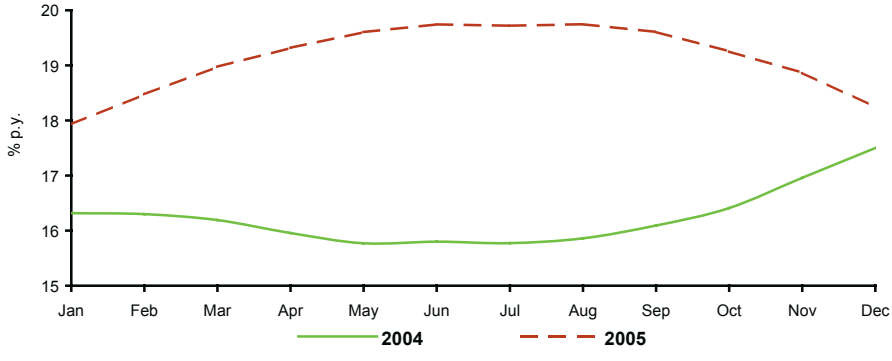
III Capital and Financial Markets

Real interest rates and market expectations

The risks of greater inflationary pressures in early 2005 were one of the factors underlying the interest rate decisions taken by Copom with the objective of ensuring continued monetary stability. However, as of August, the Committee began easing monetary restrictions as consumer inflation indices converged toward the predetermined target.

Graph 3.1
Over/Selic rate



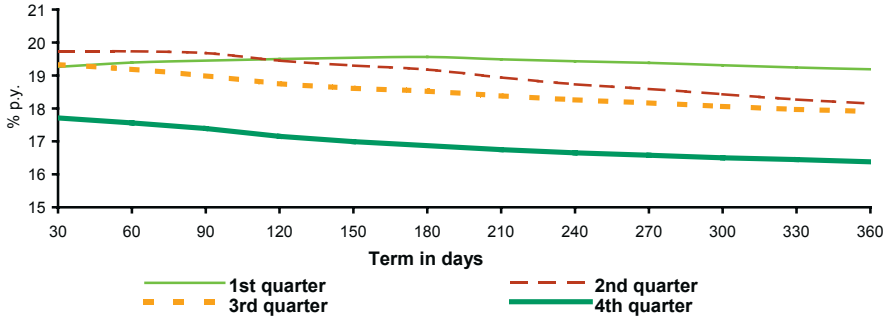
Initially, the interest futures market evolved in a manner consistent with monetary policy. Anticipating the process of monetary easing, however, rates on swap contracts reversed their upward trajectory as of the month of April. Consequently, 360-day DI x pre swap contracts where negotiated at the end of the year at 16.38% per year, down 1.5 p.p. compared to the end-2004 figure.

Graph 3.2
Over/Selic rate x dollar x swap 360 days

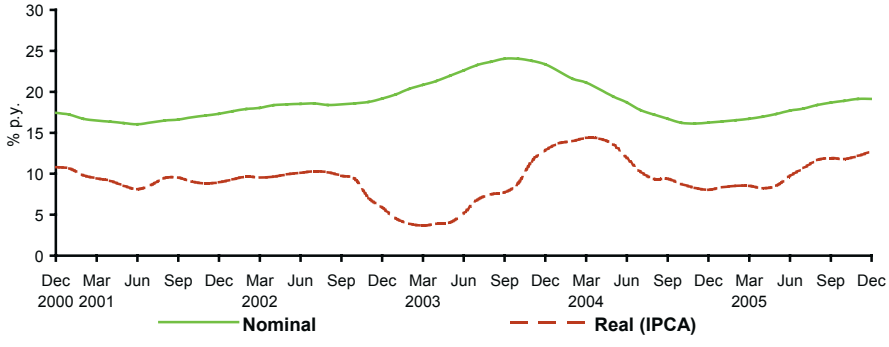


Based on a survey among private sector analysts, the real ex-ante one year interest rate calculated by BCB increased during the entire first half of 2005. Starting in July, however, this trajectory reversed course, mainly as a result of the impact of monetary policy on the evolution of wholesale price indices. With this, the rate closed the year at 11.2%, down 0.6 p.p. compared to the same 2004 period.

