV	demand deposits
EC	European Commission
ECB	European Central Bank
EMI	Monthly Industrial Estimator
EU	European Union
FAT	Worker Support Fund
FBC	Gross Capital Formation
FBCF	Gross Fixed Capital Formation
FECMG	Trade Federation of the State of Minas Gerais
Fecomercio SP	Trade Federation of the State of São Paulo
Fed	Federal Reserve Bank
Fenabrave	National Federation of Automotive Distribution
FGTS	Severance Fund Contribution
FGV	Getulio Vargas Foundation
Fiesp	Federation of Industries of the State of São Paulo
FIF	Financial investment funds
Finame	Special Industrial Financing Agency
FITVM	Investment funds in securities and stocks
FMI	International Monetary Fund

FMP	Mutual Privatization Funds
FOMC	Federal Open Market Committee
FRA	Forward Rate Agreement
Funcafé	Coffee Economy Defense Fund
GCI	Brazil - Investor Relations Group
GDDS	General Data Dissemination System
GDP	Gross Domestic Product
Gerin	Investor Relations Group
HCPI	Harmonized Consumer Price Index
IBGE	Brazilian Institute of Geography and Statistics
Ibovespa	Bovespa Index
IBRD	International Bank for Reconstruction and Development
ICEI	Industrial Confidence Indicator
ICMS	Tax on the Circulation of Merchandise and Services and the Rendering of Interstate
IDB	Interamerican Development Bank
IED	Direct Foreign Investments
IF	Financial institution
IFO	Institute for Economic Research
Igae	Global Indicator of Economic Activity
IGP-DI	General Price Index - Internal Supply
IGP-M	General Price Index - Market
IHT	Index of Hours Worked by Laborer
IIA	Index of Current Intentions
IIC	Consumer Intentions Index
IIF	Index of Future Intentions
IIF	Institute of International Finance
Imacec	Monthly Economic Activity Indicator
INCC	National Cost of Construction Index
Indec	Instituto Nacional de Estadísticas y Census
INE	Instituto Nacional de Estadísticas
Inegi	National Institute of Statistics, Geography and Informatics
INPC	National Consumer Price Index
Insee	Institut National de la Statistique et des Études Économiques
INSS	National Social Security Institute
IOF	Financial Operations Tax
IPA	Wholesale Price Index
IPA-DI	Wholesale Price Index - Domestic Supply
IPA-OG-DI	Wholesale Price Index - Overall Supply - Industrial Products
IPA-OG-PI	Wholesale Price Index - Overall Supply - Industrialized Products
IPC	Consumer Price Index
IPC	Índice de Precios al Consumidor
IPCA	Broad National Consumer Price Index
IPC-BR	Consumer Price Index – Brazil
IPC-Fipe	Consumer Price Index issued by the Institute of Economic Research Foundation
Ipea	Institute of Applied Economic Research
IPI	Industrialized Products Tax
Ipim	Índice de Precios Internos al por Mayor

IPM	Índice de Precios al por Mayor
IPO	Index of Occupied People
IPP	Producer Price Index
IR	Income Tax
IRF-M	Market Fixed Income Tax
IRRF	Withheld Income Tax
Isac	Synthetic Index of Construction Activity
Isae	Istituto di Studi e Analisi Economica
ISM	Institute for Supply Management
IVA	Tax on Aggregate Value
IVF	Index of Physical Volume
Laia	Latin American Integration Association
LBTR	Gross Settlement in Real Time
LDL	Postponed Net Settlement
LDO	Budget Guidelines Law
Lecops	Province Liability Cancellation Bill
LFT	Treasury Financing Bills
LRF	Fiscal Responsibility Law
LSPA	Systematic Farm Production Survey
LTN	National Treasury Bills
MAA	Ministry of Agriculture and Supply
MAE	Electricity Wholesale Market
Mapa	Ministry of Agriculture, Livestock and Supply
mdb	million barrels per day
MDIC	Ministry of Development Industry and Foreign Trade
MEC	Ministry of Education
Mercosul	Southern Common Market
Moderfrota	Program of Modernization of the Fleet of Farm Tractor and Associated Implements and Harvesters
MTE	Ministry of Labor and Employment
Nafta	North-American Free Trade Association
Nasdaq	National Association of Securities Dealers Automated Quotations
NBCE	Banco Central Notes - Special Series
NCM	Common Mercosul Nomenclature
NFSP	Public Sector Borrowing Requirements
NTN-B	National Treasury Notes - Series B
NTN-C	National Treasury Notes - Series C
NTN-D	National Treasury Notes - Series D
OCDE	Organization for Economic Development Cooperation
OFPUB	System of Electronic Formal Public Offers
OMC	World Trade Organization
Opec	Organization of Petroleum Exporting Countries
p.a.	per annum
p.b.	Base points
p.m.	per month
p.p.	percentage point
p.y.	per year

PAF	Financial Assistance Program
Pasep	Program of Formation of Civil Service Asstes
PCC	Job Position Classification Plan
PEA	Working Population
Pesa	Special Program for Asset Reordering
PIM	Monthly Industrial Survey
PIS	Social Integration Plan
PLE	Required Net Worth
PMAT	Program of Tax Administration Modernization and Management of Basic Social Sectors
PMC	Monthly Trade Survey
PME	Monthly Employment Survey
PMI	Purchasing Managers Index
PMPP	currency held by the public
PMSS	Program of Modernization of the Sanitation Sector
PNB	Gross National Product
PPE	Specific Price Share
PPI	Producer Price Index
PR	Reference Worth
Procera	Special Program of Credits to Agrarian Reform
Proex	Export Financing Program
Proinfa	Program of Incentives to Alternative Electricity Sources
Pronaf	National Program of Strengthening Family Farming
PSBR	Public Sector Borrowing Requirements
RCC	Resolution and Collection Corporation
Refis	Fiscal Recovery Program
RGPS	General Social Security System
RJU	Single Juridical System
RMSP	Metropolitan Region of São Paulo
RV	Sale Registration
SCC	Swap Contract with Periodic Adjustment
Selic	Special System of Clearance and Custody
SFH	Housing Financial System
SGP	Generalized System of Preferences
Simples	Integrated System of Tax and Contribution Payments by Micro and Small Business
Sindimaq	National Union of the Machine Industry
Sitraf	Fund Transfer System
SIUP	Public utility industrial services
SPB	Brazilian Payments System
SPC	Credit Protection Service
SRF	Supplementary Reserve Facility
STR	Reserve Transfer System
TEA	Scheduled Electronic Transfer
TEC	Common External Tariff
Tecban	Banking Technology Corp.
TED	Available Electronic Transfer
TJLP	Long-Term Interest Rate
TN	National Treasury

TR	Reference Rate
UE	European Union
ULC	Unit Cost of Labor
USA	United States of America
VAT	Value Added Tax
WPI	Wholesale Price Index
WTO	World Trade Organization