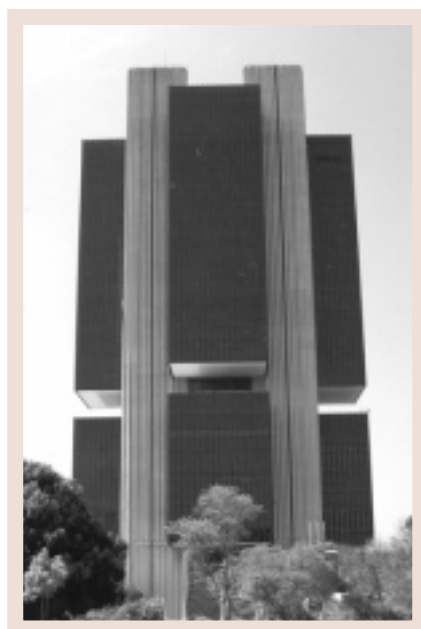


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I

## THE BRAZILIAN ECONOMY

### Foreword

In 1997, Brazilian economic policy implementation was, for the most part, dominated by the need to cope with the repercussions of the financial turbulence that exploded in Southeast Asian markets. However, despite the constraints imposed by changes in the international scenario, the level of economic activity closed the year on a positive note. Gross domestic product (GDP) growth of 3% was leveraged by industrial production, particularly in the sectors of capital goods and intermediate goods, while output of consumer goods – the locomotive of economic growth in the early years of the Real Plan – began losing steam. Investment level indicators reinforce this conclusion, registering expansion of 8.2% and 31.3% in production of inputs for the construction industry and imports of capital goods, respectively.

Notwithstanding occasional peaks in farm prices and the process of restructuring public sector tariffs, inflation continued on a downward trajectory in 1997, demonstrating that the policy of purging indexing from the Brazilian economy has clearly reached maturity. Aside from this, when viewed over a twelve month horizon, the prices of tradables and nontradables are evidently converging, mostly as a result of the decline in the expansion of the latter grouping.

Basic interest rates continued downward in the first quarter of 1997 and, as if sensing rising instability on the international scenario, leveled off and remained stable from April to October. With the flare-up of the Asian crisis toward the end of October, pressures on the exchange market began eroding the nation's reserves. In response to this situation, interest rates were raised in order to make it more costly to maintain foreign currency positions. At the same time, the adoption of restrictive fiscal measures signaled the country's intention of adjusting public sector accounts. Parallel to these measures, Banco Central issued measures aimed at stimulating foreign resources inflows. This was done by reducing the minimum average terms for amortization of new loans and renewals and extensions of already existent credit operations. Going beyond these steps, Banco Central increased the supply of papers indexed to exchange and effected definitive sale operations of longer term papers as a means of partially offsetting the drop in banking liquidity

that resulted from net outflows of exchange. These measures had the desired effect of stanching reserve losses, making it possible to recommence cutbacks in basic interest rates as of December 1997, with a sharper reduction of the TBC in relation to the TBAN.

Discount window operations consolidated their position as the major instrument for adjusting financial system liquidity. This is evident in the fact that monetary authority interventions through open market operations became increasingly less frequent, except in the period immediately following the deepening of the Asian crisis. At the same time, one can note a lengthening of the terms of the federal public securities placed on the primary market, a tendency that was partially reversed as of October.

In terms of financial savings, investments in variable income funds expanded sharply in the year, at the same time in which the volume of stock market trading also increased. In this context, one should cite creation of a new long-term savings system designated Individual Programmed Retirement Funds (Fapi), projected to provide workers with additional retirement benefits once they have stopped working. Parallel to this, alterations were introduced into the calculation of the Reference Rate (TR) reduction factor as of November 1997, making calculation of the factor considerably more transparent.

In structural terms, in comparison to the fragile financial systems of Asia, the Brazilian system clearly demonstrated its resilience in the midst of turbulence and was able to reverse international investor expectations more rapidly than many observers had expected. In this context, the national financial system was further strengthened in 1997 through creation of the Program of Incentives to Reductions in State-level Participation in Banking Activities (Proes), which is designed to foster restructuring of state-level public sector banks in the framework of the State Fiscal Adjustment and Financial Restructuring Program (Parafe). Aside from these items, the year was also marked by the first privatizations of state banks. In terms of prudential measures, particular emphasis should be given to creation of the Credit Risk Analysis Center, an entity projected to improve risk evaluation and classification in credit operations, while also implementing new measures rooted in the Basel Accord. Finally, the year was also marked by frequent mergers and acquisitions and the growing presence of foreign banking institutions. The major benefit to be drawn from this process should be enhanced efficiency.

In 1997, the National Privatization Program (PND) attained its objectives of reducing the public debt and stimulating the foreign investment inflows needed to restructure Brazil's productive system. Among the most significant steps taken in this direction, one should cite transfer of the Companhia Vale do Rio Doce to the private sector, together with the concession of mobile cell telephone services

(B Band) in four geographic areas and the concessions involving the Northeast Rail Network, the Federal Rail Network and the Port of Santos container terminal (Tecon I). One should underscore the fact that most privatization operations were effected at a significant premium in relation to minimum auction prices. Other factors that contributed to modernization of the nation's productive infrastructure were approval of enabling legislation on the constitutional amendments that ended the system of market reserve in inland waterways and took a more flexible approach to the state petroleum and telecommunications monopolies. Here, one of the high points was creation of the National Telecommunications Agency (Anatel).

At the state level, revenues on privatization accounted for 59% of total National Privatization Program income. The cause of this process was intensification of privatizations and sales of minority holdings in the electric and financial sectors. In relation to state government debts, special credits totaling R\$ 103.3 billion were set aside in the 1997 budget as a result of agreements formalized with various states under the terms of Proes and Parafe. Among these, particular mention should be made of the agreement between the federal government and the State of São Paulo for the purpose of refinancing the state debt and restructuring its financial system. The Federal Senate granted authorization for refinancing the debts of the States of Bahia and Ceará.

In 1997, the major infraconstitutional measures taken to finance the public sector were levying of the Provisional Contribution on Financial Transactions (CPMF) and extension of the Economic Stabilization Fund. At the same time, progress was achieved in efforts to approve needed structural reforms. In this sense, even though the Social Security Reform made its way through the two houses of Congress, the year came to a close without definitive approval of this important measure. However, one factor that contributed significantly to discussions on the need for structural reforms as the only instrument capable of truly adjusting public sector accounts was issue of the fiscal and monetary measures taken by the federal government in November to cope with the rapidly deteriorating Asian situation.

The current account result came to a deficit of 4.16% of GDP, reflecting the trade and service account results. However, on the other hand, inflows of long-term funding aided greatly in improving the level and quality of the financing of the current account deficit. In this sense, one should highlight strong growth in net direct foreign investments, emphasizing that just one third of these funds were channeled into privatization programs.

The fundamental guideline of 1997 exchange policy was preservation of the mechanism of gradual exchange rate devaluations. Banco Central defined the new exchange band parameters in February and sponsored spread auctions that resulted

in an average exchange devaluation of 0.6% per month during the course of the year.

Despite the US\$ 8.4 billion 1997 trade deficit, a number of positive points should be stressed with regard to Brazil's foreign trade profile. Among these, the most important is the upturn in export growth, moving in precisely the opposite direction of imports. The favorable performance of exports was a consequence of increased volume in a scenario of rising international prices. The major factors in this process were increased sales of farm products and the greater dynamism of manufactured goods of high aggregate value.

Insofar as imports are concerned, in structural terms, the downward slide in total imports has resulted from the increased pace of activities in economic sectors that have little demand for imported inputs, as well as from the effects of government measures taken to eliminate the tax and financial distortions that tended to give a competitive edge to foreign-made products. With respect to the composition of imports, the capital goods sector continues as the major product category and reflects the ongoing process of modernization and expansion of the nation's industrial structure that has further intensified with attainment of economic stabilization and implementation of the National Privatization Program.