Graph 3.3
Yield curve – Swap DI x Preset
Quarterly average



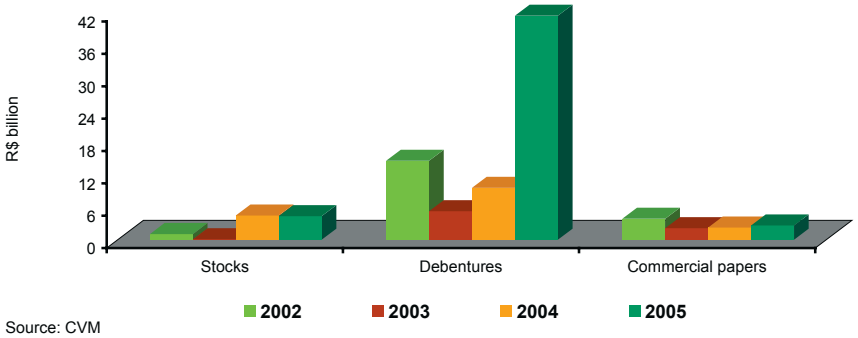
Graph 3.4
Over/Selic rate accumulated in 12 months



Capital market

The volume of primary capital market offers, including stocks, debentures and promissory notes registered at the Securities and Exchange Commission (CVM), totaled R$48.5 billion in 2005, compared to R$16.3 billion in the previous year. Basically, this growth was driven by debenture issues, with 85.6% of the total. Primary stock issues continued evolving at the pace set in 2004 and closed with a total of R$4.3 billion. Credit Rights Investment Funds (FIDC) were another important source of business funding in the period. Based on CVM data, 2005 registrations of quota issues totaled R$8.6 billion, up 67.7% over the final 2004 level.

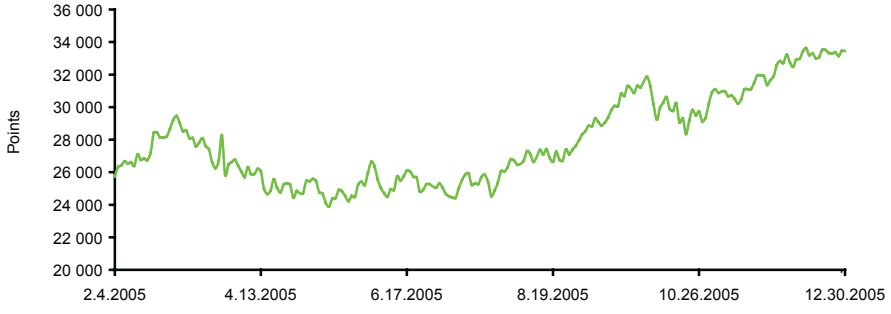
Graph 3.5
Primary market – Issues



Source: CVM

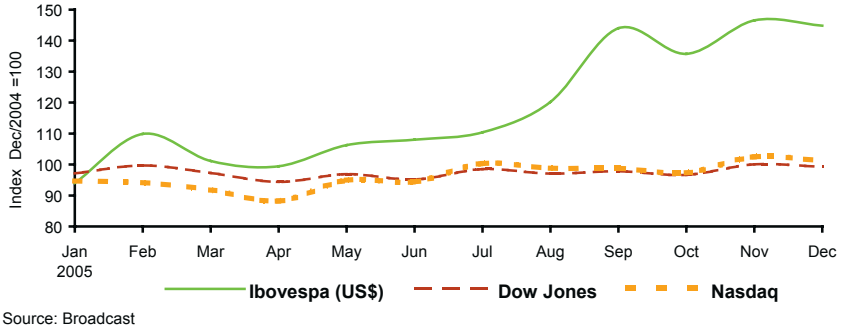
Regarding the secondary market, the São Paulo Stock Exchange Index (Ibovespa) reached 33.5 thousand points in 2005, posting cumulative profitability of 30.1% in the year. In the same context, the volume of trading increased 31.5%, with a daily average of R$1.6 billion. In dollar terms, the São Paulo Stock Exchange (Bovespa) registered profitability of 44.8% per year, well above the 1.2% Nasdaq result and the 0.8% Dow Jones decline registered in American stock exchanges.

