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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 (1970/75) 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.

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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: Aggregate Demand, Aggregate Supply, International Economy, Capital Account, Prices and Prospects for Inflation. Basically, the analysis of aggregate demand involves consumption, investments, budget operations and the gap of foreign resources. With regard to supply, the analysis is centered on the behavior of the production indicators of the farm and industrial sectors and the labor market. 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. The next part of the report is a consequence of international economic performance and deals with capital movements, underscoring the ways in which they contribute to meeting foreign payment needs. 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. Finally, prospects on inflation growth are analyzed.

Executive Summary

Considering the three major shocks that hit Brazilian economy last year, GDP growth in 1999 (0.8%) can be regarded as satisfactory. These shocks were the exchange rate devaluation, the doubling of international oil prices and the real increase in government managed prices. That adverse scenario did not prevent the IPCA from being within the inflation target. In other words, despite the negative supply shocks, the inflation rate reached 8.9%.

Recent inflation figures confirmed the analysis presented in the December *Inflation Report* that the rise in inflation in the last quarter of 1999 was not a mounting inflationary process but just transitory effects of negative supply shocks. IPCA showed a significant drop and some indices even showed deflation in February.

The inflation rate has benefited from the appreciation of the real and the new crop in the beginning of 2000. However, international oil prices have been rising well above the level expected in the last *Report*. The average oil price in the futures markets remains above the one previously foreseen, increasing the pressure for further domestic byproducts price adjustments.

Fourth quarter GDP growth showed a significant output recovery. Several indicators released in the beginning of this year reinforced this trend, endorsing expectations of a much higher growth rate this year.

Durable and capital goods have been leading the recovery cycle since these sectors are more sensitive to credit conditions and expectations. Among durable goods, car sales played a major role. After being sharply hit by the adverse domestic and external environment last year, car output registered a significant increase in January-February, particularly for exports.

Credit supply have been recovering since mid-1999 and should keep *momentum* due to lower reserve requirements, lower default rates and improvement in domestic outlook. Despite the basic interest rate stability since September, lending rates have been falling and the real interest rate is the lower in the last few years.

The higher economic growth should revert the downward trend in real wages and stimulate the employment level, though the recovery in unemployment rates only happens after some lag. Those two factors will increase the wage bill in the next few years and should boost consumption.

Fiscal policy in 1999 has played a fundamental role in the achievement of the inflation target. Despite the inherent risks associated with an electoral year, fiscal policy should continue as one of the pillars of economic stability. The achievement of the Economic Program fiscal goals last year has had positive impacts on the financing of the public debt, leading to longer maturities and lower debt service. Hence, one-year Treasury bonds have been placed at rates below the current basic interest rate.

Monthly trade balance surpluses have already reappeared, and their magnitude should increase in the second and third quarters due to seasonal factors. The prices of the main export commodities have shown a slight recovery and, despite higher oil prices, terms of trade have marginally improved. Nevertheless, export *quantum* has been growing quickly, reflecting the exchange rate devaluation. A trade balance surplus is expected for the year.

The progress in the fiscal area, in tandem with the favorable trade balance, has produced positive outcomes on the external financing pattern and the "Brazil risk" perception. The risk *premium* for sovereign and private bonds has decreased consistently, with positive impacts on the exchange rate. Also, foreign direct investments have increased expressively in the first months of 2000. All those factors together guarantee sound and comfortable financing for the balance of payments.

The perspective of a robust world growth has improved the external outlook, though there are still risks of an eventual sharp deceleration of the US economy. Growth for other industrial economies and especially for Latin American countries should increase Brazilian exports, with positive impacts on domestic outlook.

However, the baseline scenario still encompasses a considerable degree of uncertainty. The supply side shock represented by the recent hike in international oil prices, and the adjustment in government managed prices expected for the second and third quarters are important factors that cannot be neglected. The baseline scenario considered by Copom in this *Inflation Report* cautiously re-evaluates the impacts of these factors on inflation. Moreover, the expected real adjustment in the minimum wage not only worsens the budget deficit of the social security system but will also raise the IPCA directly, given its current calculation methodology.

The main transmission mechanism of monetary policy operates through the aggregate demand channel. There is a six to nine month lag between the setting of interest rate and its full impact on prices. Therefore, the current monetary policy decisions will only affect perceptibly inflation rate from the last quarter of 2000 on. The fan chart presented in this *Report* shows that the central inflation forecast is comfortably below the 4% target for 2001. The monetary policy followed in the last half-year has aimed at reacting preemptively to the increase in inflation expected for the second and third quarters of 2000, when the above-mentioned shocks – especially the rise in government managed prices – are supposed to take place. The reduction bias introduced in the last Copom meeting might be exercised in case there is a short-term decline in the uncertainty concerning the magnitude of these shocks, reassuring that the targets will be met.

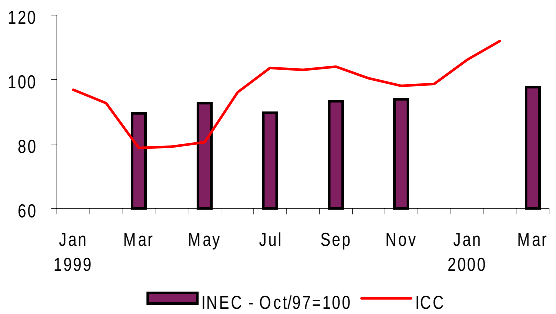
1 – Aggregate demand

1.1 – Consumption

In the final months of 1999 and early months of the current year, consumption indicators were impacted by more promising economic conditions generated by ongoing recovery in the level of economic activity, expanding credit and the outlook for positive growth in 2000. These factors were, for example, reflected in the recent evolution of consumer expectation indicators calculated by representative industrial and commercial organizations.

A good example is the Consumer Confidence Index (ICC), which is released monthly by the Trade Federation of the State of São Paulo (Fcesp). This index evolved positively in the first two months of the year, moving from 98.6 in December to 106.1 in January and 111.8 in February. The January result was generated by growth under the component entitled future consumer expectations, which rose to a level of 128.7, as compared to 120.8 in December. In the month of February, improvement was centered on the second major component of the ICC - confidence in current economic conditions - which climbed from 72.2 in January to 86.5. The National Consumer Expectation Index (INEC), calculated by the National Confederation of Industry (CNI), came to 97.6% in March, as against 93.8% in November 1999, as a consequence of better expectations as regards its components: outlook for economic performance in 2000, perspectives for personal income and purchase intentions.

Expectations indices [1/]



1/ INEC is not calculated for the month of January.

Despite closing 1999 with negative results, the retail sector has been recovering in recent months, particularly in the last quarter. Based on

Real sales of the retail sector - Brazil [1/]

					% growth in year
Itemization	1999				2000
	1st semester	Oct	Nov	Dec	Jan
General	-3.91	-4.10	-3.76	-2.90	0.45
Excluding vehicle					
sales outlet	0.93	0.28	0.39	1.05	2.13
Consumer goods	1.11	0.27	0.32	1.01	1.93
Automotive trade	-26.87	-25.95	-24.75	-23.95	-4.99
Building materials	-6.50	-5.24	-4.55	-3.82	6.02

Source: FCESP, FCEMG and IBGE (Rio de Janeiro, Recife and Salvador)

1/ Weighted by the 1996 IBGE Annual Trade Survey: São Paulo (53.61%), Rio de Janeiro (24.83%), Belo Horizonte (12.54%), Salvador (5.16%) and Recife (3.86%).

information drawn from five metropolitan regions, the indicator of real retail trade sector sales turned in accumulated negative growth of 2.9% in the year up to December, as compared to 4.7% up to August. Once the figures for automotive sales - with the worst performance since 1993 according to the National Federation of Automotive Vehicle Distributors (Fenabrave) are eliminated from this index, the accumulated rates for the year were positive in both November (0.4%) and December (1.1%).

A Fcesp survey in the metropolitan region of São Paulo pointed to average monthly growth of 2.7% in retail business activities in the period between September and December, with a truly exceptional 6.3% rate in the final month of the period, based on data from which seasonal data have been eliminated. A breakdown on the basis of categories of usage demonstrates more clearly the factors underlying this growth. Thus, sales of consumer durables, which, together with automotive vehicles, constitute the segments most sensitive to credit conditions, registered average monthly growth of 5.9% in the final quarter of 1999. In the case of the automobile sector, the corresponding figure was 1%, which could indicate a reversal in the overall trend for the year, which closed with an accumulated loss of 31.4%. In this sense, data on the volume of consumer credits showed that this was the element most responsible for the increase in retail activities in the second half of the year.

The other São Paulo retail segments turned in average negative monthly rates in the final quarter and were responsible for the no more than moderate expansion of the trade sector in general in the period. When one looks at the year as a whole, real sales of the retail trade sector declined by 0.9%, a fact that can be attributed mostly to the reduction in real average earnings (-5.5% in the year, according to IBGE) and to the less than positive conditions that marked the first half of last year.

In January of this year, a Fcesp survey based on seasonally adjusted data detected a 3.9% drop in real sales in the retail sector of the metropolitan region of São Paulo, thus interrupting the sequence of positive monthly rates dating back to August. This result is not sufficient to conclude whether the pace of activity has declined or whether there has been a temporary slump caused by the rather high comparison base represented by the December 1999 results. However, despite this, real sales increased by 4.1% when compared to January 1999, thus suggesting that the process of recovery is moving forward. According to the National Association of Automotive Vehicle Manufacturers (Anfavea), industrial sales of the automotive sector registered a positive performance in the first two months of the year, with growth of 4.6% in January and 18.4% in February.

At the same time, other retail activity indicators point to ongoing recovery in the trade sector. According to data released by the Trade Association of São Paulo (ACSP), consultations with the Credit Protection Service (SPC) and Telecheque in São Paulo accumulated growth of 8.9% in the year up to February, with monthly average growth of 5.2% when purged of seasonal factors. Aside from this, more general nationwide consumer indicators point to positive growth early in the year, as the number of checks cleared grew by 7.9% in January, in relation to the same 1999 period. Once seasonal adjustments are made, the increase in comparison to last December came to 3.8%. Finally, the volume of credit operations with individuals registered by the financial system continued expanding in the month, following the trend that first became evident in the second half of 1999.

In the opposite sense, data released by the Brazilian Association of Supermarkets (Abras) point to a 1.5% decline in real sales of the supermarket segment in January, based on the seasonally adjusted statistical series. In the same period of the year, figures released by the Brazilian Association of Wholesalers and Distributors (Abad) indicate that real sales in the wholesale trade sector declined by 6.1% in the seasonally adjusted series. This figure followed growth of 2.9% in November and 6.9% in December. An analysis of accumulated twelve month results shows growth of 2.2%.

One should note that the improvement that occurred in credit conditions in recent years was mostly a result of default level declines that began in the second half of 1999, coupled with more favorable expectations as regards the economic scenario as a whole. As a result, these factors have made it possible to lengthen average loan terms.

As a matter of fact, the average rate of default calculated by ACSP in the metropolitan region of São Paulo and defined as the difference between new entries and cancelled entries, weighted by the number of transactions carried out in the month, dropped sharply. Consequently, the average for the period from August to December, when the process of recovery in the retail sector began, came to 5.2%, as compared to 12.6% in the period between January and July. In the first two months of 2000, however, default rates were quite high, with an average of 8.5%. Therefore, it is now considered advisable to await the results of the next few months before concluding as to any basic trends in this area.

According to Teledata calculations, the ratio between checks returned and checks received in the trade sector of ten large Brazilian cities points in the same direction, with a decline over the course of the second half of 1999 and an upswing in the default rate in January.

Analysis of interest rates practiced by the trade sector shows that, following the drop that occurred early in the second half of 1999, rates stabilized. According to the National Association of Finance, Management and Accounting Executives (Anefac), the average for the first two months of 2000 was 7.5%, the same level registered in the final three months of 1999.

Here, one should note that changes in credit conditions have generated alterations in the way people do their buying. In the twelve month period ended in February of this year, consultations with the SPC - a good indicator of installment buying - increased by 2.3%, while consultations with the Telecheque system, which tends to reflect lump sum payments, decreased by 8.5%. Growth of 18.7% in the number of credit card transactions over the twelve month period ended in January, coupled with the 3.4% falloff in the use of checks in the same period, would seem to suggest the same tendency.

1.2 – Credit

In the period from November 1999 to January 2000, consumer lending continued on the upward swing that was first noted in July 1999. At the same time, business lending was impacted by the seasonal characteristics of the period marked, as it is by considerably less demand for the funding needed for productive activities.

The strongest credit demand was concentrated in the segment of individuals and was stimulated by low inflation and a series of measures taken by the government in the final quarter of 1999 with the aim of expanding the volume of credit operations and reducing the costs of financial intermediation. Nonetheless, one should observe that the more lasting impacts of these measures will only occur over the medium and long-term. Parallel to this, the long awaited increase in the credit/GDP ratio should finally reach the desired pace when consumer credit growth is able to accompany the pace of expansion of productive investments.

Credits with non-earmarked funding

Differential between lending and borrowing interest rates of preset operations

% p.m.

Period		General	Legal Entity	Individual
1999	Jan	3.4	2.6	4.7
	Feb	3.6	2.8	4.9
	Mar	3.4	2.7	4.7
	Apr	3.7	2.9	5.1
	May	3.6	2.7	5.0
	Jun	3.4	2.5	4.9
	Jul	3.2	2.3	4.8
	Aug	3.2	2.3	4.8
	Sep	3.2	2.3	4.8
	Oct	3.2	2.3	4.7
	Nov	3.0	2.2	4.4
	Dec	2.8	2.0	4.1
2000	Jan	2.6	1.9	3.8

Despite the fact that the basic interest rate of the economy has held firm at 19% since September, there have been increasing signs of a decrease in the cost of credit operations utilizing non-earmarked funding and preset rates as of October. Among the factors that have contributed to the decline in the differential between the rates on lending and borrowing operations, one should highlight the macroeconomic conditions prevailing in the period and, particularly, the continued low level of inflation and the gradual downward slide in the rate of defaults on financial operations.

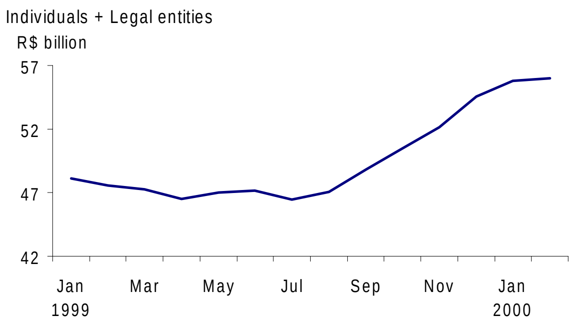
At the same time, the drop in interest rates on lending operations also resulted from the measures taken to increase the credit supply and curb the interest charged to final borrowers. In this context, several points deserve mention: the reduction in compulsory reserves on demand deposits, elimination of the reserve requirement on time deposits and reduction of the Financial Operations Tax (IOF) rate on credit operations with individuals.

Thus, the sharpest reduction in the differential between average rates on lending operations and average rates on funding contracted by the financial system occurred precisely in operations with individuals. While the monthly average differential weighted by the volume of all credit modalities dropped from 3.2 to 2.6 percentage points in the October to January period, the differential in operations with individuals declined from 4.7 to 3.8 percentage points.

The narrowing of the distance between these rates was more accentuated in those segments in which the highest rate levels are charged, such as special overdraft checks. In this case, the monthly average differential fell from 6.9 to 6.3 percentage points from October to January. In the case of personal credit operations, the differential fell from 4.3 to 3.4 percentage points, while the differential in the rates on operations involving the financing of goods dropped from 2.5 to 1.9 percentage points in the same period.

In the segment of business credits, the differential between average monthly rates declined from 2.3 to 1.9 percentage points between October and January. In this case, one should mention that the reduction was more uniform among the different loan modalities. It should be noted that the contracted rates are lower than those charged in credit operations with individuals as a consequence of the greater volume of funding involved in each operation and the quality of the guaranties offered. The strongest variations occurred in very short-term working capital credit operations, special overdraft accounts and promissory notes, which dropped from respective levels of 2.5% per month, 2.8% per month and 2.9% per month in October to 2% per month, 2.3% per month and 2.5% per month, in January, in the same order.

Amount of credit operations - non-earmarked funds[1/]



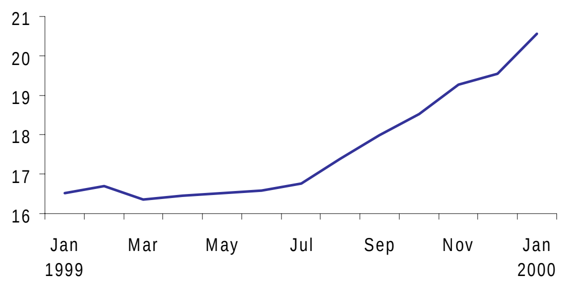
1/ Daily average balances.

The balance of credit operations with non-earmarked resources, a category that excludes real estate and rural financing, leasing operations and operations based on public sector funding transfers came to R$ 56 billion in January, for growth of 7.3% for the quarter begun in

November 1999. In that period, credits contracted with individuals came to R$ 20.6 billion, continuing the tendency first noted toward the end of the first half of 1999.

Amount of credit operations with individuals - non-earmarked funds[1/]

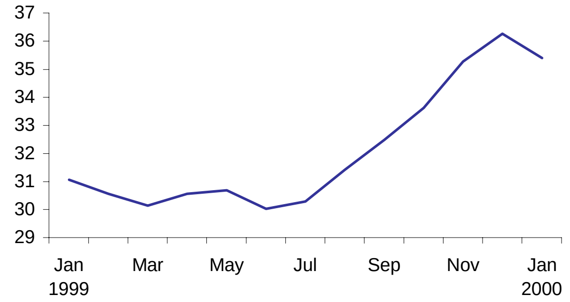
R$ billion



1/ Daily average balances.

Amount of credit operations with legal entities - non-earmarked funds[1/]

R$ billion



1/ Daily average balances.

An analysis of the performance of the various types of credit covered by the segment indicates that the strongest recovery was registered in personal credit operations, with 41.6% of operations and growth of 18.4% in the quarter and 54% in 12 months. Financing for acquisitions of goods registered growth of 19.7% in the quarter, reflecting a rise of 9.5% in the 12 month balance. Operations with special overdraft checks increased by 3.1% in January, though the final figures for the quarter and the last 12 months point to declines of 7.9% and 2.9%, respectively.

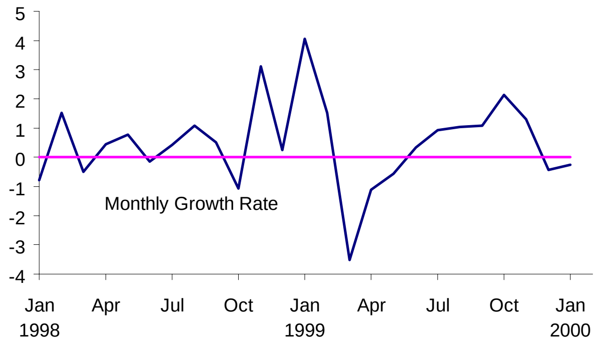
Business credit operations at rates freely determined by the market came to R$ 35.4 billion in January, for growth of 5.3% in the November-January quarter and 14% in 12 months. Operations targeted at financing merchandise acquisitions, with supplier endorsements, totaled R$ 4.3 billion, for growth of 21.9% in the quarter. Those involving the discounting of trade bills and working capital credits totaled R$ 3.2 billion and R$ 14.4 billion, respectively, with reductions of 5.5% and 3.2% in the quarter.

Insofar as short-term operations are concerned, the quarter witnessed an increase of 15% in the volume of very short-term working capital operations and 1.4% in operations with special overdraft accounts. Viewed over a 12 month horizon, growth came to respective accumulated levels of 18.9% and 12.9%.

Total financial system credits

The overall balance of financial system credits closed at R$ 236.1 billion, reflecting a drop of 2.5% in the November-January quarter.

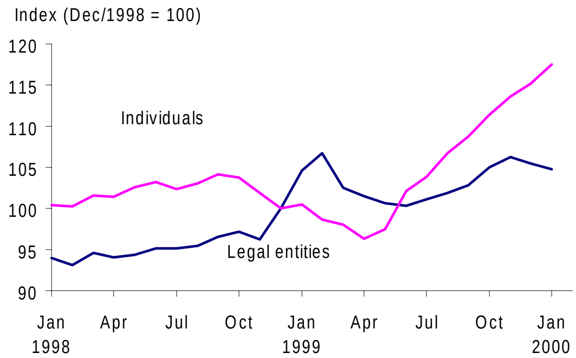
Financial System Loans: Private Sector



For the most part, this performance resulted from a drop of 23.3% in the volume of normally performing credits targeted to the public sector. These credits were renegotiated in the form of securities as part of the fiscal adjustment process in the lower levels of government being implemented by the federal government. The state and municipal banking debt registered a balance of R$ 20.7 billion, for a reduction of 23.9% in the quarter. To a great extent, this was a result of the securitization of municipal debts and debts of the State of Rio de Janeiro. Credits contracted by the federal government registered a decline of 20.8% from November to January, when they closed at R$ 5 billion.

Normally performing credits channeled to the private sector came to R$ 236.1 billion, for growth of 0.6% in the quarter, as compared to expansion of 4.3% in the previous quarter. The factors that exerted the greatest expansionary pressures were credits to individuals and to other services. The factors that exerted contractive pressures were the reduction in the stock of housing credits and the seasonal nature of operations with the trade and industrial sectors.

Growth in Loans of the Private Financial System



In the case of normally performing credits granted to individuals, the balance came to R$ 35.5 billion in January, with growth of 5.5% in the quarter and 17% in 12 months, as compared to expansion of 0.5% and 2.1% in the same periods of the previous year.

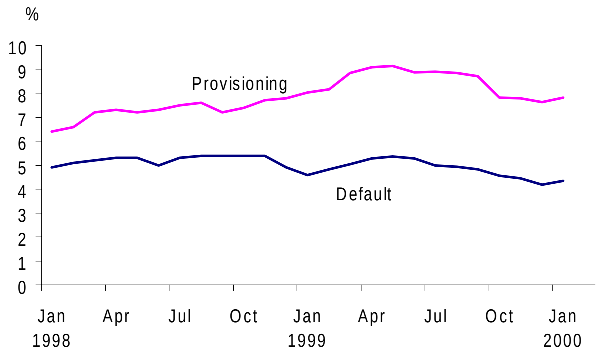
The balance of loans granted to the segment of other services increased by 4.7% between October and January and closed at R$ 30.4 billion. A breakdown of the loan flow to this segment shows that the greatest volume of disbursements was targeted to the areas of transportation and communications.

Loans to the trade sector totaled R$ 20.3 billion and registered a reduction of 0.1% in the November-January period. The balance of loans to the industrial sector came to R$ 71.1 billion, for a decline of 0.7% in the same quarter.

The balance of housing finance operations (individuals and housing cooperatives) came to R$ 57.2 billion, reflecting a decline of 0.3% in the quarter. This falloff resulted from the measure taken recently to grant incentives to persons who pay off their mortgages before maturity.

The volume of financing granted to the rural sector, including agribusiness, came to R$ 21.7 billion, reflecting growth of 2.5% in the November to January period. For the most part, this result was due to an increase in contracting operations in November with the aim of meeting the needs of the 1999/2000 summer harvest.

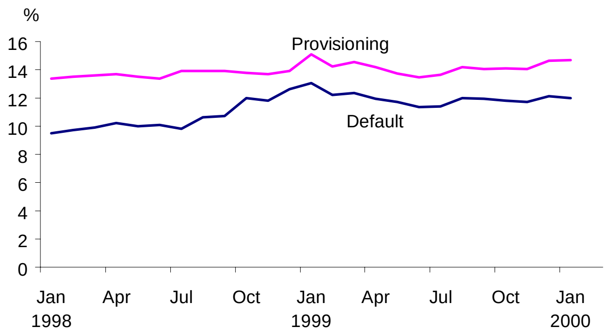
Default and provisioning of the Private Financial System



A segment-by-segment breakdown indicates that the balance of loans to rural current expenditure operations expanded by 4.7% in the quarter. Demand for this type of operation peaked in the October-November period, registering growth of 15.1%. Rural marketing credits registered a 15.6% decline as a result of the seasonal factors underlying demand for this type of operation, which is normally concentrated in the second quarter of the year. Financing for purposes of rural investment increased by 3.4% in the quarter.

The balance of credit operations in arrears and in liquidation, less income to be appropriated, totaled R$ 24.4 billion in January, with a reduction of 3.5% in relation to October 1999. Provisions for hard-to-recover credits totaled R$ 33.1 billion, or 36% more than the volume of nonperforming credits, approximately the same position as in 1999.

Default and provisioning of the Public Financial System



In the case of the public financial system, the balance of credits in default (R$ 18.7 billion) registered a decline of 3.1%, accounting for 12% of total credits. In its turn, the balance of provisions came to R$ 23 billion. The private financial system registered defaults of R$ 5.6 billion in January, corresponding to 4.3% of total credits, thus maintaining a position quite similar to the previous year. Provisions totaled R$ 10.2 billion.

Financial System Credit Provisioning

The National Monetary Council, through Resolution no. 2,682, dated 12.21.1999, has altered the criteria and expanded the classification levels of credit operations and provisions set aside for hard-to-recover credits. As of 3.1.2000, international procedures are to be adopted that call on financial institutions to analyze a borrower's risk potential so as not to restrict their analyses solely to the length of a borrowers default and the guaranties offered.

The major changes introduced by the new criteria are as follows:

a) establishment of nine borrower risk levels for which financial institutions will be responsible, with due compliance with minimum periods of arrears and a series of other types of internal and external data regarding the debtor, the guaranties offered and the characteristics of the operation;

b) requirement that credits in the process of renegotiation and that were previously classified as normally performing are to be classified at the same risk level in effect when they were first classified as in default;

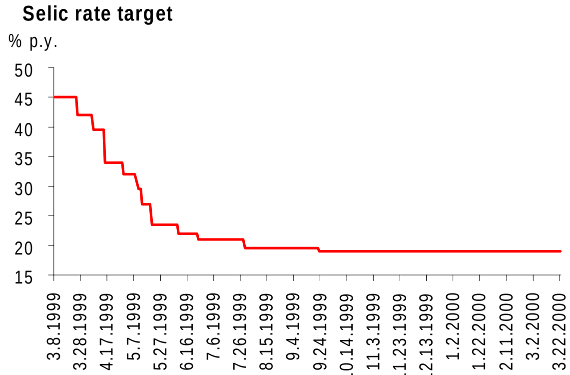
c) obligation that the criteria for constituting provisions for hard-to-recover credits, which previously depended on terms and guaranties, are now to give due consideration to the risk level of the borrower, without in any way hampering Banco Central from exercising its authority to require reinforcement of such provisions in light of information received from the Credit Risk Center.

1.3 – Monetary policy

With the vigorous efforts made to correct fiscal and exchange imbalances, the process of recovering the macroeconomic fundamentals of the Brazilian economy has been reflected in a substantial improvement in overall economic indicators, including those related to expectations regarding growth in the level of activities and investments, as well as stabilization in price levels.

These results have generated significant improvement in financial market indicators. From the end of September 1999 to early March 2000, during which the Selic rate target has remained steady at 19% per year, dollar rates have dropped from the range of R$ 2.00 to approximately R$ 1.75. In much the same way, interest rates on swap contracts between DI and preset one year rates declined from 25.5% to less than 20%.

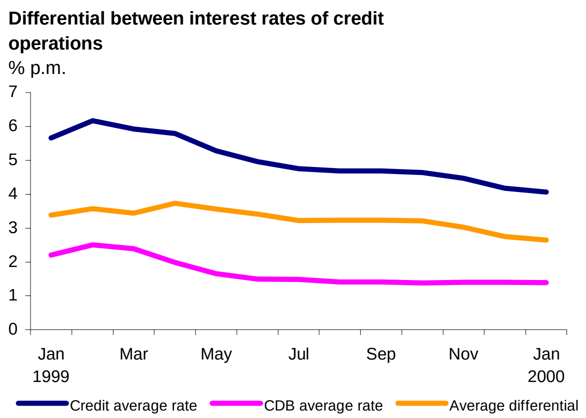
However, despite highly favorable financial sector conditions, definition of the interest rate target must take due account of the monetary policy pass-through mechanism to the real sector of the economy. Since there is empirical evidence that indicates a gap of several months in the effects of interest rate shocks on activity and price levels, Copom analyzes various medium and long term scenarios for the Brazilian and world economies against a backdrop of the feasibility of sustained economic growth and controlled inflation.



Although lower rates of interest would cause reductions in the costs and risks of financial intermediation, Copom also gives due consideration to a series of external factors, particularly the upswing in interest rates, in the developed countries, and in international oil prices. Based on these analyses, the monetary authority resolved to maintain its conservative posture in the early months of this year.