Significant advances have also been obtained in terms of foreign trade policy with extension of the Integrated Foreign Trade System (Siscomex) to import operations and creation of the Export Guaranty Fund, designed to extend insurance coverage to export credits.

In terms of the service account, growth in net 1997 outflows resulted from increased remittances of profits and dividends. Expenditures on credit cards – the most representative component under the heading of international travel – declined as of the third quarter of the year as a result of measures taken to restrict installment payments of expenditures made abroad.

The strong upward movement in 1997 amortizations, coupled with the turnaround in the net flow of short-term capital in the fourth quarter of the year, particularly in the case of portfolio investments, generated a reduction in net foreign capital inflows in comparison to 1996. At the end of the year, net outflows of capital market resources were the result of profit-taking to meet losses incurred in other markets, at the same time in which international and domestic investors sought to redefine their portfolio profiles.

Following the opposite track, inflows of financial loans expanded sharply in 1997. Among these operations, the most important were issues of notes and 30 year Global Bonds in exchange for Brady Bonds (also exchanged for internal debt

securities). The result of all this was a highly favorable restructuring of the foreign debt. Medium and long-term import financing also contributed importantly to this result.

In this framework, important conclusions were drawn in 1997 with respect to the evolution of the Brazilian economy. Viewed under the prism of a complex and turbulent international situation, the level of economic activity revealed considerable vigor. This is evident in the fact that 0.2% per year average GDP growth between 1990 and 1993 rose to 4% following implementation of the Real Plan. This achievement is even more significant when viewed in a context of consistent downward movement in the pace of inflation.

The loss of reserves at the end of the year stands as an alert to the volatility of certain categories of foreign capital and is a powerful reminder of the need for maintaining strong macroeconomic foundations as the basic instruments required to cope with foreign shocks. As the Asian crisis heightened in intensity, the effectiveness of the measures adopted by the monetary authority clearly suggests that these foundations have reached a level of relative consistency in Brazil. The best evidence of this is the turnaround achieved not only in capital flows but, even more importantly, in the expectations of economic agents as to the dimensions of the impact of the Asian crisis on the Brazilian economy. However, the other side of the coin was an unmistakable signal of the importance of approving the structural reforms now before Congress so that it will be possible to achieve a truly effective adjustment of the nation's public accounts. Once this has been attained, the country would be in the position of being able to avoid the possibility of fiscal restrictions potentializing the effects of foreign-generated shocks or inhibiting the degree of economic development required to fully consolidate the stability born of the Real Plan.

### **Production indicators**

In 1997, GDP expanded by 3%. That was the fifth consecutive year of positive growth and demonstrated the continuity of a process of expansion that began in 1993 and was interrupted for a brief period of just a few months in 1995 when it became necessary to adopt a more stringent monetary policy. By the second half of that year, the country was able to adopt a more flexible approach and, consequently, growth picked up once again and continued throughout 1996.

In 1997, economic indicators for the first quarter of the year pointed to continuity of that process. GDP expanded by 0.9% in the seasonally adjusted series, as a consequence of an increased pace of activities in all sectors and particularly under crop and livestock farming (2.7%). In the industrial sector, the increase came to 1.5% while services closed with growth of 0.2%. In comparison to the same period of 1996, growth came to 3.8%, a level easily explained by the more favorable basis of comparison.

In the second quarter, GDP reduced by 0.5% in the seasonally adjusted series. The strongest drop (2.3%) occurred in the primary sector and was caused by a 5.2% falloff in crop production. Industry declined by 0.8%, while the sector of services remained stable.

An analysis of the results of the first half of the year indicates growth of 3.9% in relation to the same 1996 period. This expansion was concentrated in the industrial sector (6.9%), particularly construction and mineral extraction, which expanded by 8.4%. Manufacturing grew by 6.3% in the period. Important changes occurred in the composition of this growth, as the categories of capital goods and intermediate goods dethroned durable consumer goods as performance leaders.

In the first three years of Real Plan implementation (July 1994 to July 1997), GDP accumulated growth of 12.4%, based on the series of quarterly indices, with an average annual rate of 4%. In sectoral terms, accumulated growth closed at 11.9% under crop and livestock farming, 15.6% under industry and 8.9% in the service sector.

**Table 1.1 - Gross Domestic Product (GDP)**

Year	At 1997 prices R\$ million	Real change rate	Implicit deflator (%)	At current prices <sup>1/</sup> US\$ million	Population (million)	Per capita GDP		
						At 1997 prices R\$	Real change rate	At current prices <sup>1/</sup> US\$
1980	601 266	9.2	92.1	237 772	118.6	5 071	7.0	2 005
1981	575 712	-4.3	100.5	258 553	121.2	4 750	-6.3	2 133
1982	580 490	0.8	101.0	271 252	123.9	4 686	-1.3	2 190
1983	563 482	-2.9	131.5	189 459	126.6	4 452	-5.0	1 497
1984	593 910	5.4	201.7	189 744	129.3	4 594	3.2	1 468
1985	640 526	7.8	248.5	211 092	132.0	4 853	5.6	1 599
1986	688 501	7.5	149.2	257 812	134.7	5 113	5.4	1 915
1987	712 805	3.5	206.2	282 357	137.3	5 193	1.6	2 057
1988	712 378	-0.1	628.0	305 707	139.8	5 095	-1.9	2 186
1989	734 889	3.2	1 304.4	415 916	142.3	5 164	1.4	2 923
1990	702 921	-4.3	2 737.0	469 318	144.1	4 878	-5.5	3 257
1991	710 161	1.0	416.7	405 679	146.4	4 851	-0.6	2 771
1992	706 326	-0.5	969.0	387 295	148.7	4 751	-2.1	2 605
1993	741 078	4.9	1 996.2	429 685	150.9	4 910	3.4	2 847
1994	784 431	5.9	2 240.2	543 087	153.1	5 122	4.3	3 546
1995	817 534	4.2	77.6	705 449	155.3	5 264	2.8	4 542
1996	840 098	2.8	17.3	775 409	157.5	5 335	1.4	4 924
1997	865 552 <sup>2/</sup>	3.0	7.9 <sup>2/</sup>	802 999	159.9	5 414 <sup>2/</sup>	1.5	5 022

Source: IBGE

<sup>1/</sup> Estimates obtained dividing the GDP at current prices by the annual average rate of exchange.

<sup>2/</sup> Banco Central do Brasil estimates.

In the third quarter of 1997, GDP expanded once again (1.1% in the seasonally adjusted series). Growth in the level of activity was mostly a consequence of industrial performance (2.4%), while services expanded by 0.5%. Crop and livestock output dropped by 2.9%, with downward movement of 3.1% under crops and 1.2% under livestock.

GDP continued expanding in the fourth quarter, albeit with lesser intensity (0.5% in the seasonally adjusted series). The dropoff in the level of activity was caused mostly by exhaustion of the credit supply and high levels of default which followed the end-of-October interest rate hike aimed at neutralizing the impact of the Asian crisis. This fact, coupled with measures in the fiscal arena (increase in the tax on income, industrialized products and imports), provoked a drop in available income and made access to credit more difficult. The repercussions of these events were felt most strongly in the subsectors of commerce and manufacturing, both of which turned in sharp drops in the final two months of the year. The positive GDP result was caused by growth in the subsectors of animal production (5%), public utility industrial services (3.2%), transports (7.5%) and public administration (0.3%).