Graph 3.6
Ibovespa



Source: Broadcast

Graph 3.7
Ibovespa x Dow Jones x Nasdaq

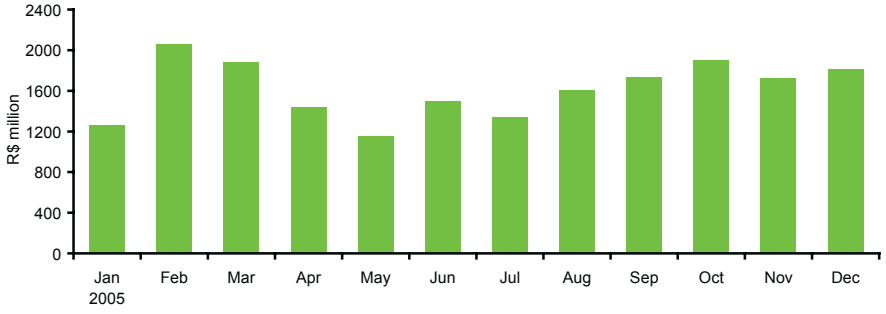


Source: Broadcast

To a great extent, 2005 market performance was driven by consolidation of macroeconomic fundamentals and diversification strategies adopted by investors. However, it is important to stress that, as of September, the process of monetary policy easing reinforced investor expectations regarding evolution of the Brazilian economy. In this scenario, Ibovespa rose to record levels on 22 different occasions during the year, peaking at 33.6 thousand points on December 14.

External stock market investments were powered by increased international investor confidence in the solidity of the Brazilian economy. Among the factors underlying this confidence were announcement of price indices converging toward the inflation target and anticipated payment of the nation's debt with the International Monetary Fund (IMF). The volume of net Bovespa acquisitions by these investors totaled R$5.9 billion in 2005, compared to R$1.8 billion in the previous year.

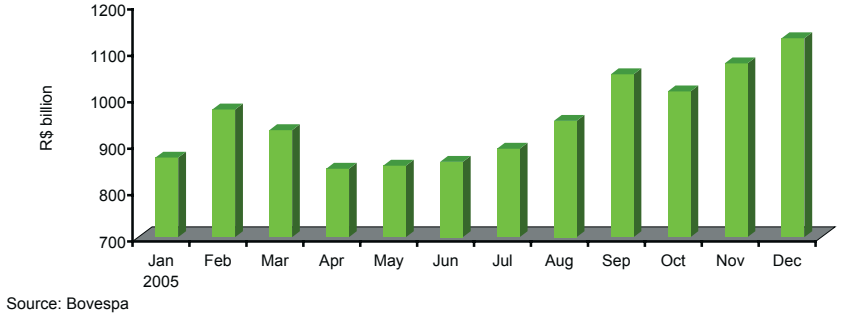
Graph 3.8
Traded average daily volume in Bovespa



Source: Bovespa

With the positive stock exchange performance, the market value of companies listed at Bovespa reached R$1.1 trillion in December 2005, up 24.7% over the December 2004 value. With regard to special trading segments that attribute value to good corporate governance practices, the market repeated 2004 performance, as eight companies opened their capital on the New Market, at the same time in which another eight migrated to

Graph 3.9
Market value
Open capital companies – Bovespa



Source: Bovespa

that segment. Consequently, in December 2005, 65 companies - representing 47.8% of market capitalization and 42.2% of trading volume - were listed in special trading segments, with 37 at Level 1, 10 at Level 2 and 18 in the New Market.