In these circumstances, when Copom closed its meeting on March 22, it had decided to maintain the Selic rate target at 19% per year but with a downward bias. This decision considered the more favorable world outlook in the short-term. Consequently, on March 28, it was decided for utilization of the bias, thus reducing in 0.5 percentage point the Selic rate target.

The degrees of monetary policy freedom have been concentrated mostly in the possibility of narrowing the margin between inflow rates and those applied to financing granted to the real sector of the economy. This is a policy fully consistent with maintenance of the rates of earnings on financial savings and simultaneous reductions in the financing rates offered to the productive sector.



With this, one can safely affirm that stronger recovery in credit operations has, to a great extent, depended on the pace of the decline in financial system margins. Here, the monetary authority has not limited itself to evaluating the effects of measures introduced during the course of 1999, but has also adopted a series of new measures in the current year.

Among the more recent steps taken, one should highlight a new cutback in compulsory reserve rates on demand resources. The 65% rate applicable to demand deposits and deposits subject to notification since October was cut to 55%, effective as of the end of March. The rate on other demand resources, which account for less than 5% of the total and were not included in the October cutback, was also reduced to 55% as of the end of March. The resources released as a result of these reductions will no longer constitute non-interest bearing banking system investments. Not only will this reduce operating costs but will also create the conditions required for a further reduction in the differential between the rates on lending and borrowing operations.

One should also stress that measures were taken to improve the quality of credit and market risk management in the National Financial System (SFN) and to adopt a more flexible approach to trading conditions on the fixed income security market. The instrument used to gain greater flexibility is introduction of forward, overdraft and option operations with fixed income securities. Not only did this have a favorable impact in reducing financial institution margins, but also made it possible to lengthen the terms of SFN operations.

In this context of reducing financial system margins, particular mention should be made of efforts to restructure both public and private financial institutions. One of the instruments used in this process is enhanced competition, including through admission of new institutions in the domestic financial market.

Banco Central has substituted discount window operations with rediscount operations with the aim of improving the operational rules governing the nation’s monetary policy. The new system, which is a component of the reformulation of the Brazilian payments system, guaranties transfer of proprietorship of the assets involved in these operations, thus reducing risks and potential costs to Banco Central. At the same time, it creates the conditions required to put an end to the auctions held daily at the end of the day as a final opportunity for institutions to offset their market positions. It is at this moment that the monetary authority either withdraws or injects financial resources into the market.

Interest rates and market expectations

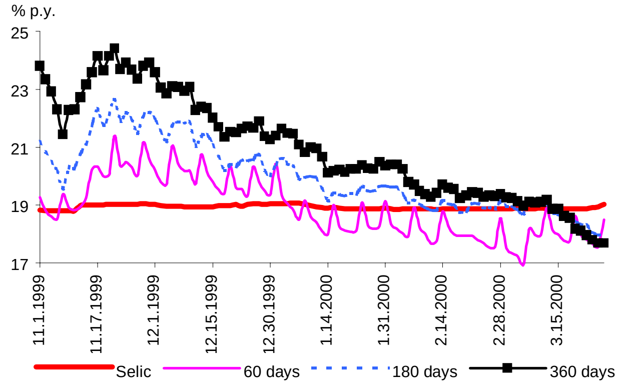
Real interest rates

%p.y.

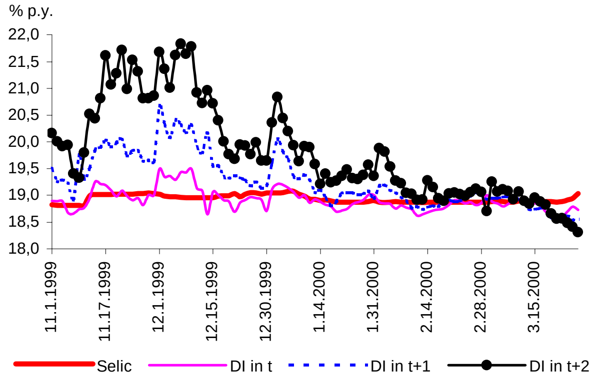
Period	Deflator						
	IGP-DI	IGP-M	IPA-DI	IPC-BR	INPC	IPC-Fipe	IPCA
1991	9.78	14.06	11.40	7.25	10.74	14.01	11.21
1992	31.12	29.39	31.49	31.28	32.04	34.14	35.28
1993	12.52	18.47	15.35	7.90	22.04	21.96	22.61
1994	24.16	29.26	30.89	14.79	21.79	20.40	23.34
1995	33.38	32.84	43.91	21.58	25.50	24.29	25.06
1996	16.54	16.69	17.87	14.43	16.77	15.78	16.29
1997	16.09	15.82	15.76	16.37	19.59	19.04	18.59
1998	26.62	26.52	26.88	26.67	25.66	31.13	26.69
1999	4.67	4.57	-2.56	15.60	15.82	15.60	15.28
2000 1/	7.49	5.81	2.97	14.87	15.42	15.53	14.56

1/ Accumulated from March 1999 to February 2000.

Selic x Swap preset



Selic x DI futures

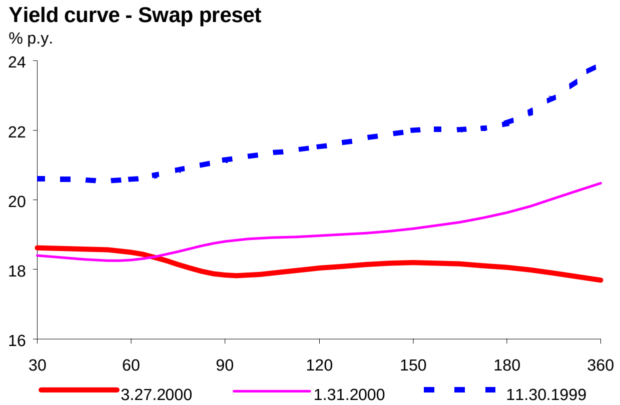


Positive developments in the economic scenario, coupled with greatly improved country risk perceptions on the part of economic agents since December, have been mirrored in the behavior of the interest rate market.

Maintenance of the Selic rate at 19% per year in the final quarter, together with reductions in inflation in December, generated real interest of 15.6% in 1999 when seen in light of the average consumer price indices and 4.6% when viewed against the average general price indices. These were the lowest real rates registered in the Brazilian economy since 1991.

Based on these expectations, reductions occurred in the rates practiced on both the futures market and the swap market, with the most accentuated decline occurring under longer term contracts. Another factor that contributed to the formation of a scenario of favorable expectations was Banco Central's decision to intervene in the market through its open market desk on several occasions in the month of February, taking resources for periods of up to five days at an average rate of 18.87% per year, despite the setting of the Selic rate target at 19% per year with no bias.

Interest rates on one day DI futures contracts traded on the Commodities and Futures Exchange (BM&F) closed with a sharp decline, principally as of the second maturity date. The contracts from the first to the third maturity were traded at a rate in the range of 19% per year. The sharper drop in relation to the more distant maturities indicates confidence in the economy and expectations of downward movement in the interest rate trend throughout the year. In this context, the position of contracts traded on the interest futures market reversed, as greater emphasis was accorded contracts that project longer term rates.



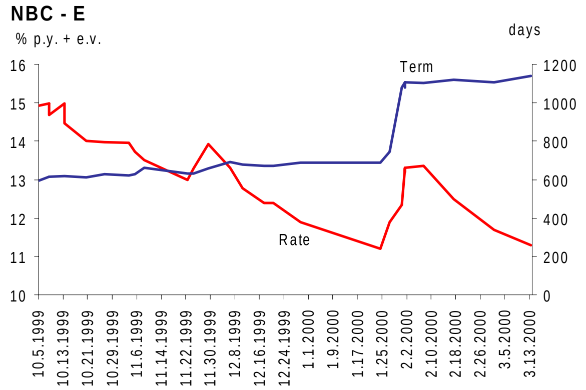
The forward interest rate structure defined by the rates applied to swap contracts involving DI and preset rates reflected the falloff in the futures rate, as evident in the shift and reduction in the incline of the curve. The rate for contracts with one year maturities moved from 24% per year in November to less than 18% per year in March, with a sharp decrease in the risk premium.

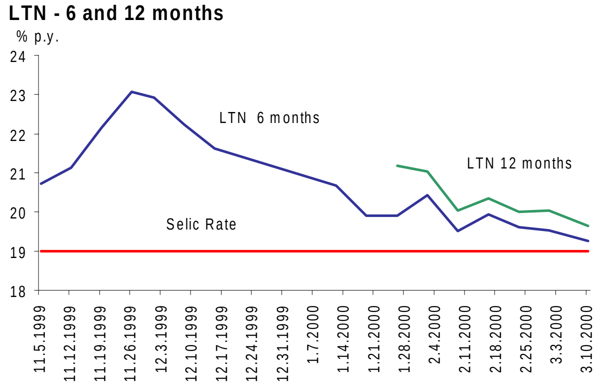
Federal public securities

In the period from December to early March, Banco Central operations through competitive offers of federal securities in definitive operations were restricted to rolling the federal securities debt indexed to exchange. This was aimed at meeting market demand for protection for liabilities indexed to foreign currency, since there was a limited supply of this type of protection in the private sector.

In December, the maturities of NBC-E closed in the range of two years at annualized business day rates between 12% and 13.4%, plus exchange variation. As of the end of January, placements of three year NBC-E were begun at rates that fluctuated between 11.8% and 13.4%. As of the end of December, Banco Central began setting the interest rate to be paid on the face value of the NBC-E in each offer, thus signaling the exchange coupon level considered adequate.

In the period from December to early March, competitive operations with federal securities issued by the National Treasury were carried out with the aim of lengthening maturities and the duration of its debt, while reducing financial costs. Starting toward the end of January, preset papers, which had been placed with terms ranging from three to six months in December, were placed with terms of one year followed, in February,





with placements for terms in the range of seven months and one year. The lengthening of the terms of these papers was accompanied by a sharp downturn in their placement rates. Seven month LTN, which were placed at 22.9% per year in the November 30 auction, were placed at 19.3% per year in the March 9 auction. In the same time frame, LTN with one year maturities were placed once again on January 21, at a rate of 21.2% per year, as compared to 19.7% per year in the March 9 placement.

In the month of February, the placement terms of National Treasury papers indexed to the Selic rate were increased to 18 months, as compared to placements in December and January with terms of just 12 months. At the same time, February operations achieved a reduction in the discount rate from an average of 0.23% per year in December to approximately 0.01% per year as of February. This lengthening of the term of these papers has facilitated management of the securities debt.

Public offers of NTN-C, which are indexed to the General Price Index - Market (IGP-M), were held for the first time since adoption of the Real on December 1, 1999, and have continued in the current year. In the following auctions, on January 31 and February 28 and 29, which involved auctions of R$ 1 billion, the system of re-offering papers from the first auction was adopted with the objective of enhancing the liquidity of these securities.

In much the same way as has been done in NBC-E auctions, the system of a single price for each maturity of these papers is also being used in NTN-C placements. The placement rates, annualized on the basis of business days, have fluctuated between 11.3% and 12.1% for three year papers and between 12.1% and 12.6% for seven year papers.

One should note that, as of the third NTN-C auction, the exchange procedures for securitized credits were altered for the purpose of further stimulating these operations. The new system is a two step process that contrasts with the former mechanism by which the credits, with predetermined discounts, could be utilized for payment of auctions much like monetary resources. The first step in the new mechanism defines the price of the NTN-C by accepting offers exclusively in cash. The second step is equivalent to an auction of the prices of securitized credits, since the participants are called upon to offer sale proposals for the credits of this type in their possession.

Aside from the changes in the definition of the NBC-E offer rates and in the procedures to be followed in exchanges of securitized credits in NTN-C auctions, one should stress that, as had been announced in 1999, other innovations were adopted in the segment of definitive operations with federal securities, all of them aimed at market improvements.

Here, one should mention that three purchase auctions were held in the current year: R$ 990 million in LTN, on January 11, anticipating redemption by 21 days; R$ 239 million in NTN-S, on February 1, anticipating redemption by 35 days; R$ 1,566 million in LTN, on March 3, with redemption anticipated by 49 days and earmarked to the purchase of the same type of security with a four month maturity term. The mechanism of anticipating redemption makes it possible for the National Treasury to take better advantage of specific more favorable moments in which it is able to place papers on the market more intensively and manage to lengthen the debt profile and preset its securities debt more efficiently.

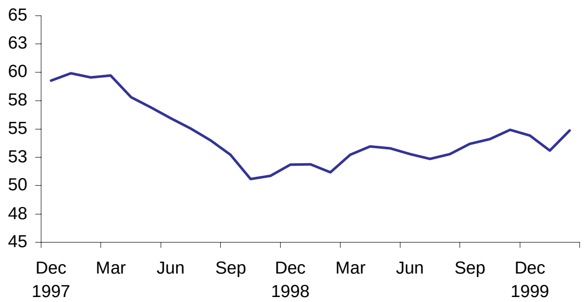
One should also mention introduction of the system of firm offer auctions that have the principal objective of evaluating demand conditions for a specific type of security before coming to a final decision as to placement. This type of auction is carried out in two stages. The first is restricted to institutions authorized to operate with Banco Central on the open market. In this case, the issuer receives up to two proposals per institution, containing references to the unit price and quantity of papers, which are then considered the minimum levels of the commitment assumed by the proponents involved. In the following stage, the issuer - after duly analyzing the proposals cited above - defines the quantity offered and the minimum price to be accepted in the second stage. The National Treasury decided to place one year LTN starting with the first firm offer auction, held on January 20 and 21.

Monetary aggregates

In the case of the money supply (M1) growth, the end of 1999 was marked by uncertainties with respect to the processing of financial operations as a consequence of expectations surrounding the transition to the new millenium. Thus, in terms of end-of-period balances, this aggregate registered December growth of 20.2%, in the wake of 6.1% expansion in the previous month. Evidently, this was a level considerably higher than the seasonal standard for the end of the year. Therefore, this stance on the part of economic agents did not impose any significant impacts on the economy.

Growth in currency demand at the end of the previous year was limited to the final days of December. This is evident in the fact that, in terms of the monthly average of daily balances, almost all M1 growth in 1999 occurred as a result of growth in nominal income, now estimated at 12.3% by Banco Central, and reduction in circulation velocity after reintroduction of the CPMF in July. The return of that tax was the element that generated growth of 5.4% in that month.

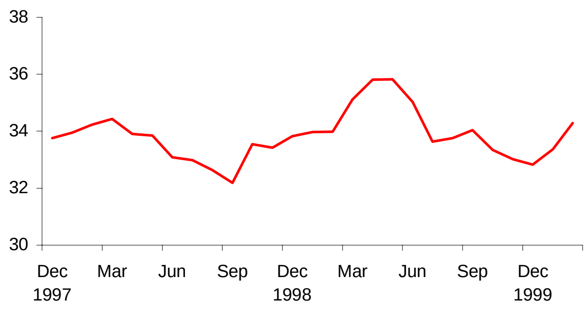
Income-velocity of currency outside banks[1/]



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

In a manner that has been coherent with the interest rate targets adopted by the monetary authority, the monetary base has responded passively to demand for currency and banking reserves. The difference between 20.5% growth in the money supply and 15.6% expansion in the monetary base (concept of average daily balances) was caused by the reduction in the rate of compulsory reserves on demand deposits and deposits subject to notification from 75% to 65% in October. This measure generated a cutback in the volume of reserves and resulted in a decrease of 13.1% in banking reserves in that month.

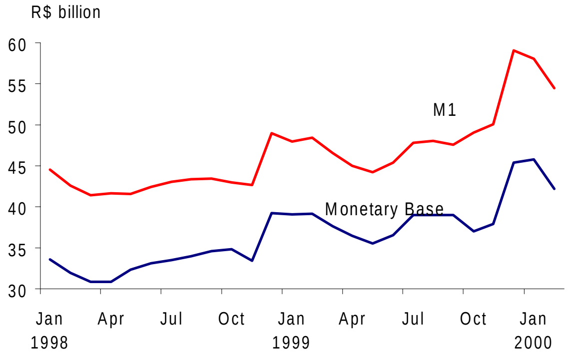
Income-velocity of demand deposits[1/]



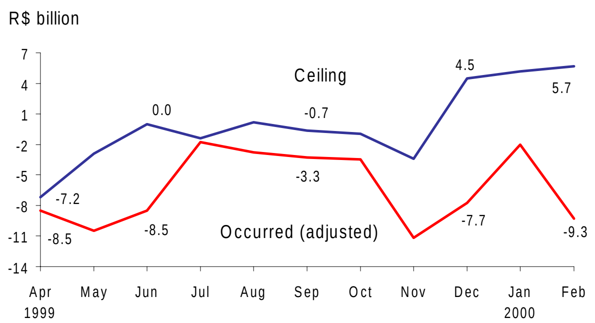
1/ Defined as the ratio between 12 month accumulated GDP (valuated by IGP-DI) and the monthly average balance of the seasonally adjusted monetary aggregate.

In the first two months of 2000, the 1% decline in banking reserves, as compared to a 6% drop in demand deposits, reflected the temporal gap in demand for these aggregates that is a result of the operational rules applicable to compulsory reserves.

Monetary Base and M1 - daily average balances



Net Domestic Assets



Performance criterion: April, June, September and December 1999.

The strong growth in demand deposits that always occurs in the final week of the year impacts demand for banking reserves only in the first week of the following year.

Banco Central has fully complied with the monetary targets negotiated with the International Monetary Fund (IMF) and expressed in the form of ceilings for Net Domestic Assets (NDA) - difference between the monetary base and net international reserves. In the month of December, the last time this indicator was used as a performance criterion, NDA closed below the R$ 12.2 billion ceiling. As of the first quarter of 2000, NDA is considered no more than an indicative target.

Among the broader monetary aggregates, the broad monetary base - a measurement of the federal monetary and security debts - expanded by 8.9% in the period from December to February. The major determining factors of this expansion were special issues of federal securities in December, mostly for purposes of exchange for state debts that had been renegotiated in the Program of Incentives to Reduction of the State Public Sector in Banking Activities (Proes) framework. The expansionary impact of these operations on the broad base was attenuated by the updating of the federal securities debt indexed to the rate of exchange.

In its broad concept (M4), the money supply registered growth of 5.7% from December to February. This performance reflects moderate primary growth of the aggregate, with no signs of significant financial system and public sector funding contracting operations on the internal market.

1.4 – Investments

Gross fixed capital formation

Just as in the case of consumption demand indicators, as of the final quarter of 1999, investment indicators also pointed to a reversal of the downward trend that had prevailed up to that point in time. Based on data purged of seasonal factors, output of capital goods, which had declined by 1.5% in the third quarter when compared to the previous three months, expanded by 7.7% in a comparison between the last two quarters. Insofar as construction inputs are concerned, the 0.2% drop was transformed into growth of 1.8% utilizing the same reference base. Even with this recovery, however, the participation of gross fixed capital formation in GDP, at current prices, moved from 19.92% in 1998 to 18.29% in 1999, according to estimates released by the Department of Economics (Depec) of the Banco Central do Brasil. The basic reasons underlying these figures were the negative results of the first half of the year.

Data available for the month of January of this year indicate that, in comparison to January 1999, the variables that indicate investment demand registered a positive performance, with the sole exception of capital goods imports, which dropped by 15.5%. In this sense, one should note that the output of construction inputs expanded by 1% and capital goods by 6.6%. It is important to stress that the contributions of capital goods production to industry and agriculture, which expanded by 36.4% and 26.6%, respectively, made them a determining factor in the final result of these two sectors of activity. This becomes even clearer when one perceives that production of capital goods for mixed purposes and for the transportation sector closed with declines of 6.3% and 0.7%, respectively.

In January, the seasonally adjusted series registered growth in the production of capital goods for the sixth consecutive month, with monthly expansion of 2.2% and accumulated growth of 9.3% in comparison to June 1999. When one considers the groupings selected, the most significant expansion occurred under construction equipment (58.3%), typically industrial equipment (8.2%) and industrial goods produced in series (7%), with reductions under transportation equipment (10.7%) and mixed use products (9.5%). At the same time, imports of capital goods also registered positive results, as the index purged of seasonal factors closed with positive 14% expansion when set against the December figures. In the opposite sense, output of construction industry inputs turned in a decline of 1.5%.

Production of capital goods

% accumulated growth in year

Itemization	1999				2000
	Sep	Oct	Nov	Dec	Jan
Industrial	-12.6	-11.1	-9.8	-7.0	36.4
Serial	-10.4	-8.8	-7.3	-4.0	49.7
Nonserial	-20.3	-19.4	-18.5	-17.6	-4.2
Agricultural	-20.5	-19.2	-17.7	-15.2	26.6
Agricultural parts	-6.6	-6.2	-3.4	-1.9	3.0
Building	-44.2	-43.0	-42.3	-41.9	1.1
Electric energy	-9.8	-7.8	-5.1	-6.1	-1.8
Transportation	-5.0	-4.0	-1.1	2.5	-0.7
Mixed	-10.4	-10.5	-10.0	-9.1	-6.3

Source: IBGE

According to Anfavea, production of farm machines and equipment expanded by 7% in the first two months of the year. In that period, output of buses and trucks dropped by 16.5% and 3.9%, respectively.

Investment indicators

% accumulated growth in year

Itemization	1999			2000
	Oct	Nov	Dec	Jan
Production of capital goods	-12.2	-10.7	-9.1	6.6
Inputs for the building industry	-4.1	-4.0	-3.6	1.0
Imports of capital goods	-15.0	-15.6	-15.8	-15.8
Direct investments (except privatizations)	1.6	2.0	0.9	162.6
BNDES	-20.9	-16.4	-4.9	...

Source: IBGE, SRF, BCB and BNDES

Insofar as financial resources are concerned, total BNDES System disbursements - BNDES, Finame and BNDESpar - came to R$ 18.1 billion in 1999, for a decline of 4.9% in relation to the previous year (R$ 19 billion). In real terms, utilizing the Broad Consumer Price Index (IPCA) as deflator, the drop closed at 12.8%. An analysis by sectors of activity indicates that resources channeled to manufacturing closed with 2.9% real growth while those targeted to the trade and service sectors, crop and livestock farming and the mineral extraction industry registered real declines of 24%, 12.4% and 16%, respectively. One should note that the long-term interest rate (TJLP) - the cost of BNDES funding - dropped from 12.5% in the final quarter of 1999 to 12% in the first quarter of 2000.

Stock variations

In general terms, surveys of stock levels point to reduction in various sectors of the economy. However, with the exception of government buffer stocks of farm products, which spent practically the entire year close to the exhaustion level, there have been no sharp drops in inventories. Consequently, there would seem to be no important short-term price pressures on the horizon.

A survey of the manufacturing sector carried out by the Getulio Vargas Foundation (FGV) detected signs of stock reductions. In the period from October 1999 to January 2000, the percentage of companies that classified their stock positions as excessive declined from 10% to 9%, while those that considered their stocks insufficient rose from 4% to 5%.

In much the same way, the Quarterly CNI Survey indicated a decline in stocks of final products from 47.1% to 45%, while also detecting an increase from 48.1% to 49% in the stock of raw materials and intermediate products in the period from September to January.

According to Fenabrave, the stock of vehicles at factory authorized vehicle sales outlets dropped by 5.2% between January of this year and the corresponding period of 1999. More detailed information on the behavior of this retail segment points to a decline of 30.5% in the stock of light commercial vehicles and 81.1% in that of buses, compared to an increase of 1.2% in the stock of automobiles and 41.4% in that of trucks.

1.5 – Fiscal result

In 1999, the central government registered a surplus of R$ 21.5 billion in its primary accounts, based on a R$ 31.5 billion National Treasury surplus and deficits of R$ 9.3 billion in the Social Security System and R$ 750 million at Banco Central.

As a proportion of GDP, the central government surplus increased from 0.6% in 1998 to 2.1% in 1999. This growth was fully consistent with the federal government's effort to comply with the targets defined for the consolidated public sector.

Revenues accumulated in the fiscal year came to R$ 211.2 billion, for nominal growth of 14.8%, compared to 1998 revenues. Total National Treasury revenues came to R$ 162.1 billion, for nominal growth of 17.6% in relation to the previous year. This result was impacted positively by the performance of net managed revenues and reflected the following factors:

a) payments of debts in arrears in the framework of PIS/Pasep, Cofins, the Social Contribution on Net Profits (CSLL) and the corporate income tax;

b) incorporation of judicial deposits to the National Treasury single account;

c) increase in the Cofins rate from 2% to 3% as a consequence of extension of its coverage to financial institutions;

d) levying of the IOF on financial investments in investment funds at the rate of 0.38%, coupled with the increase of 0.38 percentage points in the rate on credit operations with individuals and legal entities, which remained in effect throughout the period in which the CPMF was not levied;

e) taxation, under the heading of the income tax, of fixed income financial investments to be used in coverage operations;

f) increase in reals generated by the inflow on remittances abroad and the import tax.

The inflow of R$ 17.8 billion under "other revenues" of the federal government resulted basically from concessions of telecommunications services, stock participation and dividends and royalties paid by Petrobras (Law no. 9,478/1998).

Accumulated expenditures came to R$ 189 billion in the year, corresponding to 18.7% of GDP and reflecting nominal growth of 5.9% in relation to 1998 outlays. Treasury spending came to R$ 130.6 billion, equivalent to 12.9% of GDP, and social security benefits closed at R$ 58.4 billion or 5.8% of GDP.

Disbursements of the federal administration accounted for 50.8% of total outlays, with R$ 96.1 billion, reflecting growth of 1.3% in comparison to 1998. Among the various components, outlays on personnel and charges came to R$ 49.2 billion for expansion of 7.2%, despite the lesser vegetative growth in the civil service payroll as a result of the government's decision to suspend any and all promotions. Current expenditure and capital outlays came to R$ 46.9 billion, for a reduction of 4.3%. This result clearly mirrors efforts to curb spending in those categories subject to National Treasury control.

Growth of 17.1% in transfers to the states and municipalities, which totaled R$ 31.9 billion, is attributed to growth under the revenue categories included in constitutional transfers and to the change in the calculation formula of amounts due as a consequence of the loss of ICMS revenues (Enabling Act no. 87/1996). This change resulted in an increase of 77.3% in the volume of resources transferred, which closed at R$ 3.9 billion as against R$ 2.2 billion in 1998.

A breakdown of outlays on federal government personnel in 1999 according to the various civil service categories shows spending of R$ 24.5 billion (53.6% of the total) on active employees, R$ 14.3 billion (31.2%) on retired employees and R$ 6.9 billion (15.1%) on pensioners.

An analysis according to the branch of government indicates that the executive accounts for 84.7% of outlays, the judiciary for 11.7% and the legislature for 3.6%.

In January, the primary surplus closed at R$ 1.5 billion, corresponding to 1.6% of GDP, 0.4 percentage point above the January 1999 result. National Treasury accounts closed with a R$ 2.2 billion surplus. At the same time, Social Security and Banco Central accounts turned in respective deficits of R$ 725 million and R$ 43 million.

Revenues came to R$ 18.5 billion, of which R$ 14.5 billion were appropriated by the National Treasury and R$ 4 billion by the Social Security System. The Treasury's revenues registered a 23.9% nominal growth, mostly as a result of changes in tax legislation. It should be mentioned that a further R$ 1.8 billion inflow for which Cofins is liable resulted of the rate increase and the extension of its levying to financial institutions. This is in accordance with Law nº 9,718/1998 and is applied to taxable events starting in February 1999. Furthermore, there was an additional CPMF inflow of nearly R$ 500 million caused by the rate increase from 0.20% to 0.38%, effective as of 6.17.1999.

Expenditures closed at R$ 17 billion, for a nominal increase of 18.9%. Personnel expenditures amounted R$ 5.4 billion, registering an unusual 44% growth as compared to January 1999. This is a result of the total payment of the January 2000 payroll, whereas disbursements for the January 1999 corresponded to only 70% of total payroll.

Public Sector Borrowing Requirements

In 1999, the primary result of the nonfinancial public sector achieved a record surplus since these figures were first calculated in 1991 and was of great importance to ensuring the continued confidence of economic agents in the ongoing process of economic stabilization. Insofar as the nominal result is concerned, the increase in the deficit that occurred in the year was mostly caused by exchange system alterations at the federal level and to price rises in the case of state governments.

The primary surplus closed at R$ 31.1 billion as compared to R$ 106 million in 1998. This improvement is explained mostly by the behavior of the central government, which includes the federal government, Banco Central and Social Security System, and of government companies. The first of these registered a surplus of R$ 22.7 billion, as compared to R$ 5 billion in 1998, despite growth of R$ 1.8 billion in the Social Security deficit. State companies turned in a surplus of R$ 6.3 billion, thus reversing the 1998 deficit of R$ 8.1 billion. The consolidated public sector result was R$ 913 million above the performance criterion defined in the agreement with the IMF.

For 2000, expectations are that the nation will continue registering significant primary surpluses and complying with the quarterly targets worked out with the IMF. In this context, the primary surplus came to R$ 4.1 billion in January, the best figure ever achieved in the first month of the year.