**Table 1.2 - GDP real annual growth rates(%)**

Itemization	1995	1996	1997
GDP	4.2	2.8	3.0
Agricultural and livestock sector	4.1	4.1	1.2
Vegetable production	0.1	2.8	2.8
Animal production	13.2	7.1	- 2.5
Industrial sector	1.9	3.7	5.5
Mineral extraction	3.7	6.7	7.3
Manufacturing	2.0	2.8	4.1
Building	- 0.4	5.2	8.5
Public utility industrial services	7.6	6.1	6.2
Service sector	4.5	1.9	1.3
Commerce	8.5	2.4	1.3
Transportation	6.6	3.2	4.5
Communications	22.9	10.9	0.6
Public administration	0.8	0.2	1.3
Other services	4.1	2.3	0.4

Source: IBGE

Analysis of GDP growth in the year shows that the 3% increase was generated mostly by the industrial sector (5.5%), while the sectors of services and crop and livestock farming turned in below average results (1.3% and 1.2%, respectively). The industrial sector registered across-the-board positive results, with the strongest performances under construction (8.5%) and mineral extraction (7.3%). This positive trajectory was also favored by a significant increase in the volume of funding channeled to this segment by BNDES (88% in 1996 and 380% in 1997). The manufacturing industry, which accounts for the major share of the sector's output, expanded by 4.1% (2.8% in 1996), while public utility industrial services grew by 6.2%. Growth under crop farming (2.8%) reflected the recovery of income levels in the agricultural sector, as a result of both improved prices for the major products and consolidation of the process of debt securitization.

Growth in the sector of services was explained mostly by the performance of transports, a segment that was positively impacted by the grain harvest. Commerce expanded by 1.3%, with deceleration in comparison to the strong rates of growth registered since 1993.

With 1997 GDP performance, average growth in the 1990s moved from 1.9% up to 1996 to 2.1% at the end of 1997. Per capita GDP expanded by 1.5% in the year with the average rate moving from 0.5% to 0.6% on the same basis of comparison.

### **Investments**

Methodological changes adopted by IBGE for elaboration of National Accounts sharply altered the information available on investments in the 1990s. According to the previous system, average growth in gross fixed capital formation, at constant 1980 prices, reached 4.2% in the 1990-95 period. According to the new system, which uses constant values at the previous year's prices, this growth came to 3% in the same period. The new methodology made it possible to calculate variations in stocks, that had been included under consumption as of 1986, together with the participation of the public administration and other activities in outlays on construction and acquisitions of machines and equipment.

IBGE information indicated that, in 1991 and 1992, real growth in gross fixed capital formation was negative (4.7% and 6.6%, respectively). Between 1993 and 1995, there was a sharp turnaround (6.3%, 14.3% and 7.3%, respectively), explained mostly by the opening of the economy and by cutbacks in import tariffs on capital goods in 1993. These effects were also felt in 1996, when gross fixed capital formation closed with positive growth (2.1%).

According to the new system, the relation between gross fixed capital formation and GDP closed 1992 at its lowest point (17%), based on the previous year's prices, and reached its apex in 1995 (21.4%). In 1996, the final figure was 20.4%, as real growth in GDP (2.7%) was higher than that of gross fixed capital formation (2.1%).

Average participation of the public administration in gross capital formation came to 14.5% between 1990 and 1996, as the importance of the public sector lessened during the period in question (18.5% in 1990 and 11.1% in 1996). When one considers such items as gross fixed capital formation, data show a drop in the participation of construction from 65.7% in 1990 to 61.3% in 1996. At the same time, there was a drop in the importance of machines and equipment (34% in 1990 and 25.6% in 1996), with imports assuming an increasingly more important role (10.6% in 1990 and 35% in 1996).

For 1997, Banco Central estimates pointed to growth of 9.3% in gross fixed capital formation. With this result, the participation of gross fixed capital formation in GDP came to 20% at current prices and 20.3% at the previous year's prices. All the different investment indicators pointed to positive results. Production of construction inputs expanded by 8.2% (5.2% in 1996). Following the example of the previous year, the increase in the average cost of construction (3.9%) was below

**Table 1.3 - Gross capital formation (GCF) <sup>1/</sup>**

Percent

Years	Share in GFCF			Change in inventory	GFCF/GDP	
	Building	Machines and equipments	Others		At current prices	Prices at previous year
1990	65.7	34.0	2.7	-2.4	20.7	-
1991	60.4	28.7	2.5	8.4	18.1	19.5
1992	64.8	26.3	6.3	2.7	18.4	17.0
1993	62.5	24.2	5.8	7.5	19.3	18.7
1994	60.6	27.2	5.8	6.3	20.7	20.8
1995	57.4	28.9	5.8	7.8	20.5	21.4
1996	61.3	25.6	5.6	7.5	19.1	20.4
1997 <sup>2/</sup>	66.3	27.6	6.1	...	20.0	20.3

Source: IBGE

<sup>1/</sup> GFC = GFCF + stock variation.

<sup>2/</sup> Banco Central do Brasil estimate.

the average increase in price indices in the period. The sector also benefited from the continued process of public service privatizations/concessions and from growth in financial system loans to the housing sector (+10.5% for the final borrower), backed by an increase of 34.8% in the balance of savings accounts in 1997. One should also stress the increase in operations involving the system of credit securitization in the real estate sector, which raised the production capacity of companies by making available greater volumes of working capital.

In the segment of machines and equipment, growth was registered under internal production (4.7%) and imports (31.3%) and exports (17.2%). The favorable performance of imports is partially explained by the level of international interest rates, as well as by the availability of financial resources. With recovery in farm income, growth in the production of farm machines came to 42.6%, following a 21.3% decline in 1996. Special mention should be made of the expansion registered under the building and mineral extraction industries.

Abimaq/Sindimaq information on mechanical capital goods points to a drop of 0.7% in 1997, following a reduction of 13.1% in 1996. The average level of utilization of installed capacity increased from 68.3% in the previous year to 68.7% in 1997. A breakdown by subsectors shows differentiated results, with growth under machine tools (28.7%), farm machines (18.3%) and heavy mechanics (1.9%). Negative results were registered under production of printing equipment (43.9%), machines for plastics (21.9%) and textile machinery (5.3%).

In 1997, consultations and disbursements on the part of the BNDES System, composed of BNDES, Finame and BNDESpar totaled US\$ 37.1 billion and US\$ 16.5 billion, respectively, with growth of 64% and 71% in relation to 1996. BNDES resources accounted for 70% of total disbursements, followed by Finame with 20.3% and BNDESpar with 9.7%. In a manner similar to 1996, an analysis of disbursements to the productive sector shows that the strongest growth (380%) was registered by resources channeled to the extractive industry, followed by commerce and services (97%). The inflow of resources to the crop and livestock sector expanded by 77% while the flow to manufacturing came to 32%.

The distribution of resources by region registered practically no change for the north and northeast of the country (2% and 13.5% in 1997, as against 2.1% and 13.7% in 1996, respectively). Participation of the southeast and central-west regions expanded from 54% to 56.1% and from 5.4% to 8.3%, respectively, while the participation of the southern region in these disbursements fell from 24.8% in 1996 to 20.1%.