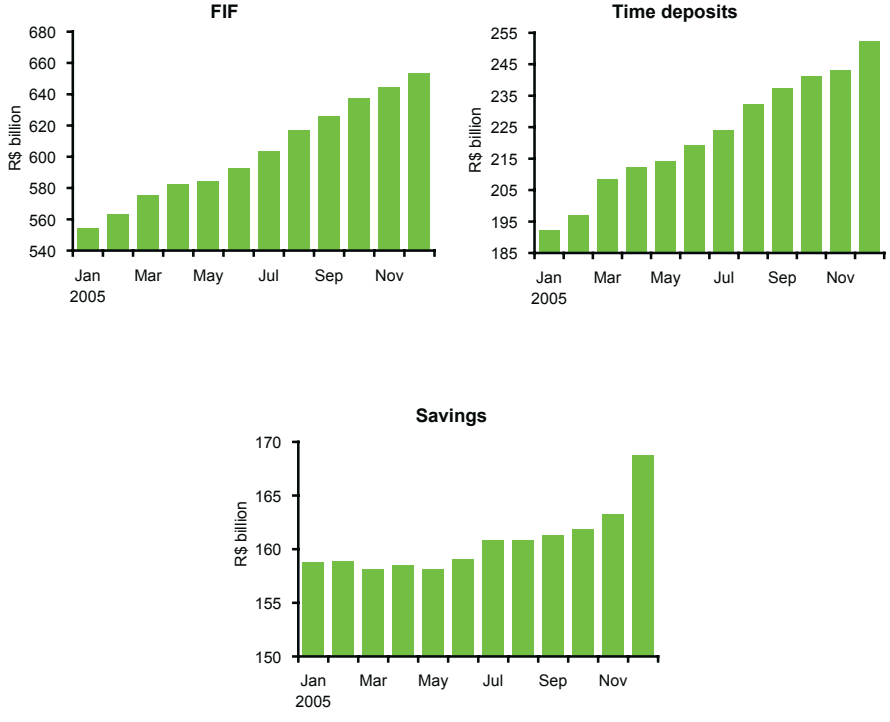
Financial investments

The balance of financial investments, including investment funds, Bank Deposit Certificate (CDB) outside fund portfolios and savings accounts, added up to R$1.1 trillion in December 2005, up 19.5% in the year.

At the close of 2005, the consolidated net worth of investment funds reached R$734 billion, for annual growth of 20.6%. Of this total, R$653.7 billion reflected exchange funds, referenced funds, multimarket, short-term and fixed income funds. The remainder, encompassing stock funds and extramarket funds, totaled R$59.9 billion and R$20.4 billion, respectively.

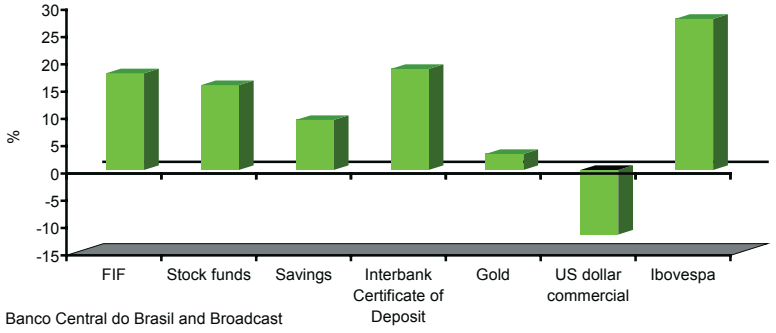
Over the course of 2005, performance of the investment fund market reflected rechanneling of investments into fixed income operations, which climbed to 54.5% of total worth in December, against 52.7% in April. Consequently, the relative participation of multimarket funds and short-term funds dropped to 20% and 2.9%, respectively.

Graph 3.10
Financial investments – Balances



In the same way, referenced funds and exchange funds declined to 22.2% and 0.3%, in that order.

Graph 3.11
Nominal income of major financial investments – 2005



Source: Banco Central do Brasil and Broadcast

Impacted by the Selic rate decline, the participation of preset public securities in the composition of investment fund portfolios increased from 20.7% in December 2004 to 32.3% at the end of 2005. In contrast, the participation of Selic-indexed papers dropped from 63.7% to 53.4%, while the share held by exchange-indexed securities slipped from 1.9% to 1%. The participation of price-indexed securities remained relatively stable at 13.3% of total resources.