Appropriations of nominal interest on an accrual basis came to R$ 127.2 billion in 1999, as compared to R$ 72.6 billion in the preceding year. Insofar as the central government is concerned, nominal interest expanded by 63.4% and reflected the alteration in the nation's exchange system in January 1999. This evinced the fact that, once this impact on the indexed securities debt is excluded from the calculation, total interest appropriated comes to R$ 49 billion (4.9% of GDP), as compared to R$ 50.1 billion (5.57% of GDP) in 1998. Nominal interest appropriated by state governments expanded by 118.3% in 1999, reflecting the evolution of the General Price Index - Internal Supply (IGP-DI), the indexing factor used in renegotiation of debts with the federal government.

Consequently, the nominal deficit in 1999 came to R$ 96.2 billion or 33% more than the 1998 result. As a proportion of GDP, the nominal deficit declined during the entire year, thus demonstrating that the impact of the exchange system alteration at the start of the year was gradually dissipated. Thus, the accumulated nominal deficit in the year, which had reached a level of 72.4% of GDP in January, dropped to 10% of GDP at the end of 1999, as compared to 8.1% of GDP in 1998.

Total real interest, understood as the difference between nominal interest and monetary updating, closed at 6.8% of GDP in 1999, as compared to 7.5% of GDP in the previous year. When seen under the prism of the exchange rate impact registered in January 1999, this result can be explained by the Selic interest rate trajectory followed during the course of the year. When deflated by the IGP-DI, the rate declined from 26.6% per year to 4.7% per year in the period. The impact of the alteration in the exchange rate system becomes clearer when one looks at real interest according to the various segments of the public sector. From this point of view, the federal government and federal state companies, which have the highest degree of exposure to exchange rates, turned in an increase, while the other government levels closed with declines in their real interest burdens.

The operational result of the public sector has evolved positively. In this sense, an analysis of 1999 indicates that the operational deficit closed at R$ 40.4 billion, corresponding to 3.69% of GDP, as compared to R$ 67.7 billion, or 7.52% of GDP, in the previous year. These figures clearly confirm the favorable trend toward a reduction in public sector borrowing requirements.

Net debt

In December 1999, the net public sector debt reached a level of R$ 516.6 billion, equivalent to 46.95% of GDP, as compared to R$ 385.9 billion or 42.38% of GDP, at the end of 1998. The federal government and Banco Central debt came to R$ 316.2 billion, or 28.74% of GDP, while the state and municipal debt closed at R$ 170.8 billion, or 15.53% of GDP. The debt of state companies added up to R$ 29.6 billion, or 6.9% of GDP.

Growth of 4.6 percentage points (p.p.) in the ratio between the total net debt and GDP, which is mostly explained by alterations in the rate of exchange, was still lower than the rate of growth in 1998 (7.8 p.p.). Asset adjustments accounted for approximately 75% of the growth in the total net debt/GDP ratio, of which about 80% was a consequence of foreign

Projects awaiting Congressional approval
Position on 2.29.2000

1 – Fiscal Liability Law

– legal instrument: complementary law (PLP no. 18/1999) - defines the fundamental principles of responsible fiscal management and general norms to guide administration of public resources;
– current voting status at Congress: approved by the Chamber of Deputies, it is now awaiting to be discussed by the Senate.

2 – Tax Reform

– legal instrument: constitutional amendment (PEC no. 175/1995);
– current voting status at Congress: the rapporteur's report was approved at the Special Committee of the Chamber of Deputies on 11.23.1999. There is no specific date to be voted by the plenary sitting.

3 – Administrative Reform regulations

3.1 – legal instrument: complementary law (PLP no. 43/1999) - regulates the loss of public offices as a result of insufficient performance and defines typical government offices;
– current voting status at Congress: approved by the Chamber of Deputies on 8.17.1999 and sent to the Federal Senate to be voted.

3.2 – legal instrument: constitutional amendment (PEC no. 137/1999) - defines the ceilings for remuneration in the three levels of government;
– current voting status at Congress: approved at the Constitution and Justice Committee of the Chamber of Deputies on 11.3.1999. A Special Committee was formed on 11.18.1999 with the task of discussing the substantive aspects of the bill.

4 - Regulation of the Social Security Reform

4.1 – legal instrument: complementary law (PLP no. 8/1999); disciplines the relationship between the federal government, states and municipalities and their closed institutions of complementary social security;
– current voting status at Congress: awaiting rapporteur's report at the Constitution and Justice Committee of the Chamber of Deputies.

4.2 – legal instrument: complementary law (PLP no. 63/1999) - deals with the complementary private social security regime;

– current voting status at Congress: approved by the Chamber of Deputies in 12.1.1999. The bill is now under examination by the Senate.

4.3 – legal instrument: constitutional amendment (PEC no.136/1999) - institutes social security contribution of the military and retired employees;

– current voting status at Congress: acceptability has been approved at the Constitution and Justice Committee of the Chamber of Deputies on 11.10.1999. The Special Committee was formed on 11.18.1999 with the task of discussing the substantive aspects of the bill.

5 – Fund for Controlling and Eliminating Poverty

- legal instrument: constitutional ammendment (PEC no. 67/1999).
- current voting status at Congress: the rapporteur's report was approved at the Constitution and Justice Committee at the Senate on 2.9.2000. Its final approval still depends on two voting sessions at the Senate and two voting sessions at the Chamber of Deputies.

debt methodological adjustments. In 1998, asset adjustments added up to 0.5% of GDP, with the methodological adjustment of the foreign debt accounting for 0.29% of GDP.

Consequently, the ratio between the net fiscal debt and GDP, which excludes the impact of asset adjustments, registered an increase of 1.6 p.p. or less than the 7.2 p.p. rise that occurred in the previous year. When one abstracts from the impact of the exchange system alteration on the securities debt, the ratio of the net fiscal debt/GDP declined by 2 p.p. in 1999, thus indicating the effectiveness of the fiscal adjustment implemented during the course of the year.

In January of the current year, the public sector net debt closed at 47.2% of GDP, reflecting asset adjustments of R$ 3.9 billion.

1.6 – Balance of goods and services

Trade balance

With the favorable impact of exchange devaluation, the 1999 trade balance result was a deficit of R$ 1.2 billion, based on exports of US$ 48 billion and imports of US$ 49.2 billion. Evidently, this figure reflected considerable improvement over the 1998 result of a US$ 6.6 billion deficit.

Trade balance - FOB

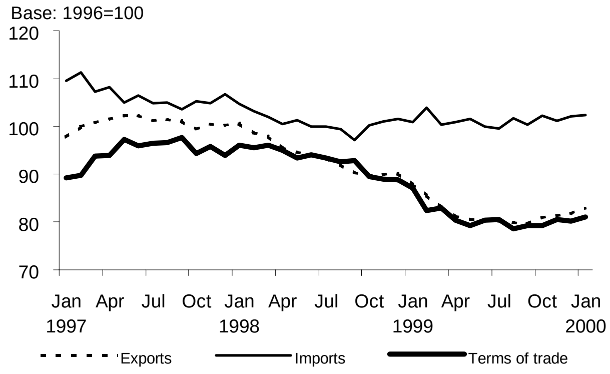
US$ million

Period		Exports	Imports	Balance	Trade flow
Jan-Dec	1999	48.011	49.218	-1.206	97.229
	1998	51.140	57.733	-6.593	108.873
% change		-6,1	-14,7		-10,7
Jan-Feb	2000	7.576	7.592	-16	15.168
	1999	6.216	6.809	-593	13.025
% change		21,9	11,5		16,5

Source: MDIC/Secex

Initially, the modification of the nation's system of exchange created expectations of a trade balance surplus in 1999. However, during the course of the year, it became evident that there were two important factors working against this possibility: very low international prices for the nation's major export commodities and a sharp decline in international demand, particularly in the case of demand for manufactured goods on the part of traditional Latin American trading partners.

Growth in price and terms of trade indices



Deteriorating terms of trade during the course of 1999 had a negative impact on the Brazilian balance of trade result. In the case of foreign sales, the price indices for basic goods and semimanufactured products declined by 15.1% and 15.2%, respectively. The impact of these falloffs was offset to some extent by efforts on the part of exporters to increase the volume of their operations. The result was growth of 8.4% in the quantum index of basic product exports and 15.9% in the case of semimanufactured goods. With this result the falloff in the value of exports was attenuated and came to a final reduction of 6.1% in the year. At the end of 1999, particularly in the final quarter of the year, export price indices moved slightly upward. However, in terms of trends, they clearly pointed to a situation of

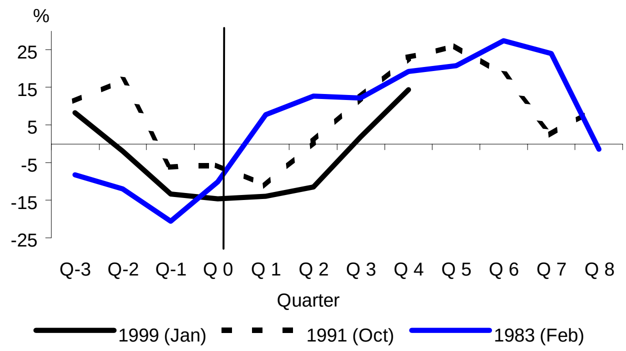
Exports by categories of goods - FOB

Itemization	1999/1998			2000/1999
	Jan-Jul	Aug-Dec	Jan-Dec	Jan-Feb
Primary products	- 15.2	1.6	- 8.8	0.5
Industrial products	- 13.8	7.7	- 5.2	28.1
Semimanufactured goods	- 11.2	13.0	- 1.7	22.1
Manufactured goods	- 14.5	6.3	- 6.1	30.0
Total	- 14.2	6.2	- 6.1	21.9

% change

Source: MDIC/Secex

Exports (Quartely) - FOB
(% change over the same period of the previous year)



Exports by aggregate factor - FOB
Major products

US$ million

Itemization	January/February		%
	1999	2000	change
Semimanufactured products	1 148	1 402	22.1
Cellulose	175	290	65.7
Steel/Iron semimanufactured goods	164	228	39.0
Unprocessed aluminum	140	161	15.0
Raw sugar	151	137	- 9.3
Leather and hides	88	115	30.7
Manufactured products	3 660	4 759	30.0
Aircrafts	197	434	120.3
Orange juice	158	236	49.4
Footwear	222	252	13.5
Transmission/reception equipments	76	224	194.7
Passenger vehicles	77	166	115.6
Car parts	147	166	12.9
Flat rolled steel	132	148	12.1
Vehicle engines	124	141	13.7
Cargo vehicles	89	91	2.2
Pumps and compressors	88	103	17.0
Tyres	71	88	23.9
Paper for writing	88	86	- 2.3
Furniture	47	68	44.7
Refined sugar	112	61	- 45.5
Plywood	38	63	65.8
Total	6 216	7 576	21.9
% share of the items	38.4	43.0	

Source: MDIC/Secex

relative stability in the prices of the major products included in Brazil's export program.

Insofar as imports are concerned, prices rose by 6.5% and the quantum index dropped by 19.9%, generating a result that was 14.7% less than in 1998.

When 1999 is divided into two periods, one observes that exports accumulated a decline of 14.2% in the period from January to July, while registering positive growth of 6.2% in the August to December period, when compared to 1998 results. Particular stress should be given to recovery in exports of industrialized goods, which had dropped by 13.8% in the first seven months of the year. These sales increased by 7.7% in the final five months of the year, utilizing the same basis of comparison.

Following a drop of 1.2% in the accumulated January-July result, the quantum index of exports - purged of seasonal factors - registered growth of 16.2% in the August-December period, with particular emphasis on semimanufactured goods (20.6%) and manufactured products (14.4%).

One should note that exchange devaluations in the past, in the framework of a fixed exchange rate system, normally took from two to four quarters before a reaction became evident in the export sector. This is what occurred in 1999, as exports turned upward more intensively as of the second half of the year.

The accumulated result of the balance of trade in the first two months of 2000 was a deficit of US$ 16 million, thus confirming the trend toward recovery, when compared to the US$ 593 million deficit that marked the same period of the preceding year.

Exports - Major markets

Itemization	% Change Feb 2000[1/]	Major markets
Semimanufactured products	30.5	
Cellulose	44.8	USA, Belgium, Japan and Italy.
Steel/Iron semimanufact.	28.0	USA, Thailand and Turkey
Leather and hides	15.5	Italy, Hong Kong and USA
Manufactured products	34.3	
Aircrafts	137.4	USA and Europe.
Orange juice	51.1	USA, Belgium, Netherlands, Japan and Australia.
Transmission/recep. equip.	157.1	USA, Argentina, Venezuela and Mexico.
Passenger vehicles	106.5	Mexico, Argentina, Italy, Venezuela and Chile.
Cargo vehicles	33.8	Argentina, Italy, Mexico, Chile.
Furniture	22.0	USA, Argentina, Germany and France.

Source: MDIC/Secex

1/ Change over the same period of the previous year

Exports and imports by Economic Blocs - FOB
Januany-February

US$ million

Itemization	Exports			Imports			Balance	
	1999	2000	% change	1999	2000	% change	1999	2000
Total	6 216	7 576	21.9	6 809	7 592	11.5	- 593	- 16
Laia	1 327	1 705	28.5	1 303	1 524	16.9	23	180
Mercosur	937	1 065	13.7	1 004	1 080	7.5	- 67	- 14
Argentina	721	844	17.0	860	936	8.9	- 139	- 92
Others	216	221	2.6	144	143	-0.5	72	78
Mexico	74	198	167.5	85	96	13.5	- 11	102
Others	316	441	39.7	215	348	62.2	101	93
USA[1/]	1 394	1 923	37.9	1 733	1 850	6.8	- 339	72
European Union	1 829	2 023	10.6	2 126	2 068	-2.7	- 297	- 45
Eastern Europe[2/]	169	164	-3.5	96	142	48.8	74	21
Asia	721	824	14.3	954	1 048	9.8	- 233	- 224
Japan	276	388	40.5	435	390	-10.3	- 159	- 2
Korea, Rep.	98	75	-22.9	150	178	19.3	- 52	- 103
China	71	88	23.5	122	133	9.1	- 50	- 45
Others	276	273	-1.1	248	347	39.8	27	- 75
Others	776	939	21.0	597	959	60.5	178	- 20

Source: MDIC/Secex.

1/ Includes Puerto Rico.

2/ Albania, Bulgaria, Hungary, Poland, Slovak Republic, Czech Republic, Romania and countries of the former Soviet Union.

In the first two months of 2000, exports of industrialized products expanded by 28.1%. Here, particular mention should be made of manufactured products which registered growth of 30% in the period, suggesting that buyer markets were finally beginning to react, particularly in Latin America. Among manufactured products, the most important were aircraft, orange juice, transmission and reception equipment, passenger cars, furniture and plywood. Among semimanufactured goods, exports increased by 22.1% and were concentrated under cellulose, semimanufactured iron and steel goods and leather and hides.

With respect to the markets for Brazilian exports, the United States still absorbs the largest individual share of sales. In the two month period under analysis, exports to the United States market increased by 37.9%. Evidently, this result was greatly aided by the continued robust growth of the American economy. A more detailed analysis of this sales performance shows that the result was leveraged mostly by manufactured products, including aircraft, coffee, cellulose, orange juice, footwear and transmission and reception equipment.

With regard to the countries of Latin American, which have registered significant recent economic recovery, one should emphasize sales of such manufactured products as transportation equipment and mobile telephones. Foreign sales to the Laia countries increased by 28.5% and were concentrated in operations with Argentina (17%), Mexico (167.5%), Chile (52.9%) and Venezuela (71.7%). Among other trade blocs, sales to Japan increased by 40.5% and exports to the European Union grew by 10.6%.

Consequently, recovery in sales to important consumer markets in Asia and Latin America, coupled with ongoing growth in operations with the United

Imports by category of products - FOB

US$ million

Itemization	January-December			January-February		
	1998	1999	% change	1999	2000	% change
Consumer goods	10 712	7 356	- 31.3	1 072	990	- 7.7
Durable	5 242	3 182	- 39.3	445	390	- 12.5
Nondurable	5 470	4 174	- 23.7	626	600	- 4.2
Raw materials	26 813	24 050	- 10.3	3 308	4 033	21.9
Fuels	4 107	4 257	3.7	382	683	78.9
Capital goods	16 101	13 555	- 15.8	2 048	1 886	- 7.9
Total	57 733	49 218	- 14.7	6 809	7 592	11.5

Source: MDIC/Secex

States and Europe, as well as stabilization of the prices of some of the nation's major export products have all contributed positively to the favorable foreign trade perspectives that marked the end of 1999 and early days of 2000.

Insofar as imports are concerned, the first two months of 2000 witnessed growth of 11.5% when compared to the same period of the previous year. This performance mirrored growth of 21.9% in purchases of raw materials and 78.5% in acquisitions of fuels and lubricants, coupled with a 7.7% decline in foreign purchases of consumer goods and a 7.9% drop under capital goods.

The increase in imports of fuels and lubricants in the two month period is a consequence of upward movement under international market oil prices from US$ 10.00 to US$ 26.60 per barrel, reflecting growth of 166% in prices, while the volume of imports dropped by 4.2%.

The growth that was registered under raw materials and intermediate goods also contributed to the performance of imports in the two month period. In this case, the total moved from US$ 3.3 billion in 1999 to US$ 4 billion this year. The increase of US$ 725 million was a determining factor in the growth of total imports between these two periods, which came to US$ 782 million.

Services

Trade in services closed with alterations that were clearly consistent with adoption of the floating rate exchange system and reacted more rapidly to changes in prices than trade in goods.

The item international travel reflected this process and, when seen in the context of the recent trade balance results, mirrors the new standard for the current accounts not related to production factors. Travel revenues have followed an upward trajectory since early

Services

Itemization	1998	1999					US$ billion
		I Q	II Q	III Q	IVQ	Year	Jan-Feb
Total	-28.8	-5.0	-7.7	-4.9	-7.6	-25.2	-2.4
Interests	-11.9	-2.9	-4.8	-2.5	-5.0	-15.2	-1.6
Profits and dividends	-7.2	-1.2	-1.1	-0.9	-0.9	-4.1	-0.1
Transportation	-3.3	-0.6	-0.7	-0.7	-0.8	-2.8	-0.4
International travel	-4.1	-0.2	-0.3	-0.5	-0.4	-1.4	-0.2
Sundry	-1.8	-0.1	-0.5	-0.2	-0.3	-1.1	-0.1
Other[1/]	-0.4	-0.1	-0.2	-0.1	-0.2	-0.6	0.0

1/ Includes reinvested profits.

Current Transactions

Itemization	1998	1999					2000-Feb (US$ billion)
		I Q	II Q	III Q	IVQ	Year	Last 12 months
Trade balance	-6.6	-0.8	0.2	-0.2	-0.4	-1.2	-0.6
Services	-28.8	-5.0	-7.7	-4.9	-7.6	-25.2	-24.6
Unrequitted transfers	1.8	0.6	0.5	0.5	0.5	2.0	1.9
Current account	-33.6	-5.2	-7.0	-4.6	-7.6	-24.4	-23.3

1999, reaching a monthly average inflow in the quarter ended last February of US$ 158.2 million, as compared to US$ 135.2 million in 1999. With regard to spending, the change was even more significant as the monthly 1998 average of US$ 476.6 million dropped to US$ 251.7 million in the twelve month period up to February.

Insofar as imports of goods and international travel are concerned, one can note that the balance of goods and services not related to production factors adjusted more rapidly to the new relative price structure. One should stress that this was not achieved solely by declining demand, but also by a domestic supply structure that made it possible to substitute some previously imported goods and services. At the same time, the same structure has demonstrated its capacity to meet foreign demand and this has certainly had a positive impact on export revenues, though the results here tend to appear at a somewhat slower pace.

With respect to services related to production factors, interest, profits and dividends and most of the items under diverse services, the overall behavior was relatively stable, particularly when seen in light of the standard of balance of payments financing in recent years, foreign indebtedness and, above all, growth in foreign direct investment.

Profit and dividend remittances from the final quarter up to February came to a monthly average of US$ 509.4 million, as compared to US$ 639.1 million in 1998 and US$ 461.4 million in 1999.

Outlays on interest accumulated US$ 3.8 billion in the same period, as compared to US$ 3.7 billion in the same period of the previous year, thus reflecting the increase in the cost of the debt contracted in the course of 1999.

Spending on diverse services related to production factors moved from a 1999 monthly average of US$ 433.1 million to US$ 445.8 million in the 12 month period up to February, coming close to the 1998 monthly average of US$ 461.3 million. This performance reflects the low level of sensitivity of this item to 1999 price changes since acquisitions of such services as technical assistance, technology supplies and purchases of computer software have been stimulated by new foreign investments and the process of economic modernization.

The service balance in the first two months of 2000 was a deficit of US$ 2.4 billion, as compared to US$ 3 billion in the same period of the previous year. With a deficit of US$ 16 million in the balance of trade and net inflows of US$ 271.3 million in unrequited transfers, the deficit in current account in the two month period came to US$ 2.2 billion. When one looks at the 12 month period up to February, the current account result was a deficit of US$ 23.3 billion, or sharply less than in the same period of the previous year (US$ 33.2 billion). A similar trajectory can be seen in a comparison between the annual 1998 and 1999 deficit, which came to respective levels of US$ 33.6 billion and US$ 24.4 billion.

1.7 – Conclusion

Consumer and investment indicators point to recovery in demand levels in the final months of 1999, when the seasonal effects that are characteristic of the period are taken into account. Though by no means conclusive, preliminary data for this year indicate an ongoing albeit less intense trend.

Among the factors that have generated this growth, one should highlight the improved overall credit conditions that have resulted mostly from alterations in operations with the trade sector. With these changes, the result has been increasing consolidation of the continued expansion of installment sales. Another factor that deserves mention is the impact of increasingly more optimistic expectations regarding overall economic conditions and the more positive outlook that now prevails among economic agents regarding consumption and investment decisions.

Despite growing demand, inventory indicators point to a relatively modest reduction in stock levels in recent months. Consequently, over the short-term, there are no significant signs of rising pressures on prices caused by shortages of farm or industrial products.

The more stable overall economic situation, coupled with an interest rate level that is the lowest since introduction of the Real and the effects of the measures taken by the monetary authority, has made it possible to reduce financial system margins in inflow operations. Consequently, though still considered high, the rates on asset operations - particularly in operations with individual consumers - have been steadily decreasing in recent months.

Since July 1999, credit operations with individual consumers have been expanding vigorously, though one must note that the volume of these operations - in absolute terms - is still far from the macroeconomic magnitude found in countries with more developed financial systems. In such National Financial System credit segments as business credits with non-earmarked funding, housing credits and BNDES operations, aggregate behavior has not generated a significant impact on aggregate demand.

To the extent that the process of economic stabilization and the downward trajectory of interest rates on asset operations solidify, personal credit will certainly expand and stimulate demand for final goods. Evidently, this process will induce greater demand for credit in other sectors and will have highly positive repercussions on all facets of the nation’s economic life. However, one must be aware that the improvements already achieved in macroeconomic fundamentals, coupled with appropriate application of monetary policy, bear the tremendous responsibility of avoiding the possibility of a more dynamic credit market being transformed into inflationary pressures.

Continued fiscal austerity in 2000 will ensure primary results that are compatible with the formation of internal savings at a level considered in keeping with the process of sustained economic growth. This trajectory, coupled with the decline in interest rates and the outlook implicit in a scenario of economic stabilization, will result in lesser public sector borrowing needs in the nominal and operational concepts, thus making it possible to achieve a consistent reduction in the debt/GDP ratio.

Completing the ongoing process of strengthening the macroeconomic fundamentals of the Brazilian economy, the current account deficit - the counterpart of external savings - has moved sharply downward. This demonstrates that the nation's external relations have been evolving in a positive way in recent months with a clear trend to lesser demand for balance of payments financing.

2 – Aggregate supply

2.1 – Crop and livestock farming

Crops

Crop production

			1000 t
Itemization	1999	2000 [1/]	% growth 2000/1999
Grain production	82 568	83 670	1.33
Cotton (seed)	992	1 124	13.31
Rice (in husk)	11 779	11 183	-5.06
Beans	2 889	2 971	2.84
Corn	32 178	32 810	1.96
Soybean	30 904	31 741	2.71
Wheat	2 436	2 436	0.00
Others	1 390	1 405	1.08

Source: IBGE

1/ It refers to the January Systematic Survey on Agricultural Production (LSPA).

Following sharp 9.7% growth in 1999 grain production, early estimates for the Brazilian 2000 harvest indicate a 1.3% rise, according to the Systematic Survey on Agricultural Production (LSPA), carried out in January by IBGE. Overall output of grain, legumes and oil-bearing crops is expected to total 83.7 million tons, as compared to 82.6 million tons in the previous harvest. In the southeast, south and central-west regions and the state of Rondônia, which now account for 90% of the total harvest, growth is expected to close at 0.5%, while the north and northeast regions expect a harvest 9.3% greater. One should note that, in light of the nation's farm calendar, these estimates include simulations of winter crops (wheat, oats, barley and rye) and the second and third corn and bean harvests. In the case of the northeast regions, some of the estimates are based on sowing intentions.

Among the major products, the greatest expansion is expected under output of herbaceous cotton (13.3%). Total expected output is forecast at 1.1 million tons, mostly in light of the excellent prices attained in the previous marketing period and expansion of this crop in the State of Mato Grosso. Estimates for the rice crop foresee 11.2 million tons, reflecting a drop of 5.1%, mostly as a result of insufficient rainfall in the State of Rio Grande do Sul, the nation's major production region.

Expected output of the first bean harvest could reach as high as 1.4 million tons, for growth of 3.6%, despite losses in the States of Rio Grande do Sul and Paraná. Soybean output is expected to expand by 2.7% to a level of 31.7 million tons despite the drought that hit some regions of the State of Rio Grande do Sul. Notwithstanding the lack of ideal climatic conditions, production in that state is still expected to climb by 21.4% in comparison to the previous year to 5.4 million tons. The first corn harvest should register growth of 2.6% and close at a level of 25 million tons, as compared to 24.3 million in 1999.

Here, one should note that, even if the current grain harvest matches the previous harvest, a greater volume of imports will be needed to meet internal supply in comparison to 1999. This is particularly true in the case of corn, since government stocks diminished from 2.8 million tons in December 1998 to 539.4 thousand tons at the end of 1999. In the coming months, prices are expected to follow a downward trajectory as the harvest is brought in and the volume of supply increases. In the second half of the year, the price trend will reverse and move upward as stock levels decline and the sector moves into the out-of-season period.

Livestock

Based on IBGE data, livestock production expanded by 3.9% in 1999 and benefited from the performance of foreign sales and declining imports. Both of these results were due mostly to the effects of exchange devaluation. One should note that the volume of exports of beef, poultry and pork registered significant growth of 81.4%, 25.8% and 2%, respectively, while exports of milk and its derivatives increased by 46.6% and imports of these goods fell by 0.12%. Growing exports during the course of the year pushed internal prices upward, principally in the off-season period. In the first six months of the current year, prices are expected to settle back as seasonal factors generate greater supply, despite expectations of continued expansion in foreign sales.

2.2 – Industry

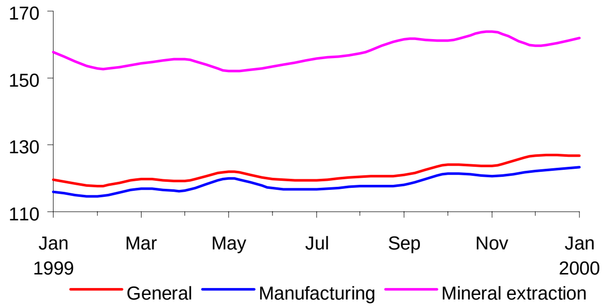
Industrial production

Growth in industrial production in the final months of 1999 confirmed the growth trend evident in the third quarter. In the period from September to December, production of the sector expanded by 4.9% (following elimination of seasonal factors) and achieved growth of 1.6% in the second half of the year in relation to the same period of the previous year. The first six months of the year closed with a decline of 3.2%. Though negative, the -0.7% 1999 result reflected improvement over even the most optimistic predictions made at the start of the year. Among the factors that contributed to this recovery, one should emphasize the impact of the exchange rate shift on exports, import substitutions and credit growth in the second half of the year. An analysis of financial system loans to individuals and the trade sector indicates respective growth rates of 11.2% and 5.6% in the period.

Recent growth was not concentrated in just a few industrial segments. This across-the-board expansion could well mean that fundamental alterations are occurring in the nation's productive system. As a matter of fact, the fourth quarter of the year witnessed positive results in fifteen of the twenty industrial segments surveyed. Based on data from which seasonal data have been purged, the segments of mechanics and transportation equipment led the way with highs of 8.8% and 6.9%, respectively, in comparison to the previous quarter. A breakdown by use categories indicates generalized growth, with the strongest performance under capital goods output (8.1%), mostly as a result of production for the transportation sector (11.7%). The sectors of intermediate goods (4.8%) and consumer durables (4.3%) also turned in results well above the overall average for the quarter.