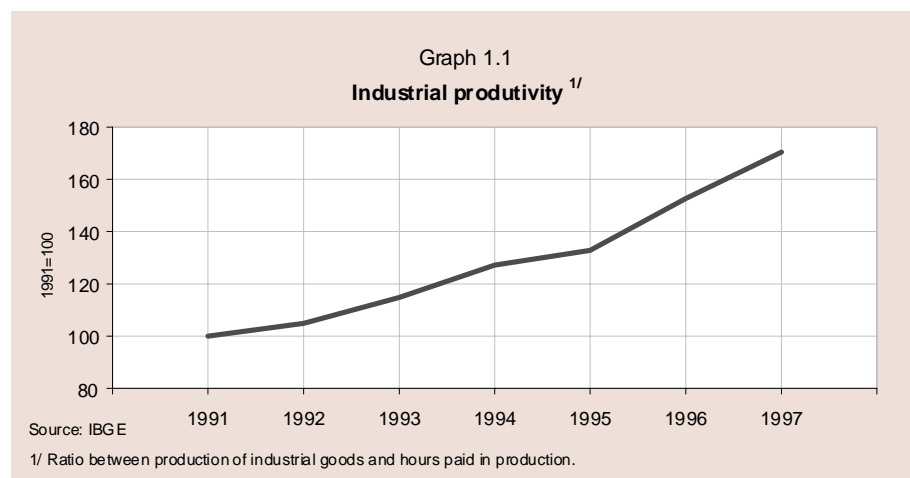
## Productivity

The positive growth of investment indicators – principally for capital goods production and imports – has been accompanied by sharp gains in productivity over recent years. This behavior reflects the restructuring of productive segments, at both the technical and managerial levels, together with the process of economic deregulation. Productivity gains have contributed to economic stabilization, by reducing costs and prices. However, on the downside, they have also generated layoffs, particularly in the manufacturing industry.

Based on the ratio between growth in aggregate value, at the previous year's prices, and growth in the employed population, IBGE estimated labor productivity for the 1991-96 period. According to this calculation, with the exception of 1992, positive growth occurred in the total productivity of labor, as average growth for the period closed at 2.5%. The sharpest increase occurred in 1996 (5.2%), as four of the 43 activities surveyed registered gains of more than 20% and 11 turned in results between 10% and 20%. In relation to the average for the period, growth came to more than 10% in eight activities.

The following activities closed the period at an above average level: crop and livestock farming (4.5%) and several industrial segments, particularly steel (11.7%), electric equipment (10.7%), electronic equipment (13.3%), automobiles, trucks and buses (14.2%), other vehicles, parts and accessories (10.1%) and public utility industrial services (11%). In the case of services, the most important result was achieved under communications (14%).

According to information available for the industrial segment, productivity expanded sharply in 1997. Productivity is estimated as the quotient between industrial production and hours paid in production. Increases of 11% were registered under



general industry, 10.8% under the extraction industry and 10.7% under manufacturing. When one considers the different industrial segments, nine of them registered productivity gains above 10%. Only furniture closed the period with a decline (-2.4%).

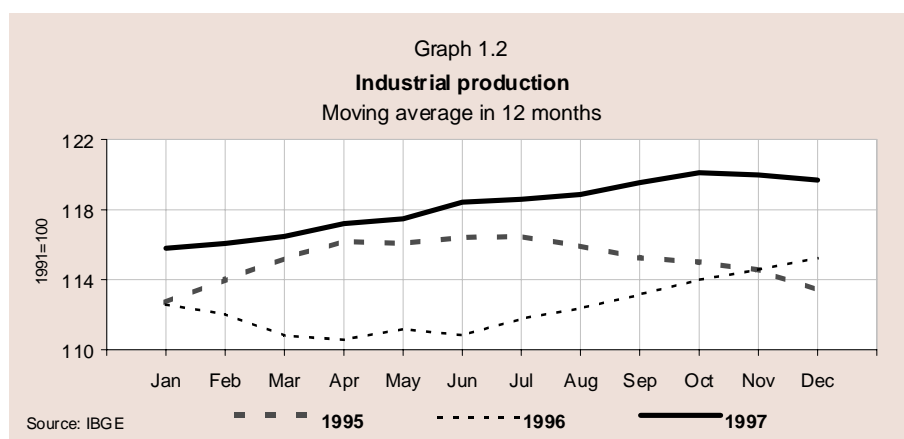
Confirming the efforts made to increase competitiveness, 892 new certificates were issued by the NBR ISO 9000 quality system in 1997, as compared to 636 in the previous year. The majority of these certificates were concentrated in the manufacturing industry.

### Industrial production indicators

According to the monthly IBGE industrial survey, industrial production expanded by 3.9% in 1997. This was the fifth consecutive year of growth and raised accumulated expansion to 24.5% since 1993. The result for the year surpassed accumulated growth of 3.5% in the 1995-96 period and was mostly a consequence of the performance of manufacturing (+3.6%), which accounts for 93% of general industry. At the same time, the mineral extraction sector expanded by 7.3%, principally as a result of growth under crude oil.

Notwithstanding the positive growth registered under manufacturing activity in 1997, the level of utilization of installed capacity measured quarterly by the Getúlio Vargas Foundation moved from 81% in January 1997 to 80% in January 1998. To some extent, this reduction was due to the decline in industrial production in the final two months of the year.

In the first quarter of 1997, industrial production (mineral extraction and manufacturing) registered a decline of 0.9% in relation to the final quarter of 1996, without taking seasonal factors into account. To some extent, this performance



**Table 1.4 - Capacity utilization** <sup>1/</sup>

Percent			
Itemization	1995	1996	1997
Manufacturing industry	79	81	80
Consumer goods	84	84	77
Capital goods	64	72	65
Building material	83	80	83
Other intermediate goods	83	84	84

Source: FGV

1/ Quarterly survey. January figures of the following year.

reflected the high level of stocks in the industry that resulted from the negative performance of the retail trade sector at the end of 1996. In the second and third quarters of the year, the level of activity in the sector improved and registered respective growth levels of 2.7% and 1.2% in comparison to the immediately previous quarters. In the final quarter of the year, the fiscal and monetary measures implemented to ward off the effects of the Asian financial crisis generated an economic downturn and, consequently, a falloff in the activity level of the sector (2.8%).

A survey of the different industrial segments indicates that 1997 registered growth of as much as 22.2% in the segment of tobacco, in contrast to a drop of 6.8% under apparel, footwear and cloth goods. In the latter case, this was the fourth consecutive year of negative growth. Of the twenty industrial segments included in the survey, fourteen turned in positive results. In order of magnitude, these were as follows: tobacco, as mentioned above, followed by pharmaceutical products (11.2%), transportation equipment (9.8%), mechanics (7.3%), metallurgical products (5.8%) and chemicals (5.5%). Among those that closed with negative growth, the most important were textiles (5.5%), with declines in the last three years, electric and communications equipment (2.4%) and leather and hides (1.7%).

A breakdown by categories of usage shows that production of capital goods turned in the best performance in 1997 (4.7%), following three consecutive years in which durable consumer goods occupied the position of leadership. In the year in question, production of these goods (2.9%) fell below the average for industry as a whole. The segment of intermediate goods (4.6%) also turned in an above average performance, as output of semidurable and nondurable consumer goods closed with the lowest rates of growth (0.7%).

As of the second half of 1997, there was an evident change in the industrial growth profile. The sectors of capital goods and intermediate goods benefited from

<b>Table 1.5 - Industrial production</b>				
Percent change				
Itemization	Percentage share (1997)	1994	1995	1996
Total		1.8	1.7	3.9
By category of use				
Capital goods	7.5	0.3	- 14.1	4.7
Intermediate goods	64.0	0.2	2.9	4.6
Consumer goods	28.5	6.2	5.3	1.2
Durable	5.2	14.5	11.2	2.9
Nondurable	23.3	4.2	3.7	0.7

Source: Monthly Industrial Survey - IBGE

increased investments in farm machines and inputs, as well as from more intense activity in the construction sector, which stimulated production of equipment and inputs for this area of activity. The positive performance of the mineral extraction industry (particularly, petroleum) and chemicals (petroleum derivatives) was also reflected in the production of intermediate goods.