Another point that deserves mention is reclassification of the former Financial Investment Funds (FIF) and Stock and Security Investment Funds (FITVM) into new categories instituted by CVM Instruction 409, dated 8.18.2004, and defined according to the composition of each portfolio. With this measure, the 2,463 FIF funds and 430 FITVM funds that existed in January 2005 plunged to April totals of just 99 FIF and 10 FITVM still to be reclassified into the modalities created by that Instruction.

The net worth of stock investment funds and Mutual Privatization Funds – Employment Compensation Fund (FMP-FGTS) and Mutual Privatization Fund – Employment Compensation Fund – Free Portfolio (FMP-FGTS-CL), which invest FGTS resources, closed December 2005 at R$51 billion and R$8.9 billion, respectively, for annual growth of 19.5% and 30.1%, in that order. In line with the upward Ibovespa movement, the increase in mutual privatization funds was generated by 57.5% growth in the value of Petrobras stock. These funds registered net redemptions of R$723 million, while stock funds generated net inflows of R$679 million.

Net inflows of extramarket funds reached R$898 million in 2005, reflecting 18.7% growth in the year. Resolution 3,267, dated 3.10.2005, retargeted the investments of these funds. According to this instrument, 75% of their portfolios should be composed of National Treasury securities, acquired outright without resale commitments. The remainder of the resources can be invested in CDBs issued by the Banco do Brasil

conglomerate, in repo operations or derivatives. The latter operations are restricted to exclusive funds, as defined in Resolution 3,284, dated 5.25.2005.

Table 3.1 – Nominal income of financial investment – 2005

%

Itemization	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	2005	Memo: 2004
FIF	1.20	1.13	1.43	1.38	1.38	1.38	1.35	1.43	1.38	1.31	1.44	1.64	17.73	15.82
Stock funds	-3.12	8.66	-8.84	-3.93	1.44	-0.03	3.28	4.83	6.90	-2.82	4.89	5.90	16.81	17.14
Savings	0.69	0.60	0.76	0.70	0.75	0.80	0.76	0.85	0.77	0.71	0.69	0.73	9.18	8.10
CDB	1.36	1.20	1.49	1.37	1.45	1.54	1.47	1.63	1.47	1.38	1.35	1.42	18.53	15.49
Gold	-5.07	2.53	1.10	-4.34	-7.65	1.53	0.00	-0.30	2.27	-0.44	4.76	9.66	2.93	-2.85
US dollar commercial	-1.12	-1.14	2.74	-5.06	-5.04	-2.22	1.71	-1.12	-5.99	1.44	-2.10	6.06	-11.82	-8.13
Ibovespa	-7.05	15.56	-5.43	-6.64	1.47	-0.62	3.96	7.69	12.62	-4.40	5.71	4.82	27.71	17.81

Source: Banco Central do Brasil, CVM, Bovespa and BM&F

The net balance of investments in time deposits increased 34.1% in the year, reaching R$252.3 billion, compared to R$188.1 billion in 2004. In the same period of time, net inflows totaled R$26.7 billion, keeping pace with growth in bank credits, since CDBs are an important source of funding for financial institutions.

Based on Resolution 3,272, dated 3.24.2005, the CMN defined the obligation to register securities issued by financial institutions and other institutions authorized to operate by BCB or that have their acceptance or guarantee. The aim in this case is to improve monitoring of the liquidity conditions of financial institutions. These registrations are to be concentrated in systems of registration and financial settlement, clearly stating the maturities and anticipated redemption values of the papers involved. It should be stressed that most of these papers consist of CDBs. Circular 3,282, dated 4.28.2005, set the period for registration of these operations at three business days and exempted operations in amounts of less than R$50 thousand from the registration obligation.

In 2005, the stock of savings accounts reached R$168.7 billion, for annual growth of 6.6%, while net redemptions closed at R$2.7 billion. The cumulative profitability of savings accounts with anniversary on the first business day of each month totaled 9.2% in the year, well below average earnings on other investments.