The result for January of this year - based on data free of seasonal influences - remained at the December level. In comparison to January 1999, growth came to 5.4% as a result of expansion in all use categories and in 17 of the 20 segments surveyed. In the case of consumer durables, growth came to 9.4%, followed by capital goods with 6.3% and intermediate goods with expansion of 6.6%. Finally, semidurable and nondurable consumer goods closed at 1.3%, somewhat below the average growth level. This behavior can be explained for the most part by lesser production of fuels (gasoline

Industrial production
Seasonally adjusted data
1992=100



Source: IBGE

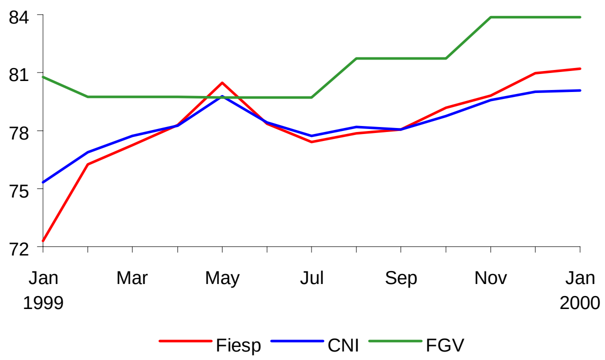
and alcohol), a fact that partly offset the positive performances registered under footwear and apparel and foodstuffs and beverages. Growth in activities based on intermediate goods - previously concentrated almost entirely in oil and gas extraction activities - included other important subsectors linked to the production of capital goods and exports as of January.

Over the short-term, the stability that was evident in relation to the month of December is explained by the 1.1% drop in the production of intermediate goods. This segment accounts for the largest share of overall industrial production and its result offset the growth registered under the other categories: 2.6% for consumer durables, 2.2% for capital goods and 0.1% for semi and nondurable consumer goods.

Utilization of installed capacity

The level of utilization of installed capacity in the manufacturing segment moved from 83% in October to 81.3% in January 2000, according to a survey carried out by FGV. Despite this decline, the final result is still the highest for this time of year since 1995 (83%). Once seasonal adjustments are made, the final figure comes to a level quite similar to that registered in the third quarter of 1997, prior to the outbreak of the Asian crisis. A breakdown into use categories shows that the consumer and capital goods industries are operating at a level of 74.5% of output capacity, while the intermediate goods sector is using 84.8% of its potential.

Utilization of installed capacity
Seasonally adjusted data
Average percentage



According to figures released by the Federation of Industries of the State of São Paulo (Fiesp), the trend evident in FGV data is clearly confirmed by results in São Paulo. Thus, in the month of January, once seasonal adjustments have been made, the level of utilization of installed capacity increased for the sixth consecutive month and closed at a level similar to that of the early months of 1995, when the level rose to the highest point in the series. Based on information up to January, the CNI survey registered 78.4% utilization of installed industrial capacity in the country in that month. Once seasonal factors have been removed, the data indicate that the current level of utilization is comparable to the first quarter of 1995, or 80% and 80.4%, respectively.

Automotive vehicle production

Output of the automobile industry declined by 15% in 1999. This result was caused by high financing costs and downward movement under both income and employment. In the first two months of this year, however, Anfavea data point to growth of 5.5% in January and 26.1% in February, based on seasonally adjusted figures. In the two month period, growth came to 34.05% as compared to the same period of 1999. To some extent, this result was a consequence of the comparison base. It should be recalled that, in early 1999, the automobile market was dominated by expectations of a price reduction as a result of the imminent signing of the Emergency Automotive Agreement.

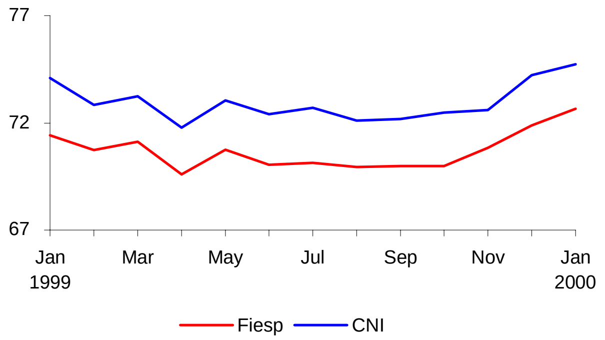
2.3 – Labor market

Employment

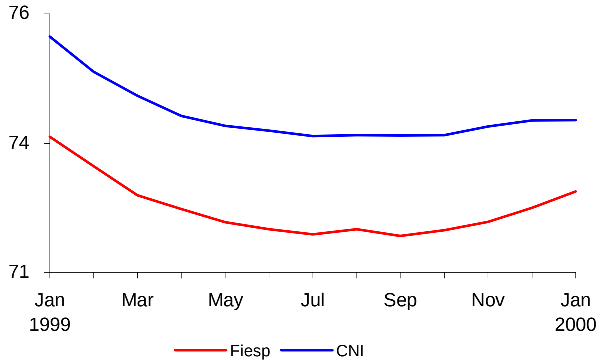
In the final quarter of 1999, labor market indicators pointed to a change in the negative trend that had been evident in most surveys since 1997. However, the positive results were not yet sufficient to appear in 12 month comparisons. The first statistics available for 2000 were derived from surveys in the manufacturing sector (Fiesp) and residential surveys (IBGE) and signaled that the recovery process was moving forward.

According to the monthly Fiesp survey carried out in January, the industrial employment indicator - duly purged of seasonal factors - expanded for the fourth consecutive month. One should note that the rates were not only positive, but gradually increased in magnitude as time moved on: 0.16% in October, 0.23% in November, 0.37% in December and 0.44% in January. However, in comparison to January 1999, the indicator registered a decline of 1.43%. The loss rises to 5.68% when compared to the average for the last twelve months. In the same period, the falloff in the number of hours

Hours worked in production
Seasonally adjusted data
1992=100



Industrial employment
Seasonally adjusted data
1992=100

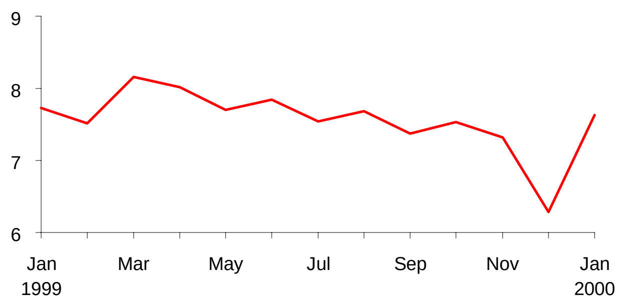


worked (10.58%), in contrast to the increase of 0.23% in industrial sales, indicate that the process of productivity gains has continued.

With regard to the employment situation, a CNI survey in 12 Brazilian states based on data available up to January indicated a trend similar to that which occurred in São Paulo in the same time period. Thus, a comparison of the first month of 2000 with that of 1999 pointed to a falloff of 2.21% in industrial employment. In terms of the 1999 average, the data raised by these surveys were quite similar: -6.03% in the twelve states and -6.08% in São Paulo. However, it should be noted that, in the final three months up to January, the series from which seasonal factors have been purged turned in consecutive positive growth rates of 0.23%, 0.16% and 0.01%. The CNI survey of industrial sales indicated an increase of 1.05% between January and December, in contrast to a decline of 8.9% in hours worked.

The Manufacturing Industry Survey carried out by FGV in the month of January revealed that industries were quite cautious as to the possibility of contracting new personnel: just 11% stated that they intended to increase their employee rolls in the first quarter of the year. Just the opposite position was expressed by 26% of the companies, while the majority (63%) had no intention of either hiring or firing employees.

Unemployment rate
%



Source: IBGE

An IBGE survey carried out in six metropolitan regions showed that 7.63% of the economically active population was classified as unemployed in January, as compared to 6.28% in December. The monthly increase in the rate of unemployment resulted mostly from seasonal factors. In comparison with January 1999, the 0.1 percentage point drop was due to growth of 2.62% in the number of persons occupied, a figure that absorbed the increase of 2.48% in the economically active population. With the exception of employers, a grouping that registered a 1.19% decline, the other categories turned in positive growth in the employment level. The largest increases occurred under unregistered workers (8.02%) and the self-employed (1.01%), demonstrating that the move toward informal labor relations has intensified. The contingent of registered workers expanded by 0.84%. A breakdown by sectors of activity shows that, in comparison with the same month of the previous year, employment increases were registered in the construction industry, industry as a whole and the service sector, with respective rates of 0.85%, 2.24% and 3.92%. In the trade sector, the final result was a 2.18% decline.

According to the Ministry of Labor, formal employment dropped by 0.07% in the month of November and 1.12% in December. However, once the seasonal adjustment is completed, the index remained stable in those months. A comparison with November and December 1998 shows that the rate of formal employment dropped 1.78% and 0.9%, respectively. In absolute numbers, 196 thousand job opportunities were eliminated in 1999, as compared to 581.7 thousand in 1998. The falloff in the number of registered workers in the last year was mostly a result of the performance of the construction industry and other services. These two areas closed with 113.1 thousand and 111 thousand less employees. Public utility industrial services also closed with a negative performance, eliminating 16 thousand job positions. In the other sectors of the economy, the final result was generation of jobs: 15 thousand in both the service sector and manufacturing industry and 14.4 thousand in the trade sector. In the month of January, the general index recovered, increasing by 0.15% in comparison to December, or 0.33% in the seasonally adjusted series. With the sole exception of the public utility industrial services, hirings surpassed dismissals in all sectors. The most significant increases were observed under manufacturing and civil construction, with respective figures of 12.2 thousand and 9.4 thousand jobs.

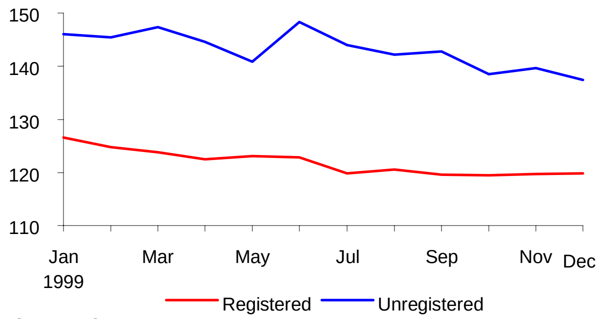
Wages and earnings

In 1999, there was an across-the-board downturn in earnings. In the industrial sector, overall wages fell for the second consecutive year and the intensity of this drop increased in the latter period. A similar performance occurred under real average earnings, as calculated by IBGE in the Monthly Employment Survey applied in the formal and informal labor markets of six metropolitan regions. However, it should be noted that the positive December results achieved under industrial indicators could well point to a change in this trend as the level of activity intensifies in the economy as a whole.

A survey carried out by Fiesp points to an increase of 0.62% in overall wages in December and 0.54% in January, once seasonal adjustments are made. Average real wages, however, increased by 0.59% and dropped by 0.25% in January, indicating that the January increase in overall wages was caused exclusively by growth in employment. In comparison to the same month of the previous year, real wages dropped by 3.67%, a factor that has contributed importantly to the 4.49% reduction in overall wages.

A CNI 12 state survey based on statistics available up to the month of December points to a decline of 9.38% in the total real earnings of labor in the manufacturing sector, thus suggesting that the trend stated above may well be uniform throughout the economy. In the specific case of the State of São Paulo, the drop came to 7.11%, as compared to a reduction of 1.6% in real average wages, thus suggesting that layoffs have been concentrated among lower income bracket workers. In January, a 0.57% increase was observed in overall wages for the 12 states surveyed, in the seasonally adjusted series.

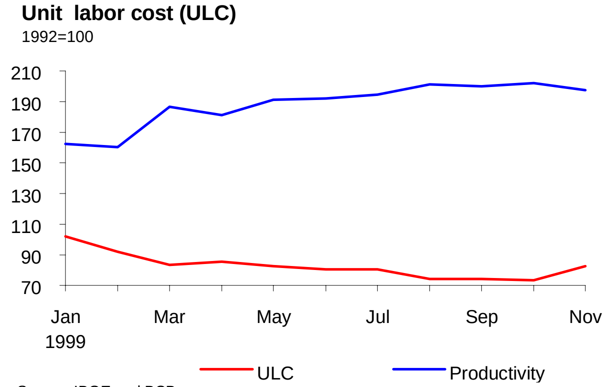
Real average earnings
Seasonally adjusted data
1992=100



Source: IBGE

According to the IBGE household survey in six metropolitan regions, nominal average earnings dropped by 0.89% in 1999. Average earnings in the year - deflated by the INPC - registered a drop of 5.48%. This downturn was most accentuated among employers and the self-employed with 10.83% and 7.29%, respectively. In the other labor categories, the declines were below the average: 4.24% among registered workers and 1.33% among those without signed working papers. On a sector-by-sector basis, the real falloff in earnings was a generalized phenomenon, though it was more intense in the industrial sector, where it came to 7.48%, followed by construction and commerce, which registered similar negative growth rates of 6.76% and 6.73%, respectively. In the case of services and other sectors of the economy, the losses were less accentuated and closed at respective levels of 4.86% and 3.21%.

Unit labor cost and productivity



Source: IBGE and BCB

The unit labor cost - ratio between the industrial payroll, deflated by the IPA-OG (industrial products) calculated by the FGV, and the index of industrial production, dropped by 17.63% in a comparison of the first eleven months of 1999 with the same period of the previous year. This result was a consequence of the fact that the 19.23% drop in the real payroll was significantly higher than the drop in physical industrial production (1.48%). The nominal unit labor cost - ratio between payroll and the value of production - dropped by 15.73% in the same period. These two indicators demonstrate that, for the most part, labor factors did not generate pressures on industrial costs in 1999.

Another important factor in reducing the unit labor cost in the industrial sector in 1999 was the increase in the productivity of the labor force. The general productivity index - division of the physical output indicators by hours worked in production, with the figures being drawn from IBGE's Monthly Industrial Survey - registered an increase of 7.1% in a comparison between January and November 1999 with the same period of the previous year. This result reflected 6% growth in the manufacturing sector and 14.58% in the mineral extraction industry. Among the industrial segments analyzed, four turned in growth of more than 10%: beverages (10.95%), rubber (11.35%), paper and cardboard (13.48%) and wood (16.41%). The only segment to close the period with negative growth was that of leather and hides (-1.47%).

2.4 – Gross Domestic Product (GDP)

The performance of GDP in 1999 was much better than had been expected at the start of the year. The early forecasts were made in the context of crises in Mexico and the Asian nations, following rapid devaluations of their currencies. These and other events that marked that period contributed to the formation of highly pessimistic expectations as regards the performance of the Brazilian economy in the year.

In this framework, the 1.4% positive growth registered by GDP in the fourth quarter of 1999 - IBGE data purged of seasonal factors - confirmed the upturn in the pace of activity. This had already become evident in other indicators, particularly in the industrial sector. As a matter of fact, the activities of this sector in the last three moths registered growth of 2.5% in comparison to the previous quarter (data purged of seasonal factors). Utilizing the same basis of comparison, GDP data point to expansion of 1.3% in the sector of services and a decline of 1.4% in crop and livestock activities, a sector in which production is not significantly impacted by short-term economic conditions. An analysis of the various subsectors shows growth of 5.6% in the manufacturing sector, 5.7% under commerce, 6.4% under communications, and a drop of 5.7% under livestock farming.

The performance of the economy in the final quarter contributed to positive growth of 0.8% of GDP in 1999, despite the fact that the 3.1% GDP growth registered in the quarter - when compared to the same period of the previous year - incorporated the statistical impact of the severely depressed activity level provoked toward the end of 1998 by the Russian crisis. GDP growth in the final quarter of 1999 reflects expansion of 14.9% in crop and livestock farming, 3.3% in industry and 1.8% in services. For the year as a whole, these headings registered variations of 9%, -1.7% and 1.1%, respectively.

GDP - Accumulated rate in the year (%)

Itemization	1998				1999			
	I	II	III	IV	I	II	III	IV
GDP	0.73	1.07	0.79	0.05	0.65	0.20	0.07	0.82
Crop and livestock	-4.23	2.37	3.08	-0.02	14.50	7.99	7.40	8.99
Industry	1.15	0.85	-0.22	-1.34	-3.93	-3.72	-3.25	-1.66
Services	1.06	1.03	1.07	0.83	1.39	1.11	0.82	1.07

Source: IBGE

The excellent performance of crop farming (growth of 11.7%) reflected the record grain harvest and was one of the major factors responsible for GDP expansion. In the case of the manufacturing sector, substitution of imports - particularly in the sector of intermediate goods - and increased quantities of foreign sales of manufactured goods in the final months of the year avoided an even sharper production decline. In the tertiary sector of the economy, the sector of communications expanded by a strong rate of 8.6% in the year, following privatization of the telecommunications companies.

2.5 – Conclusion

Supply toward the end of 1999 and early days of 2000 has been compatible with the evolution of demand. Utilizing possible stability in the year's grain harvest as a basic hypothesis, supply in the first half of the year - the period in which most crops are harvested - will be adequate, with no signs of untold price pressures.

Industrial supply will continue the recovery process begun toward the end of 1999 and should have a positive impact on the job market. Slow recovery in employment levels and the trajectories under the unit labor cost and productivity in this sector lead to the conclusion that the labor factor will not result in added production costs. The utilization level of output capacity closed above that of January 1999. Despite this, there is no evidence of exhaustion of the productive capacity that would make short-term growth in industrial output unfeasible.

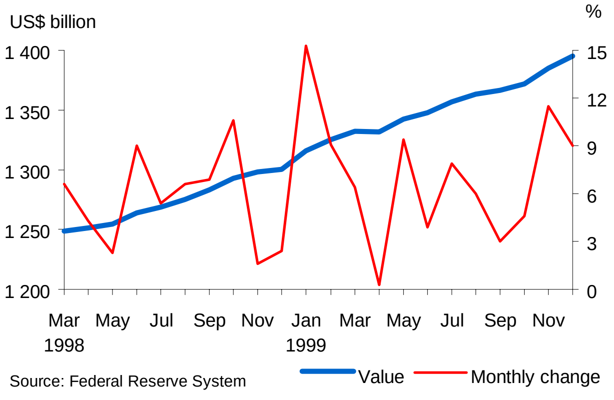
3 – International economy

3.1 – The United States

During all of 1999, the United States economy breezed along at an unprecedented clip. Powered by new technologies, coupled with budget surpluses and a strong dollar, inflation has been held firmly under control and consumer confidence has spiraled to unmatched levels.

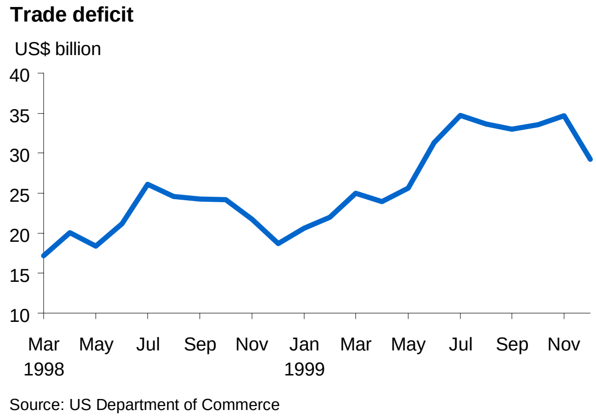
Demand indicators show no signs of a reversal in the upward trajectory. Retail sales, which had risen by 1.3% and 1.7% in November and December, expanded by 0.3% in January. However, once automotive marketing operations are excluded, sales dropped by 0.3%, a result that may well reflect a reaction to the expansion that occurred toward the end of 1999. Factory orders increased by 1.4% in November and 3.3% in December in comparison to the previous month, accumulating 1999 expansion of 6%. For the most part, these orders were concentrated under consumer durables and capital goods, particularly in the final quarter. The index of construction of new real estate and building permits expanded by 1.5% and 8.7% in January, respectively.

Credit to consumers



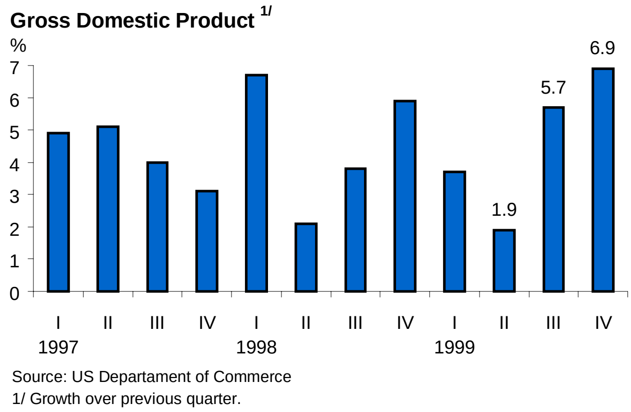
Source: Federal Reserve System

Consumer spending increased by 0.5% in January, as compared to 1.1% in December, while personal income rose by 0.7%, as against 0.3% in the previous month. Consumer credit operations increased by 14.6% in January, registering growth of 6.6% in twelve months. This performance is a reflection of and increasingly more intense degree of absorption at a time in which consumer confidence is high, stock prices are rising steadily and unemployment has plunged to its lowest level in 30 years.



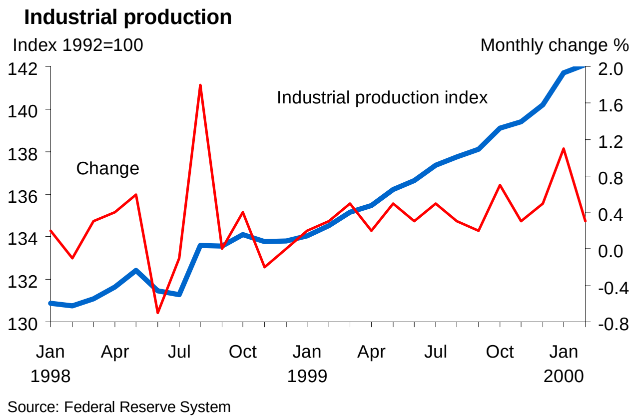
The trade deficit increased by 65.1%, totaling US$ 271.3 billion in 1999, in comparison to US$ 164.3 billion in 1998, despite a December seasonal reduction of 15.6%. Imports and exports increased by 12% and 2.6% in 1999, thus further strengthening the high level of absorption of the American economy.

Fiscal performance remained on a trajectory toward increasingly higher surpluses. In January, the positive balance came to US$ 62.2 billion, thus ratifying expectations that the surplus in the 1999/2000 fiscal year could well surpass the previous year's result of US$ 123.6 billion.



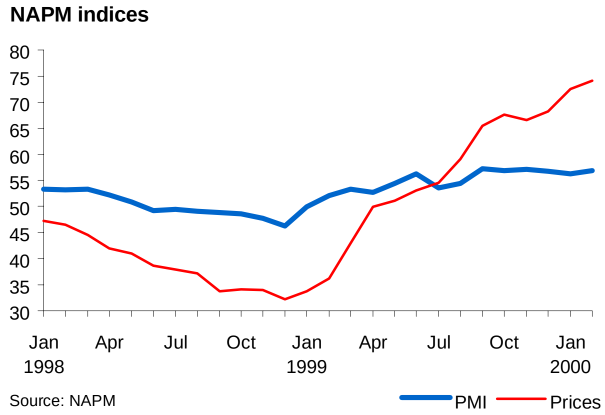
This scenario leads to the conclusion that the performance of the American economy has been powered by demand growth and that this is being adequately met by growing supply, thus avoiding internally generated inflationary pressures.

In the seasonally adjusted series, annualized GDP growth in the third and fourth quarters of the year came to 5.7% and 6.9% in relation to the previous quarter. As a result, GDP expansion in 1999 came to 4.1% or quite close to the 1998 figure of 4.3%.



In 1999, industrial production expanded by 3.6% when compared to the 1998 result of 4.2% and the 1997 figure of 6.4%. In January 2000, the pace of activity moved upward by 1% in the case of industrial production, in seasonally adjusted terms, in comparison to the previous month. Production growth is being sustained by replenishment of domestic stocks and by expanding overall demand and this situation is expected to continue into the foreseeable future.

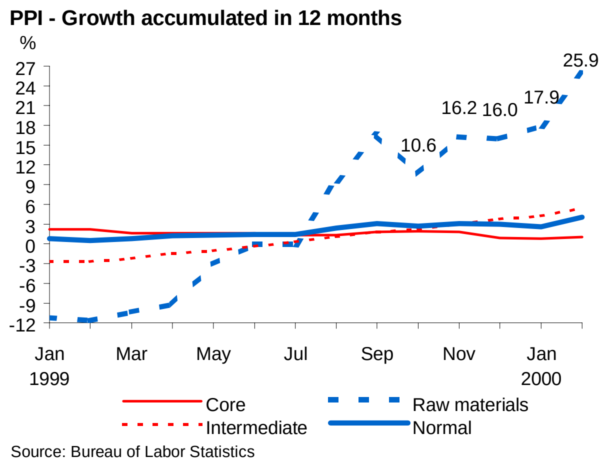
The Purchasing Management Index (PMI), which is calculated by the National Association of Purchase Managers (NAPM) and is one of the major activity level indicators of the manufacturing sector, dropped from 56.8 in December



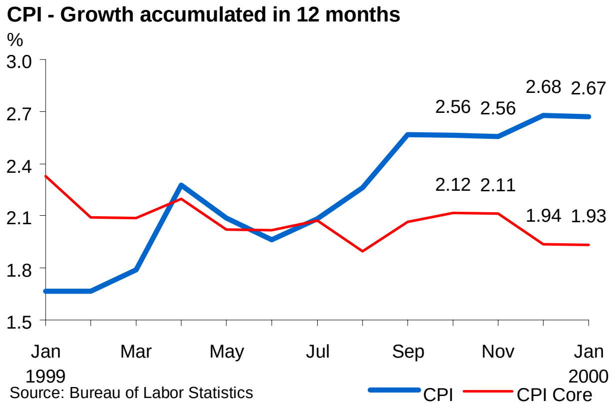
to 56.3 in January. Declines in the index were restricted to production and employment while one should mention that the component of prices paid moved sharply upward from 68.3 to 72.6. In February, the index came to 56.9, while the price component closed at 74.1. This suggests that growth is sustainable in the near future, though inflation will tend to move into an upward curve.

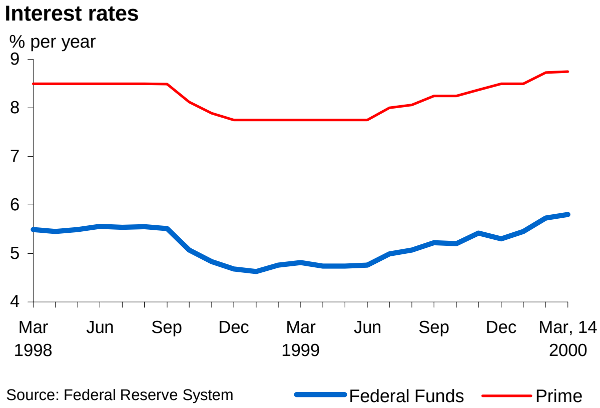
In a scenario of continued growth in labor productivity, strong demand for labor has sustained the upward trend in wage growth. Unemployment closed February at 4.1%, as compared to 4% in the previous month, thus returning to the September 1999 level. The Employment Cost Index (ECI), which calculates changes in labor earnings, rose by 1.1% in the fourth quarter, in comparison to 0.8% in the previous period, thus accumulating expansion of 3.4% in the year. Average earnings per hour worked increased by 3.5% in 1999. In January and February, this indicator rose by 0.4% and 0.3%, respectively, accumulating 3.45% and 3.6% in 12 months.

Utilizing data from which seasonal impacts have been removed, the annualized rate of labor productivity growth in the fourth quarter came to 10.3% in the manufacturing sector when compared to the previous quarter, accumulating expansion of 6.4% in 1999. In the non-agricultural sector of the economy, growth came to 6.4% in the fourth quarter, generating expansion of 3% in the year. In the fourth quarter, the unit labor cost decreased by 5.5% and 1% in the manufacturing and non-agricultural sectors, respectively, when compared to the previous quarter and utilizing annualized seasonally adjusted data.



In 1999, the Producer Price Index (PPI) rose by 3%, while the core index expanded by 0.8%. The effects of increases in energy and commodity prices are clear in the 16% growth in raw material prices, while the prices of intermediate goods increased by 3.8% in the year. In January, the PPI remained stable in comparison to the previous month, while the core dropped by 0.2%. In February, the corresponding figures came to 4.2% and 0.8%. The Consumer Price Index (CPI) rose by 0.2% in January, the same rate





as in the previous three months, while the core index - which excludes energy and foodstuffs - expanded by 0.1% as against 0.2% in December and November. In 1999, the CPI and its core registered increases of 2.7% and 1.9%, respectively, thus explaining the impact of the trajectory of oil prices on the final prices of goods and services.