There was a clear loss of momentum in the production of durable consumer goods. The factors that explain this performance were deceleration in real wage and salary gains, the lesser impact of price reductions and easier access to financing. The area most strongly impacted was that of electric-electronic appliances, with a drop of 10.7% in industrial sales. According to Eletros data, the sharpest falloff occurred in the segment of "image and sound" (13.6%). In the case of the automotive industry, the final months of the year were marked by deceleration, a process caused mostly by interest rate hikes. Despite this process, the sector accumulated growth of 14.6% in 1997, based on Anfavea figures. Production of semidurable and nondurable consumer goods was impacted mostly by the drop in the production of footwear and clothing, offsetting the positive impacts generated by such items as foodstuffs and beverages, pharmaceutical products and fuels.

## Energy

National petroleum production, including natural gas liquid (NGL), came to a daily average of 866 thousand barrels in 1997, or 7.8% more than in the previous year. The quantity of petroleum processed moved from 76.8 to 79.9 million cubic meters, while refining capacity increased from 89.6 million to 98.1 million cubic meters. Imports of crude oil closed at the same level as in 1996 (181 million barrels), while

**Table 1.6 - Oil derivatives and fuel alcohol**

Apparent consumption - daily average (1,000 b/d)

Itemization	1995	1996	1997
Petroleum	1 454	1 552	1 677
Fuel oil	211	229	246
Gasoline	242	283	309
Diesel oil	518	535	564
Liquid gas	181	191	198
Aviation kerosene	63	67	73
Other derivatives	239	247	287
Fuel alcohol	225	220	210
Anhydrous	58	64	67
Hydrated	167	156	143

Source: Petrobras

foreign purchases of derivatives (145 million barrels) expanded by 12.2%. Investments in oil prospecting and production in Brazil totaled US\$ 1.8 billion, as against US\$ 1.7 billion in the previous year.

With 7,058 productive wells in operation (6,299 on land and 759 at sea), Petrobras has obtained its best result in the Campos Basin (RJ), which now accounts for about 80% of national petroleum output. The volume of proven reserves has expanded sharply (47.9%) to a level of 7.1 billion barrels at the end of 1997, based on the methodology of the *Society of Petroleum Engineers* (SPE), used by Petrobras. Natural gas reserves came to 227 billion cubic meters, 43.9% more than in 1996.

Apparent consumption of petroleum derivatives increased by 8%, reaching a daily average of 1,677 thousand barrels. Among the major derivatives, diesel oil accounted for 33.6% of international demand, with growth of 5.4%. Daily consumption of gasoline and fuel oils, the second and third most important products in the demand structure, increased from 283 to 309 thousand barrels and from 229 to 246 thousand barrels, respectively. Consumption of fuel alcohol dropped for the second consecutive year (225 thousand in 1995, 220 thousand in 1996 and 210 thousand barrels per day in 1997). This result was due to lesser consumption of hydrated alcohol (-8.3%), a falloff explained partly by a sharp drop in the production of alcohol-powered vehicles in recent years. Consumption of anhydrous alcohol, which is added to gasoline in a proportion of 22%, expanded by 4.7% in 1997.

The country's consumption of electrical energy increased by 6.5% in 1997 and, according to Eletrobrás figures, totaled 274,272 GWh. The commercial category led in terms of consumption growth during the year, with an increase of 9.8%,

**Table 1.7 - Electric energy consumption <sup>1/</sup>**

GWh

Itemization	1995	1996	1997
Total	243 129	257 631	274 272
By sectors			
Commercial	32 285	34 767	38 191
Residential	63 581	69 047	74 104
Industrial	111 708	116 516	122 245
Other	35 555	37 301	39 732

Source: Eletrobrás

<sup>1/</sup> Self-producers not included.

followed by residential consumption (7.3%). Industrial consumption of electrical energy accounted for about 45% of the market and expanded by 4.9% in 1997.

According to Eletrobrás, the strong growth in commercial consumption can be explained by the performance of the retail trade sector and lodging and food supply services. In the sector of commerce, the building of new and enormous supermarket facilities, expansion and inauguration of shopping centers and large scale leisure facilities and expanded operating schedules are the factors of greatest importance. In the segment of lodging and food supply, the most important categories have been “business tourism”, principally in the southeast region, and traditional tourism.

Residential consumption of electrical energy expanded by 7.3%, principally as a consequence of new residential connections in all parts of the country (approximately 1.4 million), reflecting growth of 4% in relation to the previous year, and of increased average consumption per user, which came to 175 Kwh/month, as compared to 170 Kwh/month in the previous year.

Industrial electrical energy consumption expanded at a higher pace in the southern region (7.1%), where production turned in the sharpest growth (7.1%). This was particularly true in the State of Rio Grande do Sul (9%). In the southeast and northeast regions, industrial consumption of electrical energy increased by 5.9% and 1.9%, respectively, while the northern region closed with a 1.3% decline.

According to data released by the Business Information System of the Electrical Energy Sector (Siese), the installed generating capacity of the nation’s energy plants totaled 59,211 Mw in 1997, representing growth of 1,982 Mw in relation to 1996. Of this total, 53,828 Mw are hydraulic sources and 5,383 Mw are thermal (including 657 Mw

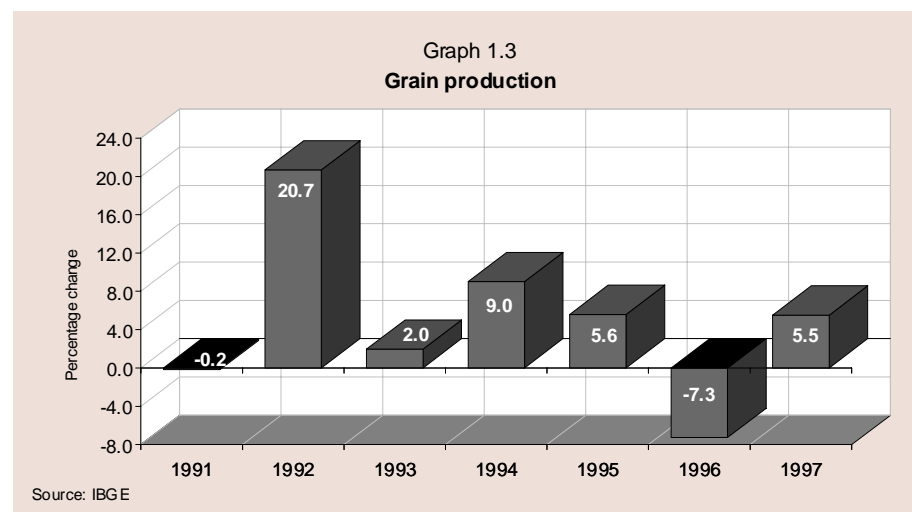
in nuclear generating capacity). Among the major generating units that went into operation, the most important were as follows: Xingó-Chesf (500 Mw), Corumbá I-Furnas (3 units with 125 Mw of output) and Jorge Lacerda C-Eletrosul (363 Mw). Investments in the electrical energy sector totaled R\$ 5.5 billion according to Eletrobrás estimates, with real growth of 3.8%, in comparison to 1996 investments.

### Crop and livestock production indicators

The crop and livestock sector registered growth of 1.2% in 1997, for expansion of 2.8% in crop production and a drop of 2.5% under livestock. In terms of crop performance, one should stress the highly positive results obtained under grains, legumes and oil-bearing crops (5.5%). This result reflecting the incentives generated by price recovery and resolution of farm debts. In the latter case, this was done through a process of securitization which provided producers with access to new current expenditure credits.

The measures taken to provide support to the 1996/97 harvest preserved the benefits and expanded the volume of resources allocated through the National Program for Strengthening Family Agriculture (Pronaf), with the objective of introducing a more dynamic structure into family-based farming, providing these undertakings with the possibility of producing on a modern and competitive basis.

Given the National Treasury's financial limitations and the opening of the economy to foreign competition, the systems used for intervening in farm production and marketing were altered significantly for this harvest. Federal government loans with sale option (EGF/COV) were suspended. This made it unfeasible to utilize the automatic mechanism through which current expenditure loans granted prior to sowing were tied to marketing loans.



By way of alternatives, less burdensome instruments were created, such as the sale option contract in which the buyer party (rural producer or cooperative) interested in avoiding the risk of fluctuations in the price of a specific product pays a premium in public auction in order to guaranty the sale of that product to the government at a floor price up to the final date of the contract. Aside from this, Directive no. 667, issued by the Ministry of Agriculture and Supply on 12.6.96, regulated the product outflow premium which consists of a credit acquired in public auction to be used to purchase stocks belonging to producers or cooperatives at the minimum guarantied floor price. The EGF was also created for agribusiness with the aim of streamlining the marketing of farm products. Based on the floor price as reference and coupled with already existent mechanisms – federal government acquisitions (AGF) and federal government loans without sales option (EGF/SOV) – these instruments preserved the government’s intervention capacity in farm markets at the minimum essential level, while leaving the task of choosing the more convenient alternatives to private agents.

Among the varied measures taken, particular stress should be given to the setting of the floor prices of products covered by the floor price guaranty policy at levels compatible with market conditions. This provision had the objective of fostering growth in the harvest of grain and regional products, particularly when agriculture is at the basis of the process of income formation and job creation. Aside from this, one should note that the floor price guaranty policy is an important price indicator and an essential element in the formation of the bank guaranties required for current expenditure and marketing financing.

Production of grain (grain, legumes and oil-bearing crops) totaled 77.7 million tons, with growth of 5.5% in relation to the past harvest (73.6 million tons), but below the volume produced in the 1994/95 harvest (79.4 million tons). Total area planted increased by 0.3%, with increases in the average yield of all crops, with the sole exception of wheat. The central south region and Rondônia accounted for 89% of production, with growth of 6.7%, while the north and northeast regions suffered a drop of 3.7%. In absolute terms, total production was distributed as follows: 36.4 million tons in the southern region, 20 million in the central-west, 12.6 million in the southeast, 6.5 million in the northeast and 2.2 million in the north.

The two corn harvests came to 34.6 million tons, with growth of 7.5%. Adequate climatic conditions contributed to the results of the first harvest (30.5 million tons), closing with production growth of 7.4%, despite the 3.5% decline in area planted. The good average yield was due to introduction of improved technologies in terms of soil management and expansion of the practice of direct sowing, coupled with the use of greater volumes of fertilizers. The second harvest produced a volume that was 8.1% higher than in 1996, even though area planted expanded by 19.7%.

**Table 1.8 - Agricultural production - major crops**

Millions of tons

Products	1995	1996	1997
Grain production	79.4	73.6	77.7
Cotton (seed)	1.0	0.7	0.6
Rice (in husk)	11.2	10.0	9.3
Beans	2.9	2.8	3.0
Corn	36.3	32.2	34.6
Soybeans	25.6	23.6	26.5
Wheat	1.5	3.4	2.4
Others	0.9	0.9	1.3
Other crops			
Bananas (millions of bunches)	568.0	561.9	577.9
White potatoes	2.7	2.7	2.8
Cocoa (beans)	0.3	0.3	0.3
Coffee (beans)	1.8	2.7	2.3
Sugarcane	303.6	325.9	336.6
Tobacco (in leaf)	0.5	0.5	0.6
Oranges (millions of fruits)	98.1	109.3	115.0
Cassava	25.3	24.6	24.4
Tomatoes	2.7	2.7	2.6
Change in real output of crop sector (%)	0.1	2.8	2.8

Source: IBGE

The positive performance registered in the central-west region was partly offset by lesser production in São Paulo and Paraná where the drought that started in March caused serious crop damage. Internal consumption, which totals about 37 million tons, with about 80% being used in the manufacture of feed, was completed through the use of 4.3 million tons in stocks left over from 1996. The marketing of corn was a rather drawn out process since the prices received by producers remained in the range of the floor price during most of the year. This situation has only changed in recent months as prices have begun recovering.

Production of 26.5 million tons of soybeans surpassed the former record production level of 25.6 million tons in 1995 and was 12.3% higher than the 1996 harvest. The area planted expanded by 7.6%, while productivity came to 2,298 Kg/ha, with growth of 4.7%. Soybean production benefited from favorable prices and, consequently, expanded. This performance was caused by statistical information released at the start of the year by the United States Department of Agriculture (USDA), indicating a drop in that country's harvest.

Soybean production was not larger due to the excess rains that occurred in Paraná and the drought that hit Rio Grande do Sul. In the other production regions, favorable climatic conditions benefited development of the crop. Particular mention should be made of the high technology now being used in the central-west region of the country, the nation's second largest producer. The region played a very important role in terms of the introduction of new species with greater potential and utilization of increased volumes of fertilizers, pesticides and lime. Average yield came to 2,617 Kg/ha, with the State of Mato Grosso turning in the best productivity results (2,778 kg/ha). Unlike previous years, marketing was processed rapidly as producers sought to take advantage of price levels even during the harvest period, when international prices were particularly high. Exports in the form of grain came to about 7.8 million tons, as compared to 3.6 million tons in the previous year.

For the second consecutive year, rice production declined as a result of cutbacks in the area under cultivation. The volume of unprocessed rice produced totaled 9.3 million tons and was 6.6% less than in the previous harvest. Production peaked toward the end of the 1980s, when the area under cultivation came to more than six million hectares. Later on, the area was gradually reduced until reaching the mark of about four million hectares planted in the last several harvests. Among the factors that contributed to this decline were farmer debts, the absence of policies capable of stimulating planting, unsatisfactory prices in recent harvests and, principally, competition from imports, particularly from Uruguay and Argentina where the quality of the product is higher and production costs are lower. The average yield of the national crop is about 2,595 kg/ha or 1.8% higher than in the previous harvest, with a minimum of 800 kg/ha in Amapá and a maximum of 5,100 kg/ha in Rio Grande do Sul. In Uruguay, productivity reaches a level of 5,900 kg/ha, while Argentina operates at a level of 5,100 kg/ha. Stocks were reduced from 1.8 million tons to 917 thousand tons.

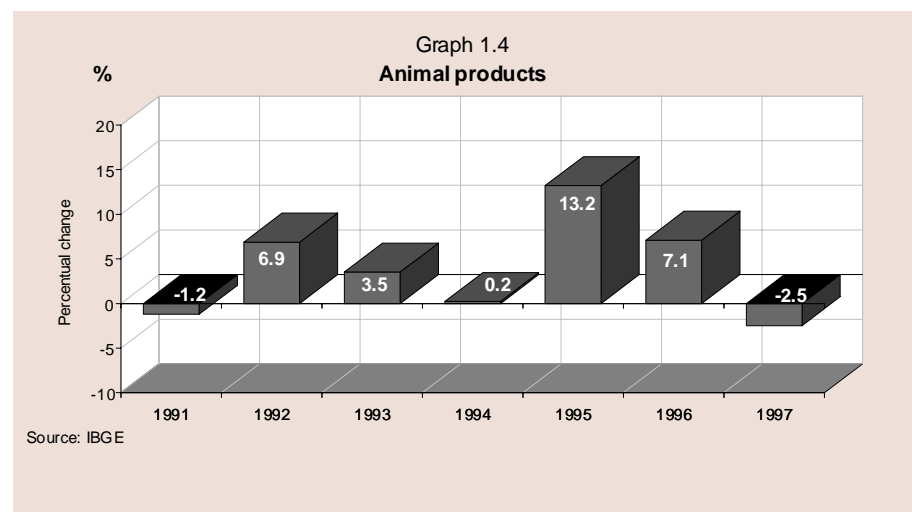
The three bean harvests totaled 3 million tons, for growth of 6.4% in production and 9.1% in average yield (623 kg/ha). In the southern region, the largest producer during the first harvest (1.4 million tons), the area harvested was reduced by 7.1%, while production expanded by 11.6%. Recovery of the volume produced in Rio Grande do Sul was a consequence of productivity increases which, as a result of adverse climatic conditions, had totaled only 300 kg/ha in 1996, but rose to 855 kg/ha in 1997. In the northeast region, which produced 49% of the second harvest total of 1.3 million tons, average yield dropped from 509 to 504 kg/ha. In the state of Bahia, the main producer of this harvest, productivity increased 1.6% (682 kg/ha). The third harvest (273 thousand tons) plays an only minor role in overall production and registered growth of 27.2% in production and 16.2% in area cultivated. Internal consumption estimated by Conab at 3.2 million tons was completed with imports of 100 thousand tons and stocks of 241 thousand tons left over from 1996.

Wheat production closed at 2.4 million tons, for a decline of 900 thousand tons in relation to the previous harvest. This reduction was caused by both a 16.6% cutback in the area cultivated and by the low level of technology applied to this crop. Drought during the period of crop development, coupled with the appearance of various crop diseases and excess rain in the period of maturation and harvest also caused significant damage to the wheat crop. Aside from losses in area and productivity, these factors also affected the quality of the wheat, principally in Rio Grande do Sul. To complete internal demand, an additional 5.5 million tons were imported.

Following the positive results of recent years, livestock production dropped by 2.5% in 1997, according to figures released by IBGE. The drop in production of cattle, swine and milk was responsible for this result. Production figures released in the IBGE Monthly Industrial Survey showed a cutback in slaughters and preparation of pork and beef (4.8%) and in the refrigeration and preparation of milk and milk-based products (2.6%). On the other hand, slaughters and preparation of poultry increased by 9.5%.

The excellent performance of the poultry sector was clearly perceived by the São Paulo Poultry Association (APA), according to which production expanded by 9.8%, with total output of 4.45 million tons. This result was positively impacted by low prices for corn, the sector's principal input. According to the Association, per capita consumption also expanded at a positive pace (6.8%) and totaled 23.7 kg.

In relation to exports, positive results were generated by all segments. Foreign sales of poultry expanded by 15.6% in comparison to 1996 and totaled 672.8 thousand tons. Exports of beef increased by 14.5% and totaled 59.3 thousand tons, while pork expanded by 4.1% to a level of 61.4 thousand tons.



### **Employment indicators**

Employment indicators registered declines in 1997. The persistence of negative results since 1995 was to some extent a result of the ongoing process of stabilization and Brazil's competitive integration into the world economy (technological advances in production and substitution of internal inputs by imports) and the high cost of the social charges generated by the labor force. This movement was reflected more intensively in the industrial sector and, among other causes, was also due to increased use of outsourcing.

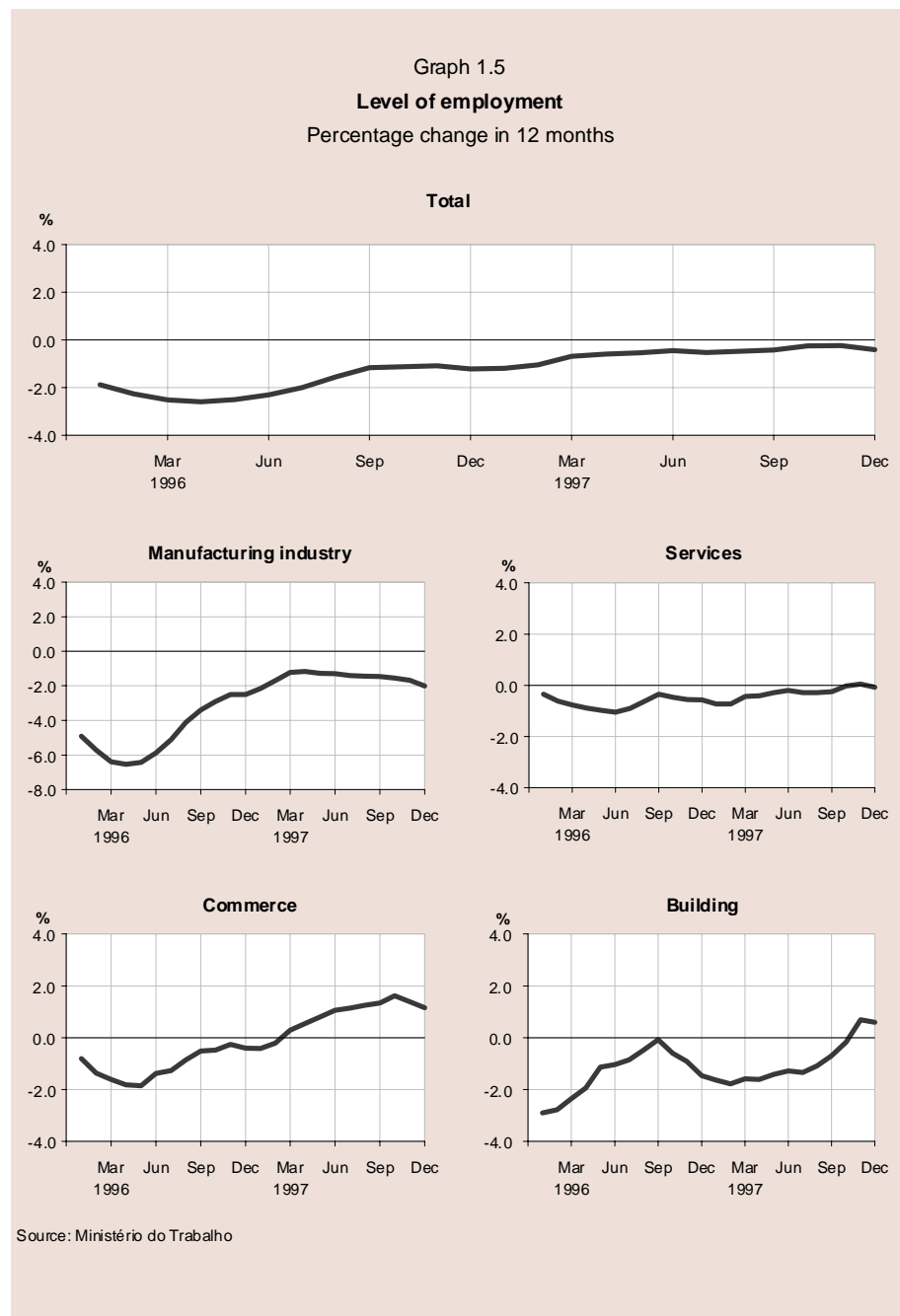
According to a Ministry of Labor survey, the level of formal employment in the country declined by 0.4% in 1997, with elimination of 121.9 thousand job positions. An analysis by sectors of activity shows that layoffs were concentrated in the manufacturing sector (-2%) and under services (-0.1%), with 122.9 thousand and 9.5 thousand job losses, respectively. Commerce (+1.1%) and construction (+0.6%) closed 1997 with 53.5 thousand and 6.2 thousand hirings, respectively.

The National Confederation of Industry (CNI) indicator, which includes information for the manufacturing industry in 12 states, showed a reduction of 5.5% in the employment level. In the case of São Paulo industry, the monthly survey undertaken by the Federation of Industries of the State of São Paulo (Fiesp) registered a decline of 4.3% in the employment level. Based on the weekly survey for São Paulo industries carried out by 47 employer associations, the decline came to 6.1% in 1997, with 113.1 thousand layoffs.

The average rate of open unemployment calculated by IBGE in six metropolitan regions increased in 1997 and closed December at 4.8%, as compared to 3.8% at the end of 1996. The average annual rate reached 5.7% in comparison to 5.4% in the previous year. An analysis by sector of activity shows an across-the-board increase in the level of unemployment, with the highest rate being registered in the manufacturing sector (5.8%). The number of persons employed declined by 0.8%, reflecting a loss of 141 thousand job positions. A breakdown of employment figures by worker category shows a reduction among registered workers and among employers, with an increase for unregistered workers and the self-employed.

Unemployment also increased in the Metropolitan Region of São Paulo during the course of 1997, according to the Employment and Unemployment Survey carried out by the Seade Foundation and Dieese, covering both the formal and informal job markets. The rate of total unemployment came to 16.6% in the moveable quarter ended in December, as compared to 14.2% in the same period of 1996, with the total number of employed persons declining by 114 thousand. An analysis by sector of activity shows a drop of 10% in the industrial workforce. This figure reflects

elimination of 162 thousand positions, mostly involving salaried registered workers, while the level of employment in the sector of commerce dropped by 1.6%, with elimination of 20 thousand jobs. In the sector of services, growth in employment came to 2.9%, with creation of 103 thousand openings, concentrated mostly among unregistered workers and the self-employed. In the segment of “other sectors”, 35 thousand jobs were eliminated, mostly in the construction industry.



### Salary and wage indicators

With introduction of the National Account System recently adopted by IBGE, it has now become possible to analyze distribution of the income generated in the 1990-96 period in the productive process by the different production factors – labor and capital – and public administration. Analysis of average participation in the period shows that the earnings of employed workers accounted for 41.8% of income generated and the earnings of the self-employed represented 6.3%. Participation of the gross operational excess came to 37.6%, while public administration came to 14.3%.

In 1997, wage and earnings indicators registered real gains, explained partly by lesser growth in price indices in the period. In comparison to 1996, growth was once again registered in all sectors and employment categories, albeit at a less intense pace.

According to the Monthly Employment Survey carried out by IBGE in six metropolitan regions, average real earnings of the employed increased by 2% in 1997, with gains in all sectors of activity. The strongest positive growth was registered under services (2.3%) and construction (2.2%), followed by manufacturing and commerce (1.2%). A breakdown by occupational category shows gains of 3.6% for unregistered workers, followed by 2.7% for registered workers and 2.2% for the self-employed.

**Table 1.9 - Real average earnings of occupied people <sup>1/</sup>**

Average percentage change

Itemization	1995	1996	1997
Total	10.4	7.4	2.0
Sectors of activity			
Manufacturing	5.9	6.0	1.2
Building	18.1	9.3	2.2
Commerce	11.8	6.9	1.2
Services	10.9	9.1	2.3
Position			
Registered	3.9	7.9	2.7
Unregistered	14.7	6.7	3.6
Autonomous	24.3	7.3	2.2

Source: IBGE

<sup>1/</sup> Deflated by the INPC. Includes the metropolitan regions of Recife, Salvador, Belo Horizonte, Rio de Janeiro, São Paulo and Porto Alegre.

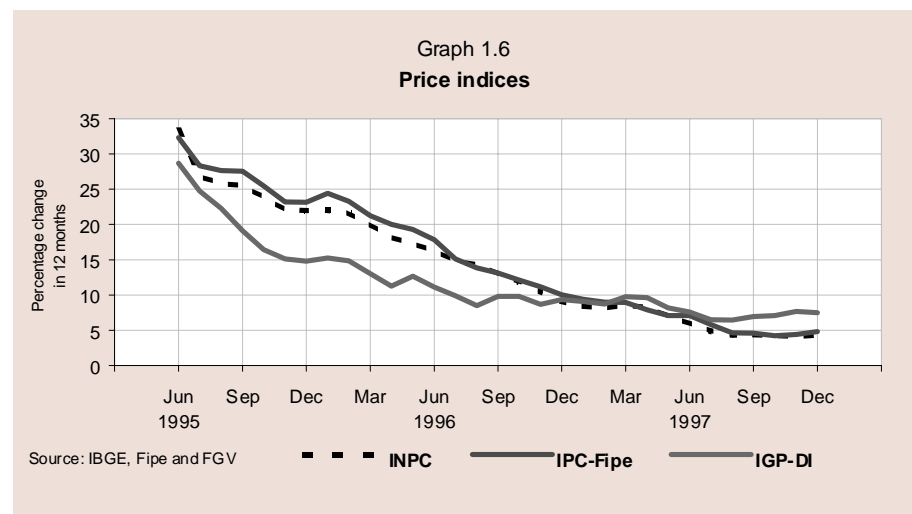
A 12 state CNI survey of the manufacturing sector showed an average increase of 1.5% in overall real wages in 1997. Considering the drop that occurred in the employment indicator, the average real wages of those who were able to preserve their jobs increased. Fiesp information indicates a similar performance, with positive average growth in real wages and overall salaries in São Paulo's industrial sector. The respective 1997 results were 5.5% and 1.2%.

The minimum monthly wage was set at R\$ 120.00 as of May, equivalent to US\$ 107.76 in December 1997.

### Price indicators

In 1997, inflation continued on a downward curve for the fourth consecutive year. Growth in the principal price indices closed at between 9.12% and 10.03% in 1996, compared to 4.34% to 7.74% in 1997. For the most part, the continuity of the downward movement resulted from a sharp drop in the prices of nontradable goods and services. The only reason why inflation did not drop at an even more accentuated pace were the fluctuations that occurred in farm prices, coupled with the restructuring of public utility tariffs.

The results of the different indicators showed that changes in general price indices were greater than those registered under consumer price indices. This performance can be explained by the continued recovery of farm prices, which had its strongest impact on the wholesale segment, at the same time in which the prices of goods and services that are nontradable abroad and significant in the composition of consumer price indices declined. These prices had accelerated more intensively in previous years, a phenomenon typical of periods of consolidation of economic stability.



The national consumer price index (INPC) registered growth of 4.34%. Among the factors that contributed to this result, one should cite growth of just 1.37% under food and beverage prices, which have considerable weight in terms of the composition of the index, and declines of 3.04% and 0.46% in the prices of residential articles and apparel, respectively. Upward pressures were generated principally by growth of 14.66% in the costs of transportation and communications. This expansion was due to the restructuring of telephone tariffs (value of each pulse and of the basic subscription) and to increases in fuel and public transportation costs. The grouping of housing (8.48%) was pressured by growth of 8.53% under rents, as well as by upward movement in residential public utility tariffs (electricity, water and sewage, gas and property taxes). In the cases of health and personal care (6.3%), pressures originated in price rises under pharmaceutical products and medical services, while the upward movement under personal expenditures was due basically to increases in the prices of education and cigarettes.

The consumer price index in the municipality of São Paulo, calculated by Fipe, registered a rate of 4.82%, as compared to 10.03% in 1996. Among the factors that contributed to the decline were a drop of 5.81% in apparel prices and a generalized downward price slide under the other product groupings, even though most of these did close at a level above that of the general index. The exception occurred in the grouping of foodstuffs which registered acceleration in relation to 1996, even though the accumulated rate was below the average (3.6%).

The general price index – internal supply (IGP-DI) calculated by the Getúlio Vargas Foundation registered growth of 7.48%, as compared to 9.34% in 1996. The wholesale price index – internal supply (IPA-DI) expanded by 7.78%, a result that was most strongly impacted by the behavior of foodstuff and raw material prices. In the concept of overall supply, pressure was generated by farm prices (17.72%), since industrial prices expanded by only 3.13%. With respect to the other components of the IGP-DI, the consumer price index – Brazil (IPC-Br), calculated in São Paulo and Rio de Janeiro, expanded by 7.21%, with its components turning in a performance similar to that of the other consumer price indicators. In comparison to most the consumer price indices, the higher rate registered under the IPC-Br can be explained by methodological questions that make this index more sensitive to public utility tariff changes. The national cost of construction index (INCC) expanded by 6.81%, with increases of 9.03% in labor costs and 4.14% in building materials.