The Federal Reserve Open Market Committee (FOMC) raised basic interest rate in February and March. The reasons behind this decision can be summarized as an effort to reduce imbalances between the pace of demand growth and that of potential supply, a differential that exists despite sharp improvement in productivity. The basic interest rate target for federal funds was raised by 0.25 percentage points in each FOMC meeting, closing at 6% per year. On the same occasions, the Council of Governors opted to raise the rediscount rate by 25 basis points, setting it at 5.5% per year. One should emphasize that the members of the FOMC made it clear that, despite recent deceleration in sectors considered more sensitive to interest rate changes, the gradualist policy of restricting credit will be maintained so as to ensure that demand growth will keep in step with potential supply.

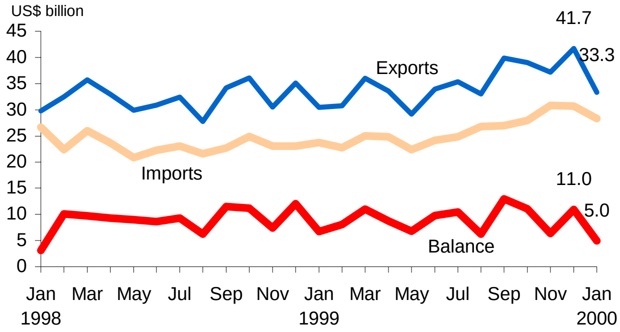
3.2 – Japan

The Japanese economy has shown some still very faint signs of recovery, particularly under demand indicators. For the most part, this is a consequence of measures taken by the government to grant fiscal incentives and of an ongoing recovery in the Asian countries. However, private demand has still not shown any significant signs of self-sustained recovery. In this sense, fixed investments by the business sector are still no better than moderate due to the conviction that sales are not about to recover over the short-term and credit demand has stagnated, while banks shifted into a rather conservative posture in their lending operations. At the same time, upward movement in the value of the yen since mid-1999, tends to exert negative impacts on business profits. However, one should note that, though there are as yet no clear signs of renewed private consumption, there are signs of improvement in employment and income conditions, coupled with real growth in the export sector and upward movement in the value of the nation's currency.

In 1999, the recovery registered in the first six months of the year was attributed to an increase in government spending and tax cuts. In the second half of the year, however, lesser governmental demand was not offset by additional private spending.

In the fourth quarter of the year, private consumption dropped by 1.6%, in comparison to the 0.2% reduction registered in the previous quarter, when compared to the same 1998 period. Residential investment declined by 5.8% and 3.2% in the final two quarters of the year, while non-residential investments increased by 4.6%, as compared to a reduction of 1.6% in the third quarter. Government consumption and investment have diminished by 0.1% and 5.4% in the fourth quarter, when compared to expansion of 0.9% and -8.5% in the preceding period.

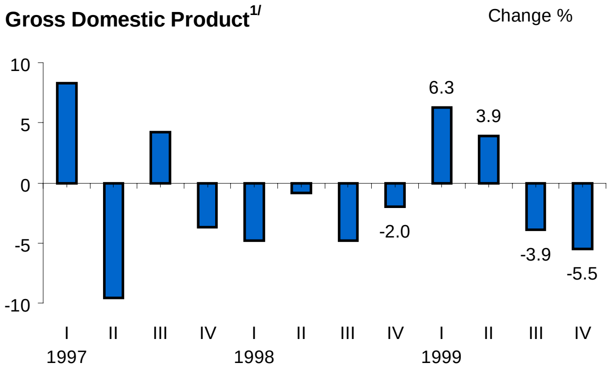
Trade balance



Sources: IFS - IMF and JP Morgan

Net exports continued on a growth trajectory despite expansion in imports and closed with 0.4% between October and December, as compared to growth of 5% in the previous quarter. Imports, which expanded by 2.8% in the third quarter of the year, increased by 4.4% in the final quarter of 1999. One should emphasize that the effects of upward movement in the value of the yen tend to conceal the improved performance of Japanese exports during the course of the year.

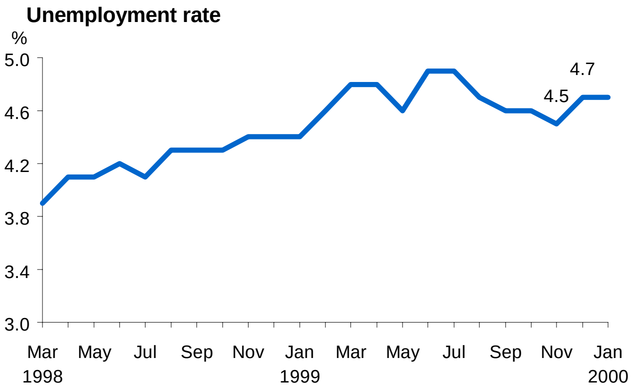
Gross Domestic Product[1/]



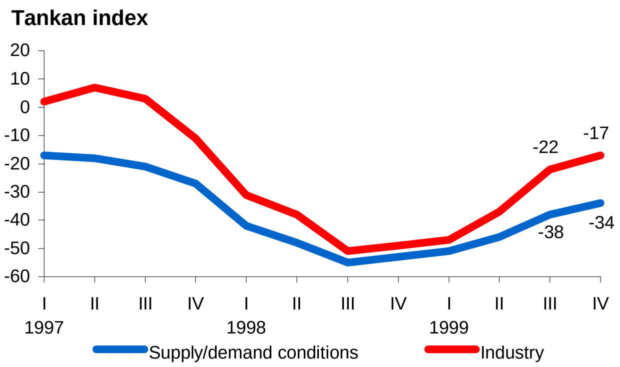
Source: Economic Planning Agency and Bloomberg
1/ Growth over previous quarter, seasonally adjusted, annualized.

In the fourth quarter, GDP declined by 5.5% in annualized terms in relation to the previous period, based on the seasonally adjusted series. It should be noted that the third quarter had already registered a drop of 3.9%. When one views the same periods of the preceding year, GDP expanded by 0.9% in the third quarter and held stable in the final quarter. According to preliminary data released by the Economic Planning Agency (EPA), GDP increased by 0.3% in 1999, compared to a drop of 2.5% in 1998.

Industrial production expanded by 4.5% in November and -1.2% in December in the seasonally adjusted series, when compared to the respective previous months. In the month of January, industrial production rose by 0.2% in relation to December and 6.5% when seen against the same months of the preceding year. One should note that, since July 1999, industrial output in relation to the same period of the preceding year has been registering positive growth.



Source: Bloomberg



Sources: Bank of Japan and Bloomberg

Insofar as employment levels are concerned, though the jobless rate has remained high by Japanese standards, some favorable signs have come to the surface: increases in hours worked and a greater supply of jobs, reflecting a drop in the velocity of job reductions. The rate of unemployment closed at 4.7% in December and January, as compared to 4.5% in November.

The Tankan confidence index, which expresses the expectations of businesspersons in relation to the overall economic situation, remained on an upward curve. In the fourth quarter of 1999, the index expressing supply and demand conditions came to -34, while expectations regarding growth in the manufacturing industry closed at -17, as compared to -38 and -22, respectively, in the previous quarter. The EPA index, which is used to foresee the activity level over the next 6 to 9 months, registered sharp 6.8% growth in January, pointing to significant short-term recovery.

Wholesale prices, which remained on a stable trajectory, varied by -0.2% in December and 0.1% in January, with 0.8% growth in February, which would seem to be a result of an increase in the prices of intermediate goods. Consumer prices moved into a deflationary trajectory as of November, with negative results of 0.6% in that month and 0.3% in December and January.

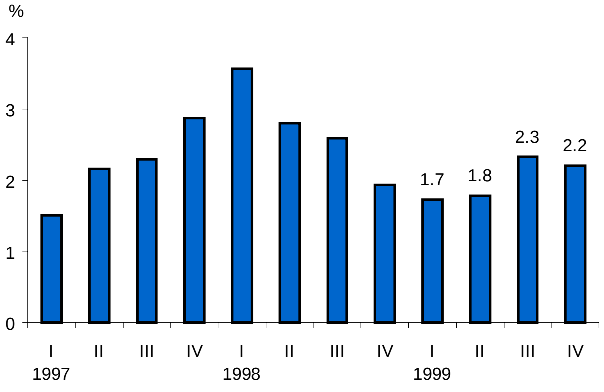
In the month of February, the yen devalued against the American dollar and reflected the varied expectations that existed in relation to the performances of the Japanese and United States economies, the outlook for an interest rate hike in the USA and deterioration in Japan's fiscal situation. At the beginning of March, the yen began to gain in value once again.

A monetary policy based on an interest rate close to zero was maintained in the fourth quarter of 1999 and early days of the new year and represents an effort to breathe new life into the nation's economy. Long-term interest rates dropped to 1.6% at the end of January, mirroring expectations that the expansionary monetary policy would be altered over the short-term. In the month of February, however, long-term interest rates increased to 1.85% as a reaction to devaluation of the yen and increases in stock prices.

The supplementary budget called for in fiscal year 2000 is designed to increase public investment, while the expansionary monetary policy is expected to provide the support needed by the economy as it swings into a positive growth phase. Government projections predict expansion of 1% of GDP in 2000, as a result of recovery in the nation's major trading partners and the consequent positive impacts on internal output. Private consumption is not expected to recover in the short-run, since the business community is now immersed in an enormous process of restructuring companies that could endanger job stability.

3.3 – Euro Zone

Gross Domestic Product [1/]



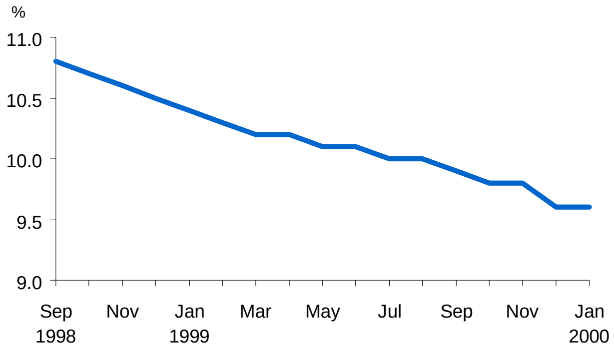
Source: Eurostat

1/ Growth over the same quarter of previous year.

For the eleven Euro Zone countries, the rate of GDP growth came to 2.3% in the third quarter of 1999, when compared to the same period of the previous year. This figure represented a further upswing in relation to the previous quarter, when expansion closed at 1.8%. Measured in seasonally adjusted data, the rate of GDP growth in the third quarter of 1999 came to an annualized level of 4.1%, when compared to the previous quarter. Projections made by the European Commission as regards GDP expansion indicate 2.1% for 1999 and 2.9% for 2000.

Industrial production has also risen sharply in annualized terms, moving from 3.1% in November 1999 to 4.4% in December of the same year. In this case, growth in the final quarter of last year registered annualized expansion of 4.1% when seen against the previous quarter. In this sector, current trends now lead to the conclusion that production indicators will move steadily upward.

Unemployment rate



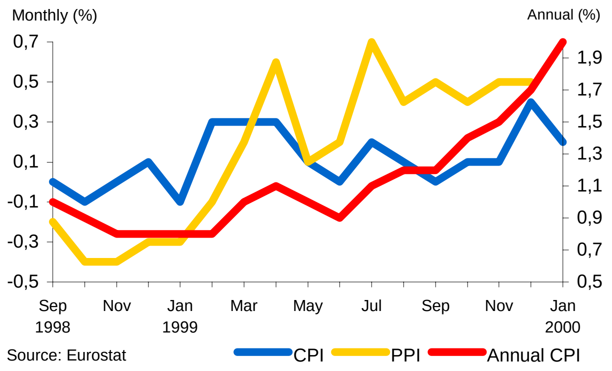
Source: Eurostat

The upturn in production has resulted in lesser unemployment. The December jobless rate came to 9.6%, as against 9.8% in October and November. The unit cost of labor increased at a constant 1.7% in each one of the first two quarters of 1999, in relation to the previous year. According to Eurostat, data from which the European Central Bank (ECB) has removed seasonal factors show that labor productivity increased at an annual rate of 0.4% in the second quarter, when seen against the situation of stability that marked the first quarter (0.1%). Here, one should underscore the fact that labor productivity in the Euro Zone is measured by the production/employment ratio and not by the production/hours worked ratio as in the case of the United States.

The favorable labor market situation has apparently stimulated growth in final private consumption. In the third quarter, this heading registered expansion of 2.4% in comparison to the same period of the previous year. The seasonally adjusted and annualized series registered positive growth of 3.3% in the July-September quarter, thus suggesting growth in consumption at the end of 1999.

In the external sector, the trade balance came to US$ 58 billion in 1999, reflecting a drop of 28.75% in relation to the preceding year. In the same time period, the volume of exports closed at US$ 820.5 billion, for growth of 3.1% in relation to 1998, while import operations totaled US$ 762.5 billion, with annual expansion of 6.72%. The fact that imports surpassed growth in exports can be attributed to some extent to higher oil prices. The dollar surplus was impacted negatively by devaluation of the euro in the period.

Inflation rates



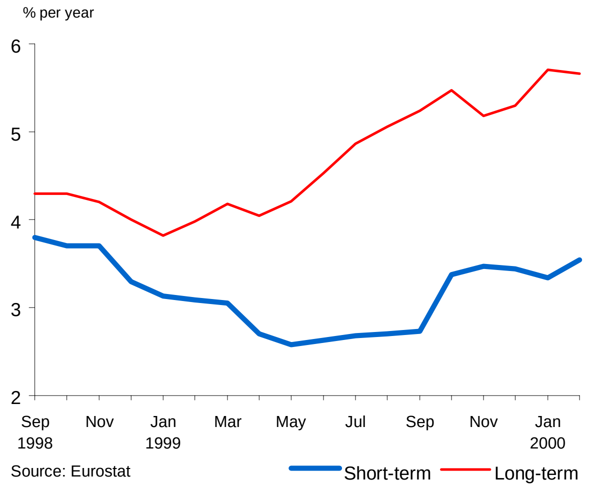
Source: Eurostat

The harmonized consumer price index expanded by 1.7% in December and 2% in January, in comparison to the same periods of the previous year, thus continuing the trend that has marked recent months. This increase was mostly impacted by energy and transportation.

In December, annual growth in the producer price index came to 4%, as against 3.1% in November, mostly as a result of increases in the prices of petroleum and some metals. The sharpest price pressure in the period was felt under intermediate goods (6.2%) and the least under capital goods (0.1%).

In this framework of accelerated growth, expansion of the quarterly movable average of the M3 monetary aggregate came to 6% in December. The annual rate of M3 growth in December 1999 was revised by the ECB to 6.2% or well above the annual reference rate of growth (4.5%).

Interest rates



Source: Eurostat

With growth of the monetary aggregates moving beyond the predicted levels and a tendency toward higher inflation, the ECB raised the basic interest rate (refinancing rate for two week loans) to 3.25% per year on February 2 and 3.5% per year on March 16. The short-term market interest rate for three month operations dropped from 3.4% per year in December to 3.3% per year in January, increasing to 3.5% in February. The interest rate on long-term government bonds (ten years) increased from 5.3% per year in December to 5.7% per year in January and remained stable in the month of February.

The seasonally adjusted index of confidence in the industry of the Euro Zone in the month of December, announced by the European Commission, confirmed the improvement that occurred in the previous month, following consistently negative results during the remainder of the year.

3.4 – United Kingdom

United Kingdom's economy continues its growth trajectory with low inflation. Price indices remain low due, principally, to imports paid with an overvalued domestic currency, when compared to other European currencies.

In January, retail sales grew by 1.5%, as compared to 0.6% in December. In comparison to January 1999, the increase came to 0.9%. One may also note a remarkable credit expansion as consumer loans registered a 9.4% increase in the fourth quarter, in comparison to the same period of the previous year. This may be related to a heated real estate market.

In December 1999, exports dropped by 1.7%, while imports remained at the same level, thus contributing to a US$ 42 billion trade deficit in the year. This performance is partly associated with the pound sterling valuation.

Demand expansion has been accompanied by growth in supply. Consequently, industrial output increased by 1.8% in December in relation to the same 1998 period. In 1999, industrial output grew by 0.5% as compared to the previous year. In the seasonally adjusted series, GDP registered a 0.8% growth in the 1999 fourth quarter, when seen against the preceding quarter. In relation to the same 1998 period, growth closed at 2,9%. This rise in production may be credited to growth in productivity which, according to the Bank of England, occurred in the entire economy and more intensely in the manufacturing sector. The official price index used to define the inflation target, which excludes mortgage interests, has accumulated a 2.1% yearly increase, below the 2.5% target accumulated in 12 months.

Competitive and regulating pressures on prices are evident in some sectors. However, when taken altogether, comprehensiveness, duration, and implication of these pressures on inflation outlook are uncertain. This scenario has encouraged the Bank of England to raise in 25 basis points the basic interest rate for the second time in 2000, setting it at 6% p.y.

3.5 – Emerging Asian economies

South Korea

Increased internal sales generated output recovery and reductions in the jobless rate. Sales in December 1999 increased by 16.2% in the retail sector and 10.5% in the wholesale sector, when compared to December 1998.

Growth in internal demand, higher oil prices and a somewhat reduced comparison base were the factors that explain the sharp 44.9% expansion in imports in the final quarter of 1999, when viewed against the same period of the previous year. In January, this growth increased by 46.3%. Foreign sales also rose sharply in the final quarter of 1999 with 24.2%, rising to 32.1% in January 2000, both in comparison to the corresponding periods of the previous year. The current accounts surplus in 1999 (US$ 25 billion) was the second largest since 1983. Here one should give special attention to the capital account, which closed at a positive US$ 0.6 billion as a result of an inflow of US$ 15.5 billion in direct foreign investment.

Industrial output, which had already expanded by 15% in 1999 and was the locomotive of 10.2% GDP growth, shot upward by 26% in January 2000, in comparison to the same month of the preceding year.

Unemployment tended downward in the period between February (8.5%) and November (4.4%), but moved upward in January to 5.3% as a result of seasonal factors.

Increases in consumer and producer prices accelerated as of the second half of last year: growth in the 12 month CPI, which had reached 0.3% in July 1999, closed January 2000 at 1.6%, while the accumulated expansion of the PPI on the same dates moved from -2.9% to 2%.

The Central Bank of South Korea implemented an expansionary monetary policy in 1999. The result was renewed economic growth and a flow of liquidity to the banks that made it possible to limit dissemination of the financial crisis that hit the Daewoo conglomerate. However, notwithstanding some valuation in the rate of exchange, the impact of growing aggregate demand and higher oil prices on domestic price levels led the Central Bank to raise its basic interest rate from 4.75% per year to 5% per year at the beginning of February 2000.

The Ministry of Finance issued the following estimates for the year 2000: real GDP growth of 7.2%; consumer inflation of 3%; current account balance of US$ 12 billion; and a fiscal deficit of 3.1% of GDP.

China

The pace of economic activity has been sustained by both internal and external sales. In the internal market, a comparison with the same month of the previous year indicates upward movement in retail sales in the period from May to October, moving into a period of relative stability from that point forward, and then expanding by 7.9% in January. This movement was solidly backed by public investment and civil service wage increases, both of which were instruments used for the purpose of stimulating aggregate demand.

In January, the balance of trade came to a US$ 1.5 billion surplus as compared to US$ 2.8 billion in December, based on US$ 16.8 billion in exports and US$ 15.3 billion in imports, reflecting expansion of 54% and 48%, respectively in relation to January 1999. In the fourth quarter of 1999, the strengthening of world and regional demand made it possible to raise exports by 16%, when compared to the same period of the previous year. In the case of imports, growth came to 8.1%, mostly as a result of public sector investments.

In the month of January, industrial production rose by 8.9%, in relation to the same month of the previous year, as compared to 7.4% in December. These figures could be interpreted as a sign of acceleration in the growth pace.

GDP growth in 1999 came to 7.1%, according to Ministry of Finance estimates, compared to 7.8% in the previous year. This is a clear indication of the difficulties experienced by the Chinese economy in its efforts to regain the growth pace that had marked the early years of the decade. The deflation process was somewhat attenuated in January as consumer prices declined by 0.2%, as compared to a 1% drop in December when compared to the same months of the preceding year.

The government followed an expansionary monetary policy in 1999, marked by growth of 20.1% in currency in circulation, 12.5% in loans and 13.7% in deposits. Maintenance of the fixed rate of exchange has been possible as a result of voluminous international reserves, which came to US$ 154.7 billion in December of last year and are still rising.

Malaysia

The Malaysian economy registered strong 5.4% recovery in GDP growth in 1999, following a decline of 7.5% in 1998. In a comparison of the fourth quarter with the same period of the previous year, the increase closed at 10.6%, thus surpassing the 8.2% mark of the third quarter. Industrial production registered a similar annual performance, with expansion of 8.9%

in December. January data point to strong 16% growth in relation to January 1999. Unemployment declined during the course of the year from 4.5% in March to 3% in November.

The trade balance closed with a 1999 surplus of US$ 19 billion. Data for January 2000 indicate growth of 4.5% in the trade surplus, based on 16.7% growth in exports and 19.7% expansion under imports. The nation's foreign trade operations have registered consistently positive results since November 1997.

Prices have been stable, with growth of just 0.1% in consumer prices in February, following a period of stability in January. The 12 month rate increased by 1.5% to 1.6% in February and January, respectively.

3.6 – Latin America

Argentina

Data for the third quarter of 1999 point to an accentuated drop in the pace of gross fixed capital formation (10.2%) when compared to the same period of 1998. At the same time, private consumption fell by 4.4% and exports of goods and services slipped by a full 5.9%. Public sector consumption increased by 1.3%, a performance that was expected for an election year. Insofar as 2000 is concerned, available demand indicators are not unanimous. The Public Service Consumption Index increased by 3.9% in January, when compared to the same month of 1999. However, supermarket and shopping center sales declined by respective rates of 2.9% and 7.1%, in the same period of comparison. In the same sense, revenues on the Value Added Tax dropped by 5.9% in the first two months of 2000, as compared to the same period of the preceding year.

The combined impact of the falloff in production, sales and tax revenues, coupled with the effects of an election year on public sector spending, was a clear worsening of the fiscal deficit. The Argentine public deficit rose to US$ 7.1 billion in 1999, corresponding to 2.5% of GDP or 39% more than agreed upon with the IMF and 31.6% above the limit defined in the Fiscal Accountability Act for the year. Aside from this deficit, the fiscal result of the provinces was a negative balance of US$ 10.8 billion, equivalent to 3.8% of GDP.

The Argentine government sent an emergency economic-financial bill to the Congress with the objective of reducing the fiscal deficit. This measure calls for suspension of payments of judicial decisions as well as new suits brought against the State for a period of 180 working days, introduces an element of greater flexibility into labor relations and adopts the possibility of layoffs of civil servants who entered government employment rolls in 1999. Parallel to these measures, the bill grants the President and ministers special powers to suspend public sector contracts signed prior to December 10, 1999 and authorizes bond issues designed to consolidate a share of the public debt.

Insofar as the external sector is concerned, exports in 1999 totaled US$ 23.3 billion or 12% less than in the previous year, while imports came to US$ 25.5 billion, for a decline of 19%. The result was a deficit of US$ 2.2 billion, as against a US$ 5 billion deficit in 1998. The reduction in foreign sales can be explained by 11% contraction in prices, since the quantum index declined by 1%. In the case of imports, the 6% drop in prices and 13% decrease in the quantum index had a mutually offsetting impact. The reduction in exports of automotive vehicles, which are mostly targeted to the Brazilian market, accounted for 43% of the reduction in foreign sales. Despite these occurrences and the devaluation of the Brazilian currency, Argentina was able to register a US$ 750 million surplus in trade with Mercosul.

The accumulated January-September 1999 current account deficit came to US$ 8.8 billion, or US$ 2 billion less than in the same period of the previous year. This result was achieved mostly as a consequence of lesser imports. Net payments of interest and dividend services remained stable at a level of approximately US$ 6 billion. The capital account balance closed with a positive US$ 6 billion backed by net inflows of US$ 7.3 billion by the nonfinancial public sector.

In the third quarter of 1999, aggregate supply of goods and services dropped by 5% when compared to the same period of the previous year. This result reflected drops of 4.1% in gross domestic product and 11.4% in imports. The productive sectors in which the sharpest falloffs occurred were manufacturing (8.3%), construction (8.5%) and commerce (9.5%). These results were partially offset by an increase of 3.1% in educational, social and health services. With the positive signs of recovery in the final quarter of 1999, the drop in the gross domestic product will be less than that suggested by the statistics for the first three quarters of the year. Among these signs, one should cite the drop in the jobless rate from 14.5% in August to 13.8% in October, together with the upturn in industrial output.

The shift in the direction of economic activity was confirmed in January 2000 by the industrial production index (EMI) which is measured by Indec. This index reached a level that was 3.2% higher than in January 1999, though still 1.7% below the level of the preceding month, in terms of data from which seasonal influences have been eliminated. In an analogous way, the January construction activity index (Isac) came to 5.6% above the January 1999 level, though 2% below the December mark. Once again, the data used in this calculation had been purged of seasonal impacts. The tendency toward growth in supply should be further stimulated by recent approval of the tax reform package by the Argentine National Congress and the cost reductions that are expected to occur as a result of this measure.

The curbing of aggregate demand has managed to maintain inflation under rigid control. Consumer prices, which had dropped by 1.8% in 1999, moved upward in January by 0.85%, as a result of introduction of the new VAT rates, and stabilized in February. Wholesale prices increased by 0.9% in February and accumulated growth of 4.7% in 12 months.

Maintenance of a fixed rate of exchange has been possible as a result of the strong international reserve position of the Banco Central of the Argentine Republic. These reserves came to $ 25.4 billion, as against financial liabilities of $ 25.2 billion. Total international liquidity of the financial system, which takes due account of the net international reserves held by the Central Bank and the foreign currency liquidity requirements of financial institutions, came to $ 38.6 billion.

Preference for financial assets in foreign currency became more accentuated during the course of the year and in the early days of the current year. The stock of total deposits, including demand, fixed time, savings and other types of deposits in foreign currency, continued expanding and registered 8.7% growth in the 12 months up to January, reaching a level of $ 47 billion (58.2%

of the total), while deposits in national currency declined by 2.3% to a level of $ 33.8 billion. Average interest on 90 day national currency loans among financial institutions (Baibor) dropped from 13.9% in December 1999 to 11.5% in January 2000 and closed at 10.8% on March 2, while the rates on foreign currency loans also declined - albeit at a lesser pace - moving from 9.5% to 8.9% and 8.8% on the same dates.

The Ministry of the Economy issued the Economic Policy Memorandum, which had been elaborated jointly with the International Monetary Fund, prior to the signing of the agreement revision with that organization which was projected to provide Argentina with an injection of US$ 7.4 billion in funding. In that document, real GDP growth in 2000 is estimated at 3.5% and the current account deficit at 4.5% of GDP, though from 40% to 50% of this deficit should be financed by direct foreign investment. The fiscal deficit is forecast at $ 4.7 billion, equivalent o 1.6% of GDP, a level fully compatible with the Fiscal Accountability Act.

Chile

Annualized GDP growth in Chile declined by 1.5% in the third quarter of 1999, the fourth consecutive period in which negative rates were registered. Industrial production has shown signs of recovery, as December closed with positive movement of 9.5% and January with 10.9%, when compared to the same periods of the previous year. The jobless rate has moved downward following a maximum of 11.5% in August 1999, slipping to 8.9% in December and 8.4% in the month of January 2000.

The country's foreign sector registered a trade surplus of US$ 1.7 billion in 1999, reflecting significant improvement in comparison to the US$ 2.5 billion 1998 deficit. In the month of January 2000, exports totaled US$ 1.5 billion, for growth of 18.4% in relation to January 1998, and imports came to US$ 1.3 billion, reflecting expansion of 4.9%.

Consumer inflation in 1999 came to 3.3%, as compared to 5.1% in 1998. In the first two months of the current year, the CPI registered 0.2% and 0.6%, respectively, with annual growth of 2.8% in January and 3.3% in February. Wholesale prices increased by 5.2% in 1999, as against 1.9% in the previous year. In January, monthly and annual growth came to -0.7%

and 13.1%, in that order, while the corresponding numbers for February were 0.1% and 13.1%.

Mexico

The Mexican economy turned in annualized GDP growth of 5.3% in the fourth quarter of the year, following expansion of 4.5% in the previous quarter. Both of these figures are based on comparisons with the same period of 1998. The rate of industrial output growth accelerated in 12 month terms from 4.93% in December to 8.16% in January of this year. The jobless rate came to 2.3% in January, as compared to 2% in the month of December 1999.

The trade balance turned in a deficit of US$ 5.4 billion in 1999, reflecting a reduction of US$ 2.6 billion in relation to the previous year’s result. The rates of export and import growth last year closed at 16.4% and 13.3%, respectively.

Consumer inflation in the first two months of the year declined from 1.34% in January to 0.89% in February, registering accumulated 12 month growth rates of 11.02% and 10.53%, in the same order. Producer prices in the month of January turned in expansion of 1.31%, raising accumulated twelve month growth to 11.02% in the period ended in January 2000. Once petroleum prices are excluded, PPI expansion came to 0.73% and 7.18%, respectively.

3.7 – Conclusion

The performance of the world economy has been positively impacted by both the remarkable performance of the American and European economies and by the recovery experienced by the emerging countries, which have been affected by a financial crisis in recent years. This prospect should not be altered as long as the effects of the interest rate increases remain unnoticed.

The United States have turned in a continued strong demand with an ongoing expansion of consumption and investments. This trend has been partly offset by surpluses. Though robust, the increase in aggregate supply raises worries as its pace of growth is inconsistent with that of the demand. Consequently, imbalances may arise, causing inflationary pressures. Theses pressures have not been reflected in consumer price indices yet. However, the growing trend of the producer price index - raw materials - may be interpreted as a sign for future price pressures. This index has accumulated a 25.9 % growth in the 12 month period up to February and was influenced by increases in international oil prices.

The late developments in the Euro Zone economies have pointed to recovery, which has been maintained by both domestic and foreign demand and a consistent growth in aggregate supply. In spite of that, significant rises in energy international prices coupled with the euro depreciating trend have fueled repeated rises in consumer price indices and stimulated benchmark interest rates.

Japan's economic recovery depends on growth of the supply side, having the demand expansion indicators little consistency with the need for sustained economic growth. This scenario is not prone to generate growth in international trade and tends to persuade the monetary authority to maintain the medium-term interest rate stable.

The Chinese economic growth rate has intensified somewhat. However, the 1999 growth rate closed at a level similar to that of 1998. On the other hand, South Korea's economy has resumed the same growth level as observed before the 1997 crisis. This fact suggests that consumer's market has been rebuilt in that region and that there is a growing trend to reactivate trade flows.

Latin American economies are recovering at different paces. While Mexico shows a consistent growth, Chile and Argentina are signaling some recovery in the activity level.

4 – Capital account

4.1 – Investments

In the early days of 2000, inflows of direct foreign investments continued on the same trajectory as in recent years and represented an important source of balance of payments financing. Foreign resources obtained in the form of capital inflows came to US$ 4.9 billion in the first two months of the year, an amount that was considerably higher than the level required to finance the current account deficit of approximately US$ 2.2 billion registered in the period.

In the period under consideration, inflows generated by privatizations came to only US$ 158 million. The steady decline in the participation of privatization resources in total direct investment inflows, corresponding to approximately 30% in 1999, stands as evidence of the rising confidence of the international community in the fundamentals of the Brazilian economy.

Investments

US$ billion

Itemization	1998	1999					2000
		I Q	II Q	III Q	IVQ	Year	Jan-Feb
Foreign	24.0	7.8	6.3	9.8	7.6	31.5	4.7
Direct	25.9	7.6	5.3	9.6	7.4	30.0	4.9
Privatization	6.1	4.1	1.0	3.3	0.5	8.8	0.2
Conversions	1.9	0.7	0.8	1.3	1.2	3.9	0.3
Others	17.8	2.9	3.6	5.0	5.8	17.2	4.4
Portfolio	-1.9	0.2	1.0	0.2	0.2	1.5	-0.1
Brazilian	-3.4	-0.7	0.6	-0.1	-1.7	-1.9	-0.6

An analysis of the 12 month period ended in February indicates that total direct investments came to US$ 29.2 billion, compared to a US$ 23.3 billion deficit in current accounts in the same period. These figures reflect continuation of the trend observed throughout 1999, according to which the investment inflow was consistently in a range roughly 25% above the financing needed to cover the negative current account balance.

4.2 – Loans and financing

Medium and long-term financing, funding from international organizations, government agencies and suppliers' and buyers' credits closed the first two months of the year with negative balances. This result reflects an alteration in the import financing profile, particularly in the case of suppliers' and buyers' credits, which accounted for a third of merchandise imports in 1998 and now stand at just 15%, as a consequence of the more flexible approach taken to the contracting of import exchange operations that has been in effect since early 1999. Part of these trade credits migrated into short-term operations, generating a temporary lag between disbursements and amortizations related to medium and long-term operations.

Uses and sources of foreign resources

US$ billion

Itemization	1998	1999					2000
		I Q	II Q	III Q	IVQ	Year	Jan-Feb
Uses	-64.3	-22.9	-16.3	-14.0	-16.6	-69.7	-7.0
Current transactions	-33.6	-5.2	-7.0	-4.6	-7.6	-24.4	-2.2
Amortizations	-30.7	-17.7	-9.3	-9.4	-9.0	-45.4	-4.8
Loans	-13.9	-12.8	-3.7	-4.0	-3.4	-23.9	-2.1
Public	...	-1.3	-1.2	-0.3	-1.1	-3.9	-0.1
Private	...	-11.6	-2.4	-3.7	-2.4	-20.0	-2.0
Financing	-16.8	-4.9	-5.6	-5.4	-5.5	-21.4	-2.7
Public	...	-0.7	-1.0	-0.6	-1.0	-3.2	-0.3
Private	...	-4.2	-4.6	-4.8	-4.6	-18.2	-2.4
Sources	64.3	22.9	16.3	14.0	16.6	69.7	7.0
Direct investments	25.9	7.6	5.3	9.6	7.4	30.0	4.9
Investments in portfolio	-1.9	0.2	1.0	0.2	0.2	1.5	-0.1
Import financing	24.9	4.5	4.0	4.0	4.0	16.5	1.6
Long-term loans	41.6	2.7	9.4	4.0	8.8	25.0	4.5
Short-term capital (net)	-31.2	-1.6	-2.8	-1.8	-3.5	-9.7	-0.7
Sundry[1/]	-12.4	-1.0	-1.6	-0.7	-1.0	-4.3	-0.9
Change in reserve (-=increase)	17.3	10.5	0.9	-1.2	0.6	10.8	-2.3
Net Reserves	34.4	24.1	23.3	24.5	23.9	23.9	26.1
RLA (Memorandum)	34.4	24.1	23.3	24.8	21.3	21.3	19.8
Regularization Operations	9.3	0.0	8.5	0.0	-5.5	3.0	0.0
International Liquidity	44.6	33.8	41.3	42.6	36.3	36.3	38.3

1/ Includes Brazilian investments abroad, constitution of collateral, Brazilian financing to foreigners, other capitals, errors and omissions and Banco Central's liabilities.

Inflows of medium and long-term loans surpassed payments of principal by US$ 2.4 billion in the first two months of the year. When placements of Bonds of the Federative Republic of Brazil are excluded, the net inflow came to US$ 1.2 billion, particularly through notes and commercial papers which, taken together, contributed a net funding inflow of US$ 967 million in the period. This amount is less than that registered in the early months of 1998, when the differential between internal and external interest rates associated with the exchange band system created conditions that were favorable to external indebtedness, particularly through banking operations.

However, in the case of 1999, inflows were larger and average terms were longer, mostly as a result of bond issues with maturities of 20 and 30 years in the name of the Federal Republic of Brazil in January and February, respectively.

4.3 – Conclusion

In the first two months of 2000, the balance of payments registered a surplus, as inflows in the name of the Republic and direct foreign investments produced a short-term asset gain of US$ 1.9 billion for Banco Central.

Despite the dwindling flow of privatization funding, inflows of direct foreign investments have continued strong, evidently reflecting investor perceptions of the efficient management that has characterized Brazilian economic policy. In this scenario, one should note that the ratio between direct investment inflows and the current account deficit will certainly benefit in the future from still persistent capital flows and improvement in the balance of trade in goods and services, particularly as the new exchange rate system reaches maturity.

The domestic exchange market has consistently confirmed positive expectations surrounding the balance of payments trajectory. This has been particularly evident in the stability of exchange in recent months and stands as the major support of the highly positive outlook for the country's trade and financial relations with the international community.

5 – Prices

In December, prices cooled off and moved into a downward curve that continued through the first two months of 2000. The factors responsible for this performance were the start of the farm harvest and the behavior of apparel prices, both of which impacted wholesale and consumer price indices.

General indices

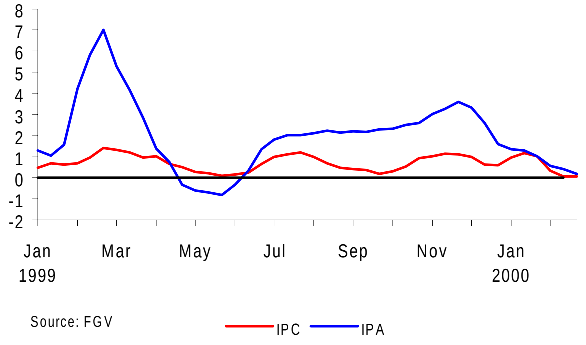
% monthly growth

Itemization	1999			2000	
	Oct	Nov	Dec	Jan	Feb
IGP-10	1,5	2,2	2,4	1,2	0,6
IPA	2,3	3,0	3,3	1,4	0,6
IPC	0,3	1,0	1,0	1,0	0,3
INCC	0,9	1,1	0,9	1,1	1,0
IGP-M	1,7	2,4	1,8	1,2	0,4
IPA	2,5	3,3	2,6	1,3	0,4
IPC	0,6	1,2	0,6	1,2	0,1
INCC	0,8	1,2	0,8	1,2	0,9
IGP-DI	1,9	2,5	1,2	1,0	0,2
IPA	2,6	3,6	1,6	1,0	0,2
IPC	0,9	1,1	0,6	1,0	0,0
INCC	1,0	0,9	1,0	1,1	0,8

Source: FGV

Sequential price indices

% monthly growth



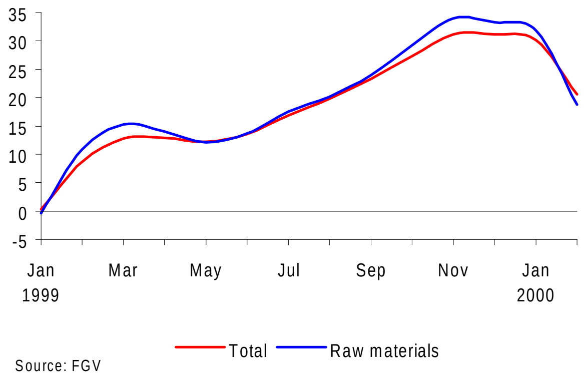
Source: FGV

5.1 – General indices

The general price indices calculated by the FGV have followed a downward curve since December, mostly as a result of declines under wholesale prices that have occurred as a result of the behavior of farm prices. Despite recent exchange valuation, the reduction in industrial prices has been less accentuated, due to higher prices for plastics, iron, steel and its derivatives and sugar. Thus, the accumulated 12 month growth performance of the General Price Index (IGP-10), General Price Index - Market (IGP-M) and General Price Index - Internal Supply (IGP-DI), which had closed at respective rates of 20.09%, 20.1% and 19.98% in the period up to December, moved downward in February to 18.03%, 16.78% and 14.96%, in the same order.

In the concept of internal supply, deceleration under the Wholesale Price Index (IPA) encompassed the prices of both consumer goods and production goods.

IPA-DI: Production goods
% growth in 12 months



Source: FGV

In the first grouping, the most accentuated change occurred under foodstuffs and reflected the decline in farm prices. The prices of production goods increased in January - albeit at a lesser pace - and reflected the upward pressures brought to bear by raw materials and machines, vehicles and equipment. In the following month, these pressures reversed direction.

5.2 – Consumer price indices

Consumer prices % growth

Itemization	1999			2000	
	Oct	Nov	Dec	Jan	Feb
Monthly					
IPCA	1.2	0.9	0.6	0.6	0.1
IPC-Fipe	1.1	1.5	0.5	0.6	-0.2
IPC-Br	0.9	1.1	0.6	1.0	0.0
Accumulated in the year (annualized)					
IPCA	8.8	9.1	8.9	7.7	4.6
IPC-Fipe	7.9	9.8	8.6	7.1	2.1
IPC-Br	8.8	10.2	9.1	14.1	6.5
12 months					
IPCA	7.5	8.6	8.9	8.9	7.9
IPC-Fipe	5.9	8.0	8.6	8.7	7.0
IPC-Br	7.2	8.6	9.1	9.5	8.0

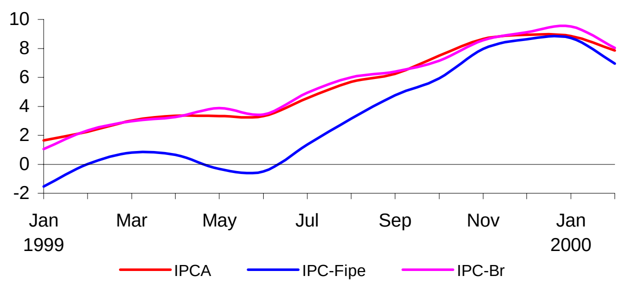
Source: IBGE, Fipe and FGV

Measured by the consumer price index, inflation turned downward in December, before stabilizing in January, mostly as a result of the seasonal pressures generated by *in natura* foodstuffs and education expenditures.

In the month of February, there was strong deceleration in these indices as the previously mentioned pressures were dissipated, the trade sector entered a period of apparel clearance sales and the prices of other food products continued downward.

The accumulated 12 month rates of the Consumer Price Index - Fipe (IPC-Fipe), Consumer Price Index - Brazil (IPC-Br) and the Broad Consumer Price Index (IPCA) declined by rates of 8.64%, 9.12% and 8.94% in the month of December to 6.95%, 8.04% and 7.86%, respectively, in February.

Consumer prices
12 month % change

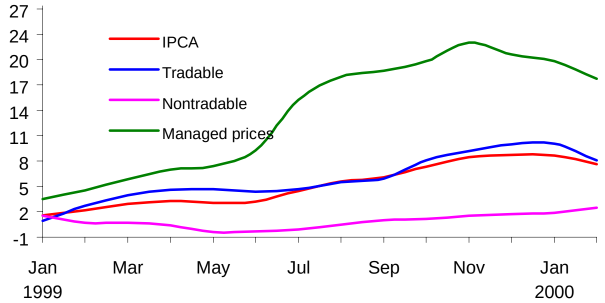


Source: IBGE, Fipe and FGV

Broad National Consumer Price Index (IPCA)

In the first two months of the year, the performance of the IPCA was principally a result of declining food prices, despite the fact that January had witnessed

Consumer prices
12 month % change



Source: IBGE

growth in the prices of such *in natura* products as tubers, roots, legumes, greens, vegetables and fruits. The index was also impacted by seasonal growth in education outlays and upward movement in the rates charged for fixed telephone services in São Paulo. In the month of February, deceleration of the index was due to an across-the-board drop in food prices, coupled with falloffs in apparel costs, stability under housing expenditures and dissipation of pressures caused by the education and communications groupings.

IPCA % monthly growth

Itemization	1999			2000	
	Oct	Nov	Dec	Jan	Feb
IPCA	1,2	1,0	0,6	0,6	0,1
Tradable	2,2	1,0	0,8	0,4	0,1
Nontradable	0,2	0,2	0,3	0,9	0,4
Managed	0,8	1,9	0,7	0,6	-0,2

Source: IBGE

The trajectory of the IPCA components in the two month period pointed to an improved performance under tradables, in relation to the results under nontradables. One should note that the negative February growth in government managed prices was caused principally by drops in fuel prices, as several states registered reductions in the margins of presumed profits for purposes of calculating ICMS payments.

IPC-Fipe

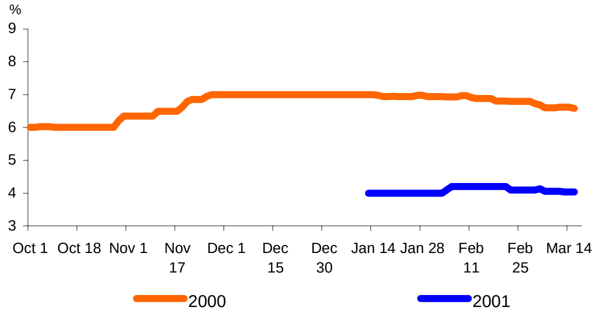
In January, inflation in São Paulo, measured by the IPC-Fipe, came to 0.57, mostly in response to increases in outlays on education and *in natura* foodstuffs. In the following month, intense declines under food and apparel prices, combined with lower prices for medicines, aided in achieving the negative growth level of 0.23%.

5.3 – Government managed prices

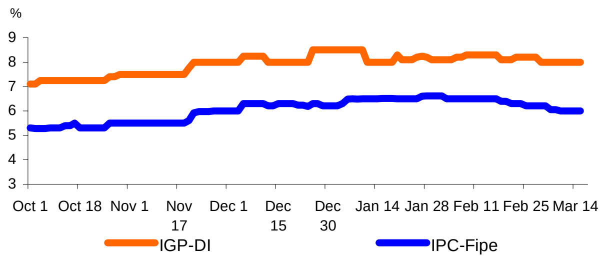
Reflecting the behavior of international market oil prices, internal prices of gasoline and diesel oil were raised by 7% while aviation kerosene was increased by 23% at the refinery level, effective as of March 1. In the case of the first two products, average consumer prices increased by 5%. Here, one should note that gasoline prices are now independently defined on the basis of competition among individual gas stations. However, the prices of diesel oil are set on a municipal-wide basis. The direct impact of these increases on the different price indices varies between 0.13% for the IPC-Fipe and 0.38% for the IPA-DI, and an estimated 0.18% for the IPCA.

5.4 – Market expectations

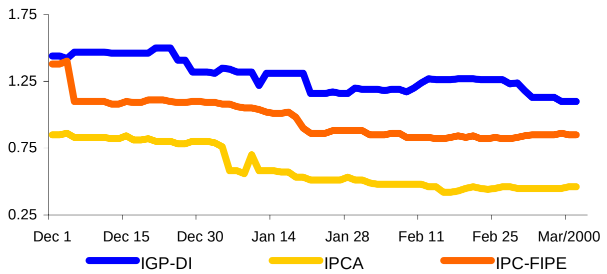
Daily Median of IPCA Expectations



Daily Median of Inflation Expectations for 2000



Standard-Deviation of Inflation Expectations for 2000



The Banco Central's Institutional Communication Group (GCI) carries out a daily survey based on a sampling of 70 financial institutions and consulting companies, with the aim of evaluating market expectations as regards annual rates of inflation. With respect to the IPCA in 2000, the surveys made in the final months of 1999 indicate a rise in the sample median, with 7% in the month of December. Starting in January 2000, expectations regarding inflation have become more optimistic and reached a level of 6.62% in mid-March. For 2001, the surveys point to an annual rate that will oscillate in the range of 4%.

Measured by the IGP-DI and IPC-Fipe, inflation expectations for 2000 turned in a performance quite similar to the IPCA, with growth from October to December and a downward curve starting in January. In the month of December, the median of expectations for the IGP-DI was 8.5%, declining to 8% in mid-March, while expectations for the IPC-Fipe registered 6.62% in December and dropped to 6% in March.

Expectations have converged in the last six months, as evinced by decreasing standard deviations. In this sense, the standard-deviations of the IPCA, IGP-DI and IPC-Fipe, which had come to 1.31%, 1.65% and 1.66%, respectively, in the month of October, closed the month of March at 0.46%, 1.1% and 0.85%.

5.5 – Conclusion

In the first two months of the year, the inflationary pressures that were felt in the final months of 1999, principally in terms of the prices of primary sector products, were dissipated. This reflected the start of the farm harvest and gradual normalization of the supply of animal protein. Aside from the direct impact of the recent fuel price adjustment that will be felt in March and of the increase in the minimum wage, scheduled to go into effect in May, there are no other significant factors on the horizon at the moment with the potential for altering the current inflationary trend in any meaningful way.

Corroborating this price scenario, GCI surveys on the trajectory of inflation in the 2000/2001 period point to market perceptions of improvement in the macroeconomic fundamentals of the Brazilian economy and increase the effectiveness of recent economic policy management.

6 – Prospects for inflation

This chapter of the *Inflation Report* presents the Monetary Policy Committee (Copom) assessment of Brazilian economic performance since the December *Inflation Report*, together with its prospects for inflation up to 2001. The projections are based on the assumption that the basic interest rate will remain unchanged during the period under analysis at 19% per year, rate set by Copom in its March 22 meeting. It is important to note that this is a strictly technical procedure. Hence, this hypothesis should not be taken as a forecast of future interest rate outcomes.

The inflation and output growth forecasts presented in this *Report* are not meant to be restricted to point estimates. They are projected within confidence intervals, reflecting the degree of uncertainty when setting the basic interest rate. Inflation forecasts are based not only on a fixed nominal interest rate, but also on the baseline scenario, summarizing the future behavior of key economic variables and their associated risks. The forecasts are presented in this *Report* in order to enhance monetary policy transparency, easing its task to maintain inflation under control.

6.1 – Determinants of inflation

Aggregate demand and supply

The effects of the negative supply shocks that had hit the Brazilian economy in the second half of 1999, specially in the last quarter, have already dissipated, validating the diagnosis presented in the December *Inflation Report*. In fact, February IPCA inflation rate, as well as all other inflation gauges, fell significantly. This drop has confirmed the temporary nature of those shocks on inflation.

Despite the shocks that have hit the economy last year, GDP growth has been quite satisfactory and the transition to a floating exchange rate regime has been completed smoothly. Output in the fourth quarter showed a consistent recovery and reinforced expectations that growth rate for this year will stand well above the one observed in 1999.

Industrial production strengthens the positive outlook, and the accelerating growth rate observed since the end of 1999 continues in the beginning of 2000. Even though growth rate for January-February has been favored by a weak comparison basis, growth has spread out to all categories, especially capital and durable goods. These two sectors have benefited from the economic stability and the increase in credit supply, and should maintain a strong performance during the year. In particular, as anticipated in the December *Inflation Report*, the durable goods sector has been driven forward by a great increase in automobile production, mainly for exports.

It is worth notice that the Brazilian economy has been growing below its potential in the last few years. Thus, the undergoing aggregate demand recovery should not engender significant inflationary pressures in the short or medium term.

One year after the currency depreciation and the shift to a flexible exchange rate regime, exports show a consistent growth, especially in terms of quantity. The upward trend seen in the last three months allows for larger trade balance surpluses forecasts in the second and third quarters, when there is a seasonal peak of agricultural products shipping. Besides, manufactured exports have benefited from the higher growth of the world economy, particularly Latin-American recovery, as already anticipated in the last *Inflation Report*.

International oil prices have been rising more than previously expected in December, but export commodity prices have also been recovering, though at a slower pace. Even forecasting a positive trade balance for 2000, large surpluses are not a necessary condition for economic growth, as long as trade balance improves and the external accounts remain sustainable in the long run.

The improvement in the external accounts has brought about positive outcomes on the FX market due to the largest supply of foreign currency and the reduction of sovereign risk. The appreciation of the real has been an important contribution to price stability during this year.

Fiscal policy has been a keystone both in controlling inflation and in the economy recovery during 1999. It will continue to play a major role in maintaining economic stability along this year. However, public accounts require constant monitoring, especially in an electoral year. Severe budget control is paramount to keep the credibility gains hardly conquered with the fiscal adjustment efforts in 1999.

Regarding the supply side, no sources of cost pressure have been detected, despite the recent rise in capacity utilization. The unemployment rate is still high and real wages have been falling. This trend should be reversed during the year, as the economy strengthens its recovery. It is worth pointing out that the decrease in unemployment rate shows up only after some lag, given that the initial rise in demand is usually met by increasing worked hours, and delaying the creation of new jobs until the consolidation of a higher demand level.

International economy

The main uncertainties in the external front are essentially the same already mentioned in the December *Inflation Report*. However, it is important to stress that Brazil is currently less vulnerable to the international environment than at the end of 1999. The recently released indicators have confirmed the improvement in the domestic macroeconomic outlook. This, in turn, has lowered significantly the external risk perception, as the latest upgrade in sovereign ratings and the reductions in Brazilian bond spreads clearly show. This improvement should more than offset the expected hike in industrial countries interest rates.

An important source of uncertainty is still the possibility of a sudden deceleration of the United States economy. This deceleration could be triggered by a higher-than-expected interest rate hike or a stock market plunge, with undesirable impacts on consumption. The current growth rate is considered too high to be sustainable in the long run, even though inflation remains under control. An increasingly tight labor market may lead to inflationary pressure or profit margins compression due to wage increases that even the high productivity gains would not be able to meet. The volatility in the stock and bond markets in the first quarter of 2000 suggests the beginning of an adjustment process to the new levels of interest rates and aggregate demand.

Given the forward-looking nature of financial markets, and despite the difficulty in quantifying the so-called wealth effect, this outlook may be the first signal of deceleration in the American economic growth. However, given the quality of the recent economic expansion, and the soundness of the fiscal stance, this deceleration should be brought about softly and gradually, as already stated in the last *Inflation Report*.

The performance of Japanese economy is another source of uncertainty, although it has fewer implications for Brazil. As pointed out in the December *Inflation Report*, the signals of economic recovery for Japan are still fragile. Fiscal measures have been incapable of fostering aggregate demand permanently, as suggested by the fall in fourth quarter GDP, the second in a row. However, two aspects must be considered. First, further GDP falls are not likely. Second, despite the overall downturn in the second half of 1999, some components of GDP performed positively, including private investment spending.

Concerning the Euroland, the Governing Council of the European Central Bank has recently decided to raise the basic interest rate due to increasing upward pressures on inflation caused by rising oil prices and the euro depreciation. The tightening of monetary policy, however, should not risk the strong cyclical upswing of these economies, and the expected growth for 2000 remains around 3%. It is worth noticing that the higher growth in Euroland helps to counterbalance the lower expansion of the American economy.

After a weak performance in 1999, Latin American countries already display recovery signs this year, as predicted in the December *Inflation Report*, benefiting Brazilian manufacturing exports.

In short, the current risks associated with the external environment seem well balanced and less intense than those analyzed in the last *Inflation Report*.

6.2 – Baseline scenario: assumptions and associated risks

The Monetary Policy Committee (Copom) forecasts are based on a set of assumptions about the behavior of key economic variables, as well as their associated risks. This set of assumptions forms the baseline scenario under which Copom makes monetary policy decisions.

The two major sources of uncertainty are the same pointed out in the December *Inflation Report*. Namely, the behavior of international oil prices and of government managed prices. Moreover, the adjustment of the minimum wage, which has not been a source of uncertainty until now, is also a concern due to its effect on the structural deficit of the social security system. A higher minimum wage worsens the public deficit and deteriorates the external risk perception.

Copom presupposes that the minimum wage rise will be in line with inflation since its last adjustment in May 1999. In other words, it is taken for granted that the rise will not threat the 2000 fiscal goals. Explicitly, Copom works with the hypothesis that the minimum wage will increase to around R$ 150.00, corresponding to a 10.3% gain. Given the IBGE current methodology, IPCA will be subjected to a 0.3-point direct impact, as this increase will be fully captured by the item "domestic workers", which weights 3.05% in the total index. Still, the baseline scenario assumes that the primary surplus of the public sector will strictly meet the fiscal targets set out in the government's Economic Program.

The baseline scenario has also reviewed upward the trend for international oil prices. The new scenario considers prices from future markets. Hence, oil price should gradually fall from its current levels, around US$ 25-26 per barrel (Brent crude), to approximately US$ 23 in December. The recent statements of some oil-exporting countries, signaling possible increases in short term production, already pushed down spot and futures prices. International prices can fall further if oil stocks stop declining, but this tendency will only become apparent in the second quarter of the year. For this reason, the baseline scenario has also introduced a downward asymmetry in the probability distribution of oil-price related risks.

The assumptions regarding government-managed prices are similar to those presented in the last *Inflation Report,* but have been cautiously re-evaluated. On one side, the exchange rate appreciation tends to bring down inflation measured by the general price indices (IGP-M and IGP-DI), which in turn will lead to lower adjustments in managed prices that are partially indexed to them. On the other side, the high current international oil prices increase the pressure for further domestic byproducts price adjustments. Thus, under a conservative approach, the underlying assumption for all government managed price adjustments averages 11.2% during the year, with a direct impact of 2.6 percentage points and a marginal contribution of 1.8 percentage points to the 12-month IPCA inflation rate. Copom considers that the risks around this projection are balanced.

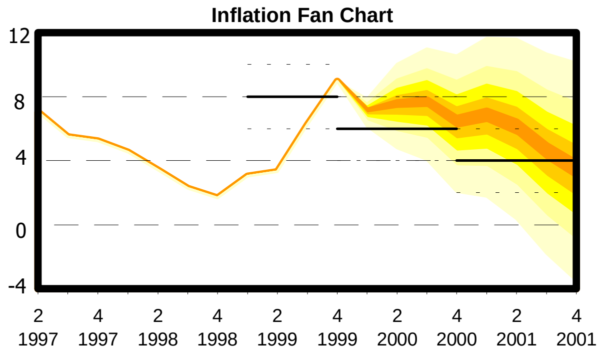
Food price should have neutral impact on inflation along the year, except for seasonal factors. This is fundamentally the same assumption made in the last *Inflation Report.* The most recent harvest estimates for 2000 indicate roughly the same figures of 1999.

International liquidity conditions have improved since December, particularly in respect to the perception of emerging markets risk. The increase and quality enhancement of capital inflows, attested by rising foreign direct investment and issuance of longer-maturities external bonds, allow for appropriate financing of the current account deficit. The world growth and the slight increase in exported commodity prices should counterweight the adverse effect of oil prices, thus reinforcing the positive trade balance trend for 2000.

Another key uncertainty under the baseline scenario refers to international interest rates. A gradual rise is expected along the year. In particular, Copom considers, based on the futures markets, that federal funds rate shall move up gradually from the current level of each 6% per year to 6.5% by year-end. This increase is consistent with a deceleration of the US economy and should not bring further implications for Brazil. Hence, the trend for lower “Brazil risk” over the course of the year is maintained, as in the December *Inflation Report*.

6.3 – Inflation forecast

Forecasted IPCA-inflation with interest rate fixed at 19% p.y.



(accumulated inflation in 12 months)

IPCA with 19% p.y. fixed interest rate

Year	Q	Confidence Intervals						Central
		50%						Projection
			30%					
				10%				
2000	1	6.6	6.8	6.9	7.1	7.2	7.4	7.0
2000	2	6.3	6.8	7.2	7.6	8.0	8.5	7.4
2000	3	6.1	6.7	7.3	7.8	8.3	8.9	7.5
2000	4	4.6	5.3	7.4	6.6	7.3	8.0	6.3
2001	1	4.7	5.5	7.5	7.1	7.9	8.7	6.7
2001	2	3.7	4.7	7.6	6.4	7.3	8.3	5.9
2001	3	1.9	3.0	7.7	4.9	5.9	7.0	4.4
2001	4	0.5	1.7	7.8	3.8	4.9	6.1	3.3

Note: Accumulated inflation in 12 months, in % p.y.. The values correspond to the ones shown in the inflation fan chart.

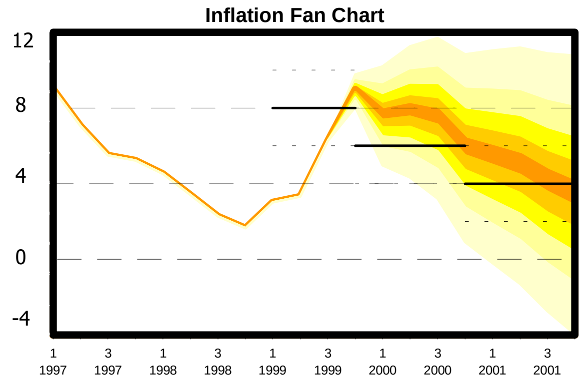
Based on available information and the assumptions with associated risks considered by Copom, a projection for the 12-month IPCA inflation rate was constructed. This projection considers interest rate constant at 19% p.a., the rate set out at the Committee’s March 22 meeting.

This projection incorporates the impact of government-managed prices as follows. The first step is to project inflation according to the baseline scenario but with no hypothesis regarding government-managed prices. This is akin to state that these prices will behave like the average of all other prices in the economy. The following step is to add to each quarter the difference between the projected inflation rate and the overall out-of-the-model adjustment in government-managed prices. This difference is then duly weighted and incorporated into the model. The result is an expected set of quarterly shocks, with a probability distribution as assessed by Copom.

The central projection for the 12-month IPCA shows a significant fall in the first quarter of 2000, followed by two hikes in the second and third quarters. This path is due to two major effects. The first is a purely statistical effect regarding the comparison basis, which was already analyzed in the last *Inflation Report*. The second is the concentration of adjustments in both managed prices and minimum wage during those two quarters. In spite of these temporary increases, the central projection for the 12-month inflation in 2000 stands at 6.3%, slightly above the inflation target. The probabilities of deviations from the central estimate are symmetrically distributed. For 2001, the inflation central path declines along the year, heading to 3.3%.

Comparing the current projection with the one of the December *Inflation Report*, reproduced on the left, the fall in inflation observed in the first

Forecasted IPCA-Inflation with interest rate fixed at 19% p.y. (December *Inflation Report*)

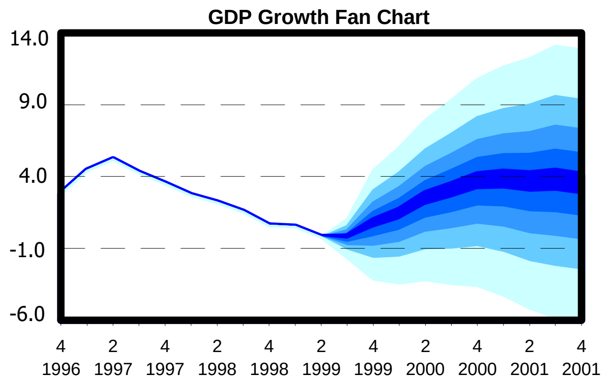


(accumulated inflation in 12 months)

quarter of 2000 produces a major shift in the expected inflation path. The current inflation forecast is lower in the first two quarters and higher in the last two, mainly due to the reassessment of the shocks introduced in the baseline scenario. For 2001, the monotonic decrease in inflation expected in the December *Report* stands no more. Projection of first quarter inflation for 2001 is slightly above the one for the same period of 2000. This generates a temporary jump in 12-month inflation rate, as the current inflation fan chart shows.

As in the last *Inflation Report*, this issue also shows the output growth fan chart constructed on the basis of the same assumptions used in the baseline scenario. It should be stressed that the forecasting errors associated with GDP growth projections are considerably larger than the ones for inflation. This happens because GDP growth projections incorporate two non-observable components, namely potential output and the output gap. Moreover, the estimation of output is, by definition, more complex and less precise than that of inflation. The central projection for output growth in 2000 is close to 3.7%, assuming for the whole year the interest rate set by Copom at 19% p.a. in its last meeting.

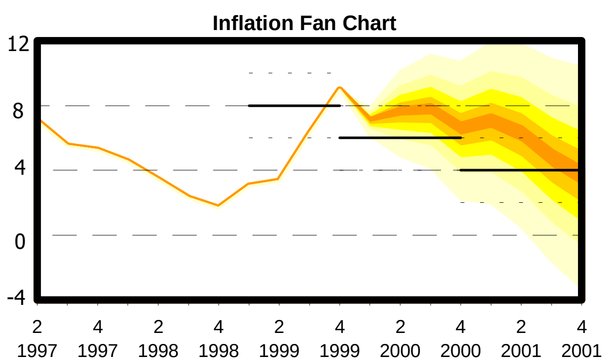
GDP growth with 19% p.y. fixed interest rate



(GDP variantion, 12 months over previous 12 months)

We also show on the left the inflation fan chart considering market expected interest rates on March 23, the day after Copom decided to keep the Selic interest rate at 19% p.a., with a reduction bias. The purpose underlying this exercise is to capture the market reaction to the latest Copom decision regarding the most important monetary policy instrument. According to futures contracts, the market expected a negatively sloped interest-rate path for the next twelve months, averaging 18% p.a. in the first quarter of 2001. This embodies a significant shift from the expected gradual rise

Forecasted IPCA-inflation with market interest rate 1/



(accumulated inflation in 12 months)

1/ In 03/23/2000 at 12:00am

IPCA with market interest rate 1/

Year	Q	Confidence Intervals						Central Projection
		50%						
			30%					
				10%				
2000	1	6.6	6.8	6.9	7.1	7.2	7.4	7.0
2000	2	6.4	6.9	7.3	7.7	8.1	8.6	7.5
2000	3	6.2	6.8	7.4	7.9	8.5	9.1	7.6
2000	4	4.7	5.5	6.1	6.8	7.4	8.2	6.4
2001	1	4.9	5.8	6.5	7.3	8.1	8.9	6.9
2001	2	3.8	4.8	5.7	6.6	7.4	8.4	6.1
2001	3	2.1	3.2	4.2	5.1	6.1	7.2	4.6
2001	4	0.7	1.9	3.0	4.1	5.1	6.3	3.5

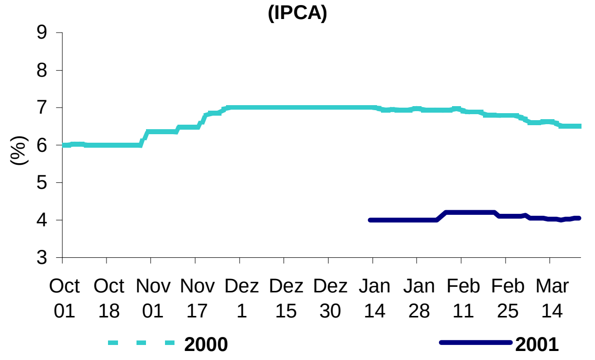
Note: Accumulated inflation in 12 months, in % p.y.. The values correspond to the ones shown in the inflation fan chart.

1/ In 03/23/2000 at 12:00am

implicit in the futures market at the end of 1999. Under this assumption, the inflation rate trajectory for 2000 differs little from the baseline projection. This is due to the estimated six to nine months lag of the aggregate demand transmission mechanism, the most important channel of monetary policy in Brazil (see box *Modeling the Monetary Policy Transmission Mechanism*).

The difference between the two projections remains small for 2001, due to other monetary transmission channels. With the achievement of the inflation targets, monetary policy gains credibility, driving economic agents to assign increasing weights to the inflation target value when forming their own expectations, and this convergence in turn favors price stability (see Box *The Role of Expectations in Determining Current Inflation*).

Daily Evolution of Market's Inflation Expectations (IPCA)



The evolution of market expectations for IPCA can be seen in the chart on the left, which represent the median of the forecasts gathered from 70 financial institutions and consulting companies. It is worth noticing the reactive pattern of these market expectations to price news, which suggest that experts seem to attach a high weight to current inflation when assessing its future trend. In fact, the inflation expected by market analysts for 2000 has shifted from 6% to 7% in response to the supply shocks observed in October-November. In February, when the signs of a sharp decline in current inflation became clearer, projections have been reviewed downwards to reach 6.5% by the end of March. Starting from January, this chart also includes the median of the projections for 2001, which has been fluctuating around the 4% target.

Other Inflation index projection

Index	Year	Confidence Interval						Central Projection	Market Projection 1/
		50%							
			30%						
				10%					
INPC	2000	4.0	4.8	5.4	6.1	6.7	7.5	5.7	6.3
	2001	0.4	1.6	2.7	3.7	4.8	6.0	3.1	4.0
IPC FIPE	2000	3.9	4.6	5.3	5.9	6.6	7.3	5.6	6.1
	2001	1.0	2.2	3.3	4.3	5.4	6.6	3.8	4.0
IGP-DI	2000	4.6	5.4	6.0	6.7	7.4	8.1	6.3	7.5
	2001	1.4	2.6	3.6	4.7	5.8	6.9	4.1	4.0
IGP-M	2000	4.7	5.5	6.2	6.8	7.5	8.2	6.4	7.3
	2001	1.1	2.3	3.4	4.4	5.5	6.7	3.9	4.8

Note: Year over year under the assumption of 19% (fixed) interest rate

1/ Market perceptions (70 institution) 3/22/2000

The *Inflation Report* also presents the Central Bank projections for other regularly used price indices and compares them with market expectations. For 2000, market projections are always higher than the ones of the Central Bank. Besides, the gap between market and Central Bank forecasts is greater (almost double) for general price indices than for consumer prices. However, the Central Bank forecasts consider a constant 19% p.a. interest rate, while the market does not disclose any underlying assumption concerning the interest rate path.

Modeling the Monetary Policy Transmission Mechanism[1]

The Central Bank has estimated/calibrated a group of structural models with the main objective of identifying and simulating the mechanism of monetary policy transmission in Brazil, including the main channels of transmission as well as the lags involved.

A simple structural model with the following basic equations can summarize this family of models:

(i) an IS type equation expressing the output gap as a function of its own lags, real interest rate (*ex ante* or *ex post*), and real exchange rate;

(ii) a Phillips curve expressing the rate of inflation as a function of its own lags and leads, the output gap, and the nominal exchange rate (and imposing the long-term neutrality condition);

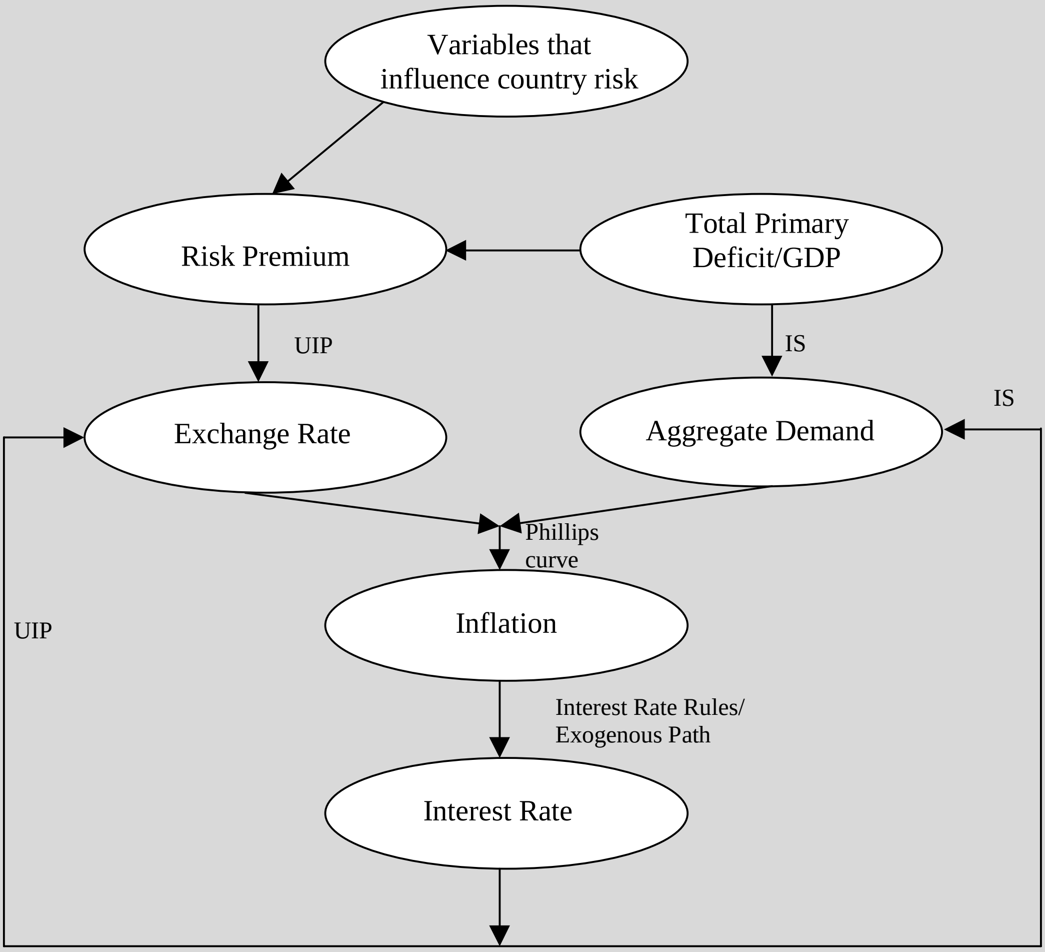
(iii) an uncovered interest parity condition relating the differential between external and domestic interest rates with the expected rate of devaluation of the domestic currency (the Real), and the risk premium; and

(iv) an interest rate rule, alternatively fixed rules on nominal or real interest rates, Taylor-type rules (with weights for contemporaneous deviations in inflation and output), forward-looking rules (with weights for deviations of expected inflation from the target), and optimal deterministic and stochastic rules.

This family of models allows several reduced-form specifications, depending on which issues the Copom wants to discuss in detail. An example may clarify the flexibility of this modeling approach. Suppose that the government is fully committed to a fiscal adjustment, so that the targets for the primary surplus of the consolidated public sector will be observed. In this case, the fiscal policy will produce important effects on aggregate demand, which should be explicitly taken into consideration.

One possible way to incorporate this information into the model is to include a fiscal variable directly in the IS equation. In this specification, two variables represent policy instruments: the interest rate and the primary fiscal surplus. The first is a Central Bank instrument and the second is a Treasury instrument. The following diagram summarizes these assumptions, showing the basic relationships involved.

[1] This Box summarizes some of the issues discussed in the paper Bogdanski, J., Tombini, A.A., and Werlang, S.R.C. (2000) "*Implementing Inflation Targeting in Brazil*", BCB Working Paper. The paper is available in http://www.bcb.gov.br/ingles/public/inflationtarget.pdf.



IS curve

The standard specification of an IS curve could be, in a quarterly frequency:

(I) $h_t = \beta_0 + \beta_1 h_{t-1} + \beta_2 h_{t-2} + \beta_3 r_{t-1} + \varepsilon_t^h$

where:

h $\rightarrow$ log of output gap

r $\rightarrow$ log of real interest rate [log(1+R)]

ε^h $\rightarrow$ demand shock.

The addition of a fiscal variable can be accomplished by including the term *pr* (log of (1+PR)), public sector borrowing requirements (PSBR), primary concept, as a percentage of GDP:

(II) $h_t = \beta_0 + \beta_1 h_{t-1} + \beta_2 h_{t-2} + \beta_3 r_{t-1} + \beta_4 pr_{t-1} + \varepsilon_t^{hf}$

Phillips curve

(III) $\pi_t = \alpha_1 \pi_{t-1} + \alpha_2 E_t(\pi_{t+1}) + \alpha_3 \pi_{t-2} + \alpha_4 h_{t-1} + \alpha_5 \Delta(p_t^F + e_t) + \varepsilon_t^n$

where:

π $\rightarrow$ log of price inflation
h $\rightarrow$ log of output gap
p^F $\rightarrow$ log of foreign producer price index
e $\rightarrow$ log of exchange rate
Δ $\rightarrow$ first-difference operator
$E_t(\cdot)$ $\rightarrow$ expectation operator, conditional on information available at time t
ε^n $\rightarrow$ supply shock.

Exchange Rate - Uncovered Interest Parity

The nominal exchange rate is determined by the uncovered interest parity condition, which relates expected changes in the exchange rate between two countries to their interest rates differential and a risk premium:

(IV) $E_t e_{t+1} - e_t = i_t - i_t^F - x_t$

where:

e $\rightarrow$ log of exchange rate
i $\rightarrow$ log of domestic interest rate
i^F $\rightarrow$ log of foreign interest rate
x $\rightarrow$ log of risk premium.

Taking the first difference $E_t e_{t+1} - E_{t-1} e_t - \Delta e_t = \Delta i_t - \Delta i_t^F - \Delta x_t$ and assuming for simplicity that the expectation change follows a white noise process, $E_t e_{t+1} - E_{t-1} e_t = \eta_t$ it is possible to specify the exchange rate dynamics as:

(V) $\Delta e_t = \Delta i_t^F + \Delta x_t - \Delta i_t + \eta_t$

There are two exogenous variables in this equation: the foreign interest rate and the risk premium. Given the relative stability of foreign interest rates, reasonably accurate projections can be obtained from contracts traded in international futures markets. However, the risk premium – which can be measured by the spread over Treasury bonds of Brazilian sovereign debt – has presented high volatility in the last years. The risk premium is usually associated to macroeconomic fundamentals and a number of other subjective factors that are not easily anticipated. Hence, two alternative approaches have been considered. The first is to make assumptions about the future evolution of the country's risk premium, conditional on the overall scenario, translating them to an exogenous path that will be used in simulations. The second approach is to link the risk premium behavior to the main objective factors thought to influence it, letting it be endogenously determined by the model.

An assumption consistent with the "fiscal" IS curve is that the risk premium will respond to the fiscal stance, with any perceived improvement in the fiscal position reducing the premium accordingly. Additionally, a number of other factors may have a considerable influence on expectations and hence, on the risk premium. A list of these factors would typically include international liquidity conditions and interest rates, foreign capital markets performance, commodities prices, current account balance perspectives, and country rating. The link with the UIP condition could be:

(VI) $$\Delta X_t = \gamma_1 \Delta X_{t-1} + \gamma_2 \Delta PR_{t-3} + \sum_{j=3}^{n} \gamma_j \Delta Z_{j,t-t_j}$$

where:

X $\rightarrow$ risk premium

PR $\rightarrow$ PSBR, primary concept, as a percentage of GDP

Z $\rightarrow$ variables that influence country risk.

The Role of Expectations in Determining Current Inflation

An important tool used by the Central Bank of Brazil to forecast inflation is a basic structural model made up of the following four equations: an aggregate demand (the IS curve), an aggregate supply (the Phillips curve), an exchange rate and an interest rate rule equation[2] .

In this box, we discuss the roles of past and (expected) future inflation on current inflation determination. Two specifications were initially used to estimate the Phillips curve:

(I) $$\pi_t = \alpha_1^b \pi_{t-1} + \alpha_2^b \pi_{t-2} + \alpha_3^b h_{t-1} + \alpha_4^b \Delta(p_t^F + e_t) + \varepsilon_t^b$$

(II) $$\pi_t = \alpha_1^f \pi_{t-1} + \alpha_2^f E_t(\pi_{t+1}) + \alpha_3^f h_{t-1} + \alpha_4^f \Delta(p_t^F + e_t) + \varepsilon_t^f$$

where π is the inflation rate, h is the output gap, p^f is the international price level, e is the nominal exchange rate, Δ is the difference operator, $E_t(\cdot)$ is the expectation given the information set at time t and ε are random iid shocks. All variables are expressed in logarithms.

Observe that, from (I), only past inflation explains current inflation rate while, from (II), both past and expected inflation are variables in the equation. According to the rational expectation hypothesis

[2] A description of the model is found in: Bogdanski, Tombini, and Werlang (2000), op. cit.

and the monetary theory, only expected inflation should be an argument in the Phillips curve. The primary rationale for introducing lagged inflation in the equation is empirical. Estimates using lagged inflation present a better fit, possibly because there is some information in past inflation that is not contained in $E_t(\pi_{t+1})$.[3]

Several estimates of (II) were carried out, based on different measures of expected inflation. In general, the coefficient associated with future inflation was 1.5 times greater than the one associated with lagged inflation. This ratio, though, appeared to be at odds with the current reality of Brazilian economy for two reasons. Firstly, such a ratio implies a degree of credibility that has not yet been achieved by the inflation-targeting regime. Secondly, when there is a high degree of inflation forward-lookingness, as defined by the ratio, inertia is low, implying a faster than actually observed adjustment of inflation and output.

In order to solve this problem, it was adopted a pragmatic approach: the Phillips equation used the arithmetic mean of the coefficients estimated under specifications (I) and (II). Consequently, there was a reduction in the influence of the forward-looking term on current inflation. Such a hybrid specification, together with the other equations of the model, generated an inflation/output gap dynamics that seemed to be more realistic than the ones obtained with equations (I) and (II) separately.

It should be stressed that the chosen specification has an important consequence for monetary policy decisions. The greater the degree of forward-lookingness, the lesser will be the sacrifice ratio of monetary policy. Similarly, when the degree of forward-lookingness is high, the change in interest rate required to correct inflation deviations from the target is smaller. Therefore, comparing to specification (II), the hybrid specification implies a more conservative Central Bank stance. We expect that, as the inflation targeting regime gains credibility, expected inflation will converge to the target and the degree of forward-lookingness will increase. Hence, we also expect a reduction of the monetary policy costs during disinflation experiences.

[3] There is also some theoretical justification for inflation persistence. For example, inflation persistence can be caused by costs of changing inflation rate, as in: Fuhrer, J. & Moore, G (1995): "Inflation Persistence", *Quarterly Journal of Economics*, 440, Feb.

Leading Inflation Indicators

The inflation-targeting regime requires a preemptive action of the Central Bank when setting monetary policy instruments, due to lags in the transmission mechanism. In this sense, it is essential to deal with econometric forecast techniques to properly assess the response of eventual shocks that may deviate the future inflation path from its target.

Macroeconomic forecasts aims at providing policy-makers with the best possible set of information to support the decision making process. There are several different technical approaches forecasting either a qualitative or a quantitative realization of a random variable. Structural models use theoretical relations among some macroeconomic variables to generate forecasts. On the other hand, non-structural and auto regressive models use only statistical relationships among variables. Both can incorporate shocks that affect the future path of the dependent variable. Another different approach relies on the construction of leading indicators.

Historically, the first leading indicators were built in the thirties by the National Bureau of Economic Research (NBER) of the United States and have been used as predictors of economic cycles ever since. As of 1961, the US Department of Commerce has been releasing monthly estimates of leading indicators of business cycles. However, only from mid-eighties on techniques for the construction of leading inflation indicators were put on the road.

The most recent technology has led to the consensus of building up composed indexes using the combination of several economic variables. Differently from econometric regression methods, their main contribution is to capture early warnings of the future inflation path. This methodology was developed to draw out from one or more variables movements that anticipate the future inflation trajectory. Such a anticipation is possible, for example, when there is an inherent chronological sequence between the variable and the productive process. This is the case for cardboard, which is widely used as an input for the industrial sector.

Leading indicators, like non-structural models, do not rely on economic theory as they do not intend to capture any economic causality. However, the path of a variable can be occasionally hit by shocks that do not reflect any possible future changes of inflation. The construction of a composed index, by capturing a common component among the variables, minimizes this effect. The algorithm of Kalman Filter has been used as a tool to combine the variables.

On the selection of candidate variables to compose the leading indicator, as well as on the appraisal of its predictive power, all correlations with inflation are analyzed. Moreover, several econometric tests as Granger causality and quadratic probability score of a Markov switching series are conducted.

In order to develop leading inflation indicators for Brazil, over two hundred economic series were evaluated. The forty-nine candidate-variables listed below were selected through the above-mentioned econometric tests.

Variables evaluated for the construction of leading inflation indicators in Brazil

	Variables	Source
	Money and Finance	
1	Sales tax revenue	DEPEC/BACEN
2	Monetary base	DEPEC/BACEN
3	Total net debt of the public sector /GDP	DEPEC/BACEN
4	M1	DEPEC/BACEN
5	M2	DEPEC/BACEN
6	M3	DEPEC/BACEN
7	M4	DEPEC/BACEN
8	IBOVESPA	BOVESPA
	Employment and wages	
9	Employment in construction sector	Ministry of Labor
10	Worked hours in the manufacturing industry – SP	FIESP
11	Real wage bill in manufacturing sector - SP	FIESP
12	Payroll in the mining sector	IBGE
13	Real wage in manufacturing sector – SP	FIESP
14	Employment in the service sector	Ministry of Labor
15	Employment in the civil construction	Ministry of Labor
16	Employment in trade sector	Ministry of Labor
17	Unemployment rate	IBGE
	Prices	
18	Basic basket price index	DIEESE
19	Wholesale price index	FGV
20	Wholesale price index – Construction	FGV
21	Wholesale price index – Machinery, Equipment and Vehicles	FGV

	Variables	Source
	Prices	
22	Wholesale price index - Raw material	FGV
23	Wholesale price index - Gross Raw material	FGV
24	Wholesale price index - Semi-elaborated raw material	FGV
25	General price index	FGV
26	National Construction Cost index	FGV
27	National index of price received by Agricultural Producers	FGV
28	Consumer price index, Tradables	DEPEC/BACEN
	Level of Activity	
29	Consumption of Electric Energy - SP	ELETROBRÁS
30	Total industrial capacity – SP	FIESP
31	Total industrial capacity – Brazil	CNI
32	Domestic demand index	DEPEC/BACEN
33	Sales of Cement	FGV
34	Industrial production index	IBGE
35	Industrial production index – Mining industry	IBGE
36	Raw material production for Construction	IBGE
37	House appliances sales	ELETROS
38	Real Industrial sales	FIESP
39	Vehicles domestic sales	FENABRAVE
	External Indicators	
40	Net External debt of public Sector/GDP	DEPEC/BACEN
41	Exports	DEPEC/BACEN
42	Commodity price index	FGV
43	General Commodity price index	FGV
44	Industrial Commodity price index	FGV
45	Industrial Commodity price index - metals	FGV
46	Import price index	FUNCEX
47	International reserves	DEPEC/BACEN
48	Real Exchange rate	DEPEC/BACEN
49	Effective real exchange rate	DEPEC/BACEN

Annex

Minutes of the 42nd meeting of the Banco Central do Brasil Monetary Policy Committee (Copom)

Date: 12.15.1999
Place: 8th floor meeting room Banco Central Headquarters – Brasília – DF
Called to order: 5:50 PM
Adjourned: 10:10 PM

In attendance:
Members of the Board
Daniel Luiz Gleizer – **Acting Governor**
Carlos Eduardo de Freitas
Edison Bernardes dos Santos
Luiz Fernando Figueiredo
Sérgio Darcy da Silva Alves
Sérgio Ribeiro da Costa Werlang

Department Heads
Fernando Antônio de Moraes Rego Caldas – Department of Economics **(Depec)**
Daso Maranhão Coimbra – International Reserve Operations Department **(Depin)**
José Antônio Marciano – Department of Banking Operations **(Deban)**
Alexandre Antonio Tombini – Research Department **(Depep)**
Eduardo Hitiro Nakao – Open Market Operations Department **(Demab)**

Other participants:
Alexandre Pundek Rocha – Senior Advisor to the Board and Executive Secretary of Copom
Claudia Safatle – Press Advisor **(Asimp)**

The Board analyzed the recent evolution and outlook for the Brazilian and international economies in the framework of the country's new monetary policy regime, which is designed to ensure compliance with government defined inflation targets.

Aggregate supply and demand

Aggregate demand indicators for October and November point to moderate recovery, with slight growth in consumption and investment levels. The volume of credit has been expanding in a framework of declining default levels and more favorable credit conditions offered by the trade sector.

Up to October, real revenues of the retail trade sector in five metropolitan regions accumulated a reduction of 4.63%. However, when one excludes the performance of factory authorized vehicle sales outlets from this calculation, the overall result is one of stability. In the same period, revenues on consumer goods remained stable, while vehicle sales dropped by 29.75%, followed by a reduction of 5.47% under building materials.

The upward movement under private sector credits that began in the second quarter of 1999 continued. The October default rate in the private financial system (4.6%) followed a downward trajectory, while the rate for the public financial system also dropped, albeit at a lesser pace.

Notwithstanding expectations of lesser primary surpluses in the final months of the year, 1999 fiscal performance has been quite satisfactory and easily surpassed the targets defined in the economic program agreed upon with the IMF. Not only has this aided in attenuating the “Brazil risk”, it has also increased confidence that the 2000 targets will be achieved.

In the month of October, the consolidated public sector primary surplus (performance criterion) came to R$ 1.4 billion. The primary surplus for the year totaled R$ 32 billion or R$ 6 billion more than the fiscal target worked out with the International Monetary Fund (IMF) for the period. In the nominal concept, public sector borrowing requirements totaled R$ 7.9 billion. When the impact of the exchange devaluation is excluded from the public debt indexed to exchange, the nominal deficit closed in the range of R$ 6.2 billion.

Exports expanded in both October and November. The accumulated trade balance up to November registered a deficit of US$ 1.5 billion, as compared to US$ 6.1 billion in the same period of the previous year. Foreign sales came to US$ 43.3 billion or 8% less than in the previous year. Here, one should note that export volumes have been expanding since July, while the price indices for these goods – expressed in data purged of seasonal factors - have been improving since September. In comparison to the same period of the previous year, imports up to November declined by 15.9%. Average prices for imports rose sharply, mostly as a consequence of oil price hikes.

The service account accumulated a deficit of US$ 21.8 billion up to November, as compared to US$ 25.5 billion in the same period of the preceding year. The 31% rise in interest payments was more than offset by a 45.6% reduction in net outlays under other headings, particularly profits and dividends, transportation and international travel.

According to IBGE statistics, GDP remained stable in the third quarter of the year. In October, industrial output expanded in all use categories. November figures are expected to reveal a similar result with no significant pressures on production costs. In the series purged of seasonal factors, industrial output expanded by an estimated 0.52% in October, bringing the result for the year to an accumulated drop of 2.2%. Output of capital goods expanded by 3.1% in the same month.

Average nominal labor earnings remained stable in September, closing the first nine months of the year with an accumulated loss of 4.52%. According to IBGE figures, open unemployment in October came to 7.92%, as against 7.64% in September.

Prices

The November broad consumer price index (IPCA) registered growth of 0.95%, as against 1.19% in October, mirroring lesser expansion under food and transportation. These items closed at 1.35% and 2.15%, as against 1.77% and 3.24%, respectively, in the previous month. The prices of tradable goods, which had previously been responsible for considerable pressure on the index, increased by 0.96%, as compared to 2.16% in October. In contrast to this performance, government managed prices increased by 1.90%, compared to 0.76% in October, while the prices of nontradables remained practically stable.

In the same month, the consumer price index-Fipe (IPC-Fipe) expanded by 1.48%, mostly as a result of price increases under food (2.46%) and transportation (4.89%). In the last twelve months, the IPCA and IPC-Fipe registered growth of 8.65% and 7.98%, respectively.

According to a Banco Central survey, expectations of economic analysts for the major price indices were revised upward during the course of November. Insofar as December is concerned, observers expect a lesser rate of inflation as the effects of the off-season harvest period wane. Forecasts for 2000 point to IPCA growth in the range of 6.2% to 7%.

External Environment

Despite predictions of a growth slowdown in 1999, the United States economy has continued thriving. The impact of recent interest rate increases has yet to be felt. Based on revised data purged of seasonal factors, GDP expanded at an annualized rate of 5.5% in the third quarter, when compared to the previous quarter. In October, consumer credit expanded by 3.7%, as compared to 3.1% in September. In November, retail sales increased by 0.9%, thus surpassing the 0.3% growth level registered in October.

Following a period of stability in September, industrial output moved upward (0.6%) once again in the month of October. For the second consecutive month, unemployment remained stable in November (4.1%), while average hourly labor earnings increased by 0.15%, raising accumulated positive growth in comparison to November 1998 to 3.9%. In the twelve month period ended in November, the raw material producer price index expanded by 16.2%, while the index for intermediate goods rose by 3%. Measured by the consumer price index, inflation remained stable. The National Association of Purchase Managers' November index (NAPM) came to 56.2 in November, as compared to 56.6 in October.

In Japan, GDP dropped by 3.8% in the third quarter when compared to the previous quarter. The first quarter, it should be recalled, registered strong growth. The third quarter falloff was caused by a decline in consumption in all sectors of activity, including the public sector. However, one should also note that, when compared to the third quarter of 1998, the Japanese GDP expanded by 0.9%. The trade balance dropped by 1.3% in October as a result of greater demand for imports and valuation of the yen. In much the same way, seasonally adjusted industrial output declined by 2.3% following a September drop of 0.8%. Unemployment held steady at 4.6%. The Tankan indicator of expectations – manufacturing industry - moved from –22 to –17, thus pointing to a sense of confidence in the continuity of the recovery process, albeit at a less accelerated pace.

In the case of the Euro Zone, the outlook was bright, particularly with regard to the expected performance of the German and French economies. In the month of October, industrial output expanded by 0.8% in relation to the same period of the previous year, while unemployment dropped from 10% in September to 9.9%. The most relevant monetary aggregate, M3, expanded by 6% in October, as against 6.4% in September. The harmonized consumer price index rose by 0.1% and closed with an accumulated twelve month total of 1.4%, while the producer price index increased by 0.5% in September and 1.3% in twelve months.

Growth in the United Kingdom was steady as industrial production expanded by 0.2% in October, with a drop under exports. In accumulated twelve month terms up to November, the purged consumer price index closed at 2.2%.

Argentine industrial output increased by 0.1% in October, as compared to 1.9% in September and 4.8% in August. With the impact of the recession in that country, tax revenues shrank by 4.7% in the period from January to October. The fiscal situation deteriorated in 1999 and the deficit for the year was estimated at US$ 5.8 billion. Among other measures, the fiscal adjustment now being negotiated with the Argentine congress depends on approval of the budget for 2000, redistribution of revenues and expenditures among the central government and provinces and increases in already existent taxes coupled with creation of new levies.

Prospective assessment of inflation trends

In relation to the 41st Copom Meeting, the forecast trajectory for the federal funds rate was altered. Based on an analysis of futures market operations, quarterly increases of 0.25 percentage points are expected as of the first quarter of 2000, until reaching a level of 6.25% per year. With regard to international petroleum prices, expectations of an increase during the winter season in the industrialized nations were maintained, with a subsequent downturn followed by stabilization in the range of US$ 20 to US$ 22 per barrel for Brent type crude.

The major identified risk is that of growth in government managed prices, a question already cited in the minutes of the 41st Copom Meeting. The basic scenario uses a conservative estimate of an average 9.2% increase in 2000, which would generate a direct impact of 2.3 percentage points on inflation in that year.

Inflation trends were simulated according to the available models and respective confidence bands and were based on the central scenario, which includes the hypothesis of maintenance of the Selic rate at 19% per year. These simulations led to the conclusion that there is a probability of almost 50% that inflation in the second and third quarters of 2000 will close at a level 1 percentage point above the central trend stated in the fourth review of the Program negotiated with the IMF. However, the same simulations indicate that maintenance of interest rates at the current level will make it possible to achieve the 1999, 2000 and 2001 inflation targets.

Money market and open market operations

At its November 10 meeting, Copom decided to maintain the Selic rate target at 19% per year and eliminate the downward bias.

From November 11 to December 14, the National Treasury carried out eleven LTN auctions and five LFT auctions. Preset papers were readily absorbed by the market in operations marked by longer maturities, thus indicating improvement in the overall economic environment. In six auctions, LTNs were sold with terms of 6 months.

On December 1, the National Treasury carried out two NTN-C auctions at uniform prices, with terms of three and seven years. Though buyers were allowed to effect payment to the Treasury with securitized credits for which they were liable, there was a general preference for liquidation in cash.

Definitive operations with Banco Central securities were limited to sales of NBCE and had the sole objective of offsetting redemptions of debt updated according to exchange rate variations.

Following its strategy of allowing the Selic rate to float more freely, Banco Central reduced its open market interventions. Consequently, in the period between November 11 and December 14, the institution limited its interventions aimed at bringing financial system liquidity into line to just seven, with five being effected through overnight operations.

Monetary policy guidelines

Now that the wave of seasonal shocks and increases in government managed prices that had generated upward pressure on price levels has been largely absorbed, inflation is expected to turn downward in coming months. Recovery in demand has been slow and the exchange value of the nation's currency has risen (as a result of the broadening of exchange market intervention limits, Banco Central market interventions, the decision taken at the 41st Copom Meeting and combined auctions on the forward dollar market).

Fiscal policy has aided in maintaining price stability and recent results indicate that the targets for the primary surplus in 1999 and 2000 will be met. Exports, which were impacted by a generally unfavorable international market scenario in 1999, have already begun reacting. On the external scenario, market expectations point to a rise of 0.5% in the federal fund rate in the first half of 2000.

Based on its analysis of current data and the outlook for 2000, Copom opted not to alter the Selic rate target of 19% per year and refrained from indicating a bias. This position is justified by the need to:

1. confirm the diagnosis regarding inflation trends. More recent wholesale and consumer price indices point to some degree of deceleration, though the drop in inflation measured by the IPCA from October to November was at best modest;

2. give due consideration to uncertainties regarding the behavior of government managed prices in the coming year. This is still the major source of concern in light not only of the direct impact of these prices on inflation in 2000 but also their indirect effects on the other prices of the economy.

At the close of the meeting, the members were reminded that the Committee will meet once again on January 19, 2000, at 4:30 PM, as called for in the Schedule of Ordinary Copom Meetings, released by Banco Central Communiqué no. 7,065, dated 11.18.1999.

Minutes of the 43rd Meeting of the Banco Central do Brasil Monetary Policy Committee (Copom)

Date: 01.18.2000 and 01.19.2000
Place: 8 th floor meeting room Banco Central Headquarters – Brasília – DF
Called to order: on date 01.18 at 3:55 PM and on date 01.19 at 06:40 PM
Adjourned: on date 01.18 at 7:10 PM and on date 01.19 at 7:20 PM

In attendance:
Members of the Board
Armínio Fraga Neto – **Governor**
Carlos Eduardo de Freitas
Edison Bernardes dos Santos
Luiz Fernando Figueiredo
Sérgio Darcy da Silva Alves
Sérgio Ribeiro da Costa Werlang

Department Heads
Altamir Lopes – Department of Economics **(Depec)**
Daso Maranhão Coimbra – International Reserve Operations Department **(Depin)**
José Antônio Marciano – Department of Banking Operations **(Deban)**
Alexandre Antonio Tombini – Research Department **(Depep)**
Eduardo Hitiro Nakao – Open Market Operations Department **(Demab)**

Other participants:
Alexandre Pundek Rocha – Senior Advisor to the Board
Sérgio Goldenstein – Senior Advisor to the Board and Executive Secretary of Copom
João dos Reis Borges Muniz – Press Advisor **(Asimp)**

The Board analyzed the recent evolution and outlook for the Brazilian and international economies in the framework of the country's new monetary policy regime, which is designed to ensure compliance with government defined inflation targets.

Aggregate supply and demand

Signs of expansion in aggregate demand began to appear toward the end of 1999. Growth occurred under industrial sales and check and credit card transactions and was accompanied by a moderate increase under banking credit, all in a framework of declining default levels.

In November, the supermarket segment and wholesale trade sector turned in nominal growth of 16.4% and 20.9%, respectively, when compared to the same month of the preceding year. In the retail sector, real revenues in five metropolitan regions accumulated a 4.41% drop in the year up to November. However, when one excludes factory authorized vehicle sales outlets from this calculation, the final result was very close to stability (0.23%).

In December, automotive sales expanded by 2.9%, with growth of 10.2% under exports and a 1% decline under internal market sales. Marketing of farm machines increased by 12.2%, with positive growth under both exports (28.6%) and internal market sales (7.8%).

With exception of the São Paulo retail trade sector, the first signs of credit growth became evident and were paralleled by a generalized drop in default levels. Based on expanded credit operations with the trade (4.2%) and rural sectors (2.6%), normally performing loans extended to the private sector by the financial system increased by 0.8% in November. Defaults in the private financial system have followed a downward trajectory since May 1999. In the public financial system, the default level moved into a downward curve in the September-November quarter. In the month of December, credit card transactions increased by 30.6% and the volume of checks cleared expanded by 1.9%. A comparison with December 1998 shows growth figures of 20% and –5.3% in the same order, indicating considerably less intense utilization of checks as a payment instrument.

In the month of January, the consumer confidence index (ICC), which is released by the Trade Federation of the State of São Paulo (FCESP), turned upward. The highlights of this index were the items expectations, with an increase from 120.8 to 128.7, and current economic conditions, with growth from 65.4 to 72.7.

In accumulated terms for the year up to November, investment indicators registered negative growth rates. Output of capital goods and building industry inputs dropped by 10.2% and 3.9% in the year, with a less intense decline in the final six months. The rate of gross fixed capital formation in the third quarter of the year came to 17.9% of GDP at current prices, as against 18.1% of GDP in the previous quarter.

In the month of November, the consolidated public sector primary surplus came to R$ 758 million, raising the accumulated total in the year to R$ 32.8 billion, compared to the target of R$ 27.8 billion specified in the agreement with the IMF. When one excludes the impact of alterations in the rate of exchange on the internal debt indexed to exchange, the nominal public sector deficit closed at R$ 3.1 billion.

In 1999, export and import operations declined by 6.1% and 14.8% in relation to the previous year. The trade balance registered a deficit of US$ 1.2 billion in the year, as against US$ 6.6

billion in 1998. One should stress, however, that export volumes have increased since July while foreign market prices have shown signs of recovery since August. In the case of imports, the volume index registered moderate growth in October and November, while average prices have risen sharply since the second quarter of the year, mostly as a consequence of oil price hikes. In 1999, the service account accumulated a deficit of US$ 25 billion, as against US$ 28.8 billion in the preceding year. The 27.7% increase in interest payments was more than offset by a 42.3% reduction under net outlays on other headings, particularly international travel, profits and dividends and transportation. The 1999 current account deficit of US$ 24.4 billion was easily financed by an inflow of US$ 30 billion in direct foreign investments (23% greater than the deficit).

Supply indicators suggest a moderate degree of recovery toward the end of 1999. In the seasonally adjusted series, November industrial output remained stable, with growth of just –0.1%, while expansion in December is estimated at 2.4%. A breakdown of November industrial output by category of utilization shows that production of capital goods increased by 1.2% and output of intermediate goods expanded by 0.7%. Reflecting stability in the output of consumer durables and a 1.8% reduction in semidurable and nondurable consumer goods, the heading of consumer goods in general closed with a decline of 2%.

Labor market indicators now point to a gradual decline in the jobless rate. In 1999, average unemployment closed at 7.56% as compared to 7.60% in the previous year. In the month of December, unemployment dropped to 6.28% following 7.32% in November, reflecting growth of 0.84% in the number of jobholders and a reduction of 0.29% in the economically active population.

External environment

In the United States, indicators point to a high level of aggregate demand with potential imbalances in relation to the pace of growth in supply. However, it should be noted that price indices have not revealed any significant sources of consistent pressures. Retail sector sales increased by 1.2% in December and closed with 9.7% expansion in the year, with record vehicle sales of 16.8 million units in 1999. In the series purged of seasonal factors, consumer credit operations expanded by 4.6% in October and 13.7% in November. Real estate construction rose by 0.12% in October. The October balance of trade (goods) closed with a negative US$ 33.7 billion and an accumulated deficit of US$ 283.5 billion in the year.

The growth trajectory under output remained strong. Based on seasonally adjusted data, GDP expanded by an annualized rate of 5.7% in the third quarter (revised) in relation to the previous quarter. Industrial production expanded by 0.4% in December, closing with accumulated growth of 5% in 1999. Average hourly wages increased by 0.15% in November, in comparison to the previous month and 3.9% when compared to November 1998. The rate of unemployment has remained stable at 4.1% since October.

Price trends continue favorable. The consumer price index (CPI) increased by 0.2% in December, with accumulated growth of 2.7% in the year. The CPI core increased by 0.1% and 1.9%, in the same periods. The producer price index (PPI) and its core increased by 0.1% in December, accumulating respective growth rates of 3% and 0.9% in 1999. A breakdown of the PPI pointed to expansion of 15.8% under raw materials and 3.9% under intermediate goods.

In Japan, growth in aggregate demand is still highly tenuous and reflects moderate growth in private consumption, downward movement in public and private investments and foreign sales that were impacted negatively by valuation of the yen. The trade surplus dropped to US$ 6.3 billion in November, reflecting growth in import demand and valuation of exchange. On the supply side, the situation can be summarized in low stock levels and high levels of utilization of installed production capacity. The rate of unemployment continued on a downward curve and closed November at 4.5%, when compared to 4.9% in July. Real wages have registered positive growth in recent months.

In the Euro Zone, the economy has begun expanding at a more consistent pace and this has been reflected in both product and industrial output. In the third quarter of the year, GDP expanded by a seasonally adjusted rate of 4.2% in annualized terms, in relation to the previous quarter. Unemployment has moved steadily downward and closed November at 9.8%. The monetary aggregate M3 increased by 6.2% in November in comparison to the same month of 1998. The harmonized IPC expanded by 1.5% in twelve months up to November, as compared to 1.4% up to October.

Based on data from which seasonal factors have been removed, GDP in England expanded by 3.1% in the third quarter in annualized terms, when compared to the preceding quarter. In the face of doubts regarding the possibility of sustaining the rate of growth, the Bank of England introduced a preventive increase in basic interest rates of 25 base points to a level of 5.75% in January 2000.

Industrial output in Argentina increased by 1.5% in November, registering the fourth consecutive month of positive growth. However, in accumulated terms for the year, the final result was a decline of 8.3%. The 1999 fiscal deficit came to US$ 6.9 billion or considerably more than the US$ 5.9 billion level predicted by the government. At the provincial level, the deficit came to US$ 3.7 billion, as against an expected negative result of US$ 1.7 billion.

Prices

In 1999, the broad consumer price index (IPCA) expanded by 8.9%. This result was consistent with the annual inflation targeting system that has been used as the basic monetary policy guideline since the month of June. The target defined for 1999 was annual IPCA growth of 8%, with upward or downward deviations of up to two percentage points.

In December, the pace of price increases slowed. Wholesale price indices reflected drops in farm and industrial prices, while consumer price indices showed that the impact of earlier alcohol and gasoline price increases had been fully absorbed. In December, IPCA expanded by 0.6%, as compared to 0.95% in the previous month.

In 1999, the general price index – internal supply (IGP-DI) and general price index – market (IGP-M) increased by 19.98% and 20.10%, respectively. However, the strongest growth occurred under the wholesale price index – internal supply (IPA-DI), with 28.9% in the year. The consumer price index – Fipe (IPC-Fipe) accumulated growth of 8.6% in the period.

According to a Banco Central survey, the expectations of analysts with regard to the major price indices in the first quarter of 2000 point to lower inflation, particularly in general price indices.

Prospective assessment of inflation trends

Any evaluation of the inflationary outlook should begin with identification of shocks capable of impacting the future price level trajectory. The potential shocks cited in both the December Inflation Report and at the previous Copom meeting remain essentially valid. The basic scenario considers an increase in federal fund rates that has already been absorbed by futures markets; an average 9.2% increase in prices set by the public sector in 2000; farm sector neutrality with respect to price pressures during the year, already taking due account of the seasonal increase in agricultural products in the first half of the year; and fiscal policy compliance with the R$ 36.7 billion target for the consolidated public sector accumulated primary surplus in 2000, with highly positive influence in terms of price stability.

In relation to the macroeconomic environment considered in the December Inflation Report, the major difference is elimination of the doubts that had generated considerable wariness within highly computerized sectors of the economy as regards transition to the new century. With respect to the rate of exchange, the process of valuation of the nation’s currency that began in December was confirmed in average terms in the first half of January. This process has been further strengthened by sharp declines registered in the value of the risk premium on Brazilian sovereign debt papers since the fourth quarter of 1999.

Based on alternative scenarios that deviate slightly from the core scenario, economic models were subjected to a series of simulations. These simulations lead to the conclusion that maintenance of interest at current levels will, with a high degree of probability, make it possible to comply with inflation targets in 2000 and 2001.

Short-term forecasts as well as antecedent inflation indicators were presented. Analysis of these results leads to the conclusion that inflation will tend downward in the early months of 2000. In more specific terms, antecedent indicators suggest a more abrupt drop in inflation in the month of February. It should be noted that January results still tend to reflect the supply problems that occurred under fruit and vegetables as a result of prolonged rain in the southeast region. At the same time, they also incorporate the seasonal factors characteristic of the start of the school year.

According to the daily survey carried out by Banco Central, expectations of inflation according to the IPCA, measured on January 18, indicated a median rate higher than the target for 2000 (6.94% as against a target of 6%).

Money market and open market operations

On December 15, 1999, Copom not only maintained the Selic rate target unaltered at 19% per year but also resolved, once again, not to indicate a bias. This decision was in keeping with the expectations of practically all the participating market institutions consulted.

Between December 16, 1999 and January 18, 2000, the National Treasury carried out three LTN sales auctions, one LTN purchase auction and two LFT sales auctions. No alterations were introduced into the programming of market security placements previously announced by the National Treasury.

Definitive operations with Banco Central papers were, once again, restricted to sales of two year NBCE. The three NBCE auctions were carried out at uniform prices and had the objective of rolling the maturing debt since they resulted in net placements of just R$ 49 million. One should note that, since December 28, 1999, the NBCE coupon has been defined in each issue notification.

Continuing its efforts to construct a more dynamic federal securities secondary market, Banco Central intervened in the money market on ten different occasions for a total of 24 business days.

The objective was to manage the financing cost of these papers in situations marked by imbalances in banking reserves.

Analyzing the January 17 position of interest rate forward operations, one notes a shift into a downward curve. At the same time, one perceives that the interest curve is practically horizontal, with one year swap operations generating 20.65% per year as compared to the Selic rate target of 19% per year.

Monetary policy guidelines

Analysis of supply and demand reveals an absence of imbalances capable of generating inflationary pressures for the inflation targeting system in the foreseeable future. Consumption and credit indicators point to a process of still tenuous recovery with an outlook for considerable improvement during the course of 2000. However, they do not stand as risks to supply and demand equilibrium and, consequently, are not considered sources of inflationary pressures. Fiscal policy will remain austere and will contribute positively to price stability. Since December, the foreign sector – and, more precisely, the trade balance – has performed well and one can expect strong improvement in export operations. Having overcome the sense of wariness that dominated highly computerized systems during the transition to the new century, the early days of 2000 were marked by strong capital inflows and improvement in foreign financing conditions. Monitoring of the farm harvest reveals no significant price pressures during the year.

The overall scenario is more conducive to price stability than in the period prior to the previous meeting of the Committee. Monetary policy decisions are taken on the basis of evaluation of a series of factors that, one way or another, introduce risks in terms of the future evolution of inflation, including: 1) growth in public sector prices and tariffs during the course of the year, with potential for exerting pressure on the inflation trajectory independently of supply and demand conditions; 2) a trend to gradually more restrictive monetary policies in the United States, England and Euro Zone during the year; and 3) the behavior of international oil prices which, at the moment, are being pressured by the harsh winter season in the United States.

The decline in inflation measured by the IPCA from November to December points to convergence to a trend that is more compatible with inflation targets. However, the first figures for January inflation, particularly as measured by the consumer price index (IPC) of the general price index – market (IGP-M), suggest a rather modest drop in relation to December 1999. However, it should be noted that several seasonal factors – such as those consequent upon the start of the school year and fruit and vegetable supply problems caused by heavy rain in the southeast region – have impacted this performance.

Having analyzed the economic scenario and the outlook for 2000, Copom resolved to maintain the Selic rate target at 19% per year, with no indication of a bias.

At the close of the meeting, it was announced that the Committee would meet again on February 15, 2000, at 5:00 PM, for the technical presentations and on the following day, at 4:30 PM in order to discuss monetary policy guidelines, as called for in the Schedule of Ordinary Copom Meetings, released by Banco Central Communiqué no. 7,228, dated 01.19.2000.

Minutes of the 44th Meeting of the Banco Central do Brasil Monetary Policy Committee (Copom)

Date: 02.15-16.2000
Place: 8th floor meeting room Banco Central Headquarters – Brasília – DF
Called to order: 5:15 PM on 02.15 and 4:50 PM on 02.16
Adjourned: 7:50 PM on 02.15 and 7:10 PM on 02.16

In attendance:
Members of the Board
Armínio Fraga Neto – **Governor**
Carlos Eduardo de Freitas
Daniel Luiz Gleizer
Edison Bernardes dos Santos
Luiz Fernando Figueiredo
Sérgio Darcy da Silva Alves
Sérgio Ribeiro da Costa Werlang

Department Heads
Altamir Lopes – Department of Economics **(Depec)**
Daso Maranhão Coimbra – International Reserve Operations Department **(Depin)**
Luiz Gustavo da Matta Machado – Department of Banking Operations **(Deban)**
Alexandre Antonio Tombini – Research Department **(Depep)**
Eduardo Hitiro Nakao – Open Market Operations Department **(Demab)**

Other participants:
Alexandre Pundek Rocha – Senior Advisor to the Board
Antonio Carlos Monteiro – Executive Secretary of the Board
Gustavo Bussinger – Consultant to DEPEC
Sérgio Goldenstein – Consultant to the Board and Executive Secretary of Copom
João dos Reis Borges Muniz – Press Advisor **(Asimp)**

The Board analyzed the recent evolution and outlook for the Brazilian and international economies in the framework of the country's new monetary policy regime, which is designed to ensure compliance with government defined inflation targets.

Aggregate supply and demand

The early days of the year were marked by signs of moderate growth in aggregate demand. Upward movement was detected under industrial and trade sector sales, as well as consumer credit operations. In a framework of more dynamic world economic growth, the drop in the accumulated twelve month trade deficit in the December-January period suggests a positive turnaround in this area as well.

In the month of January, industrial sales of automotive vehicles and farm machines expanded by 6.3% and 0.7%, in that order, when compared to the previous month. Data on factory authorized vehicle sales outlets from which seasonal factors have been eliminated point to growth of 16.3% in sales. The best performance occurred under automobiles (27.3%) and buses (34.3%). Credit card transactions and check clearing operations expanded by 6.6% and 2.7% in relation to December, with growth of 10.6% and 7.9% in comparison to January 1999, respectively.

The Consumer Confidence Index (ICC), released by the Trade Federation of the State of São Paulo (FCESP), has risen steadily since November. In February, it hit the mark of 109.9, the highest level of the past twelve months, reflecting improvement in the overall economic situation as perceived by consumers. The item current economic conditions moved from 72.2% in January to 86.5% in February, while expectations remained stable at 128.6% in the last two months.

Following a sharp decline in the second half of 1999, default indicators have begun leveling off. At the São Paulo Consumer Protection Service (SPC), the net default rate came to 7.2% in January, as compared to 8.5% in December. According to Teledata, the company that operates the Tele-Cheque system, defaults in Rio de Janeiro closed the first month of the year at 1.35%, following 1.2% in December and 1.9% in November. Checks returned for insufficient backing in the month of January came to 3.2% of checks cleared (nationwide). In December, this ratio had closed at 2.9%.

In 1999, investment indicators registered negative growth, though the intensity of the drop was less intense in the second half of the year. Production and imports of capital goods dropped by 8.9% and 15.8% up to December, respectively, when compared to accumulated declines of 10.7% and 15.6% up to November. Production of construction industry inputs fell by 2.9% and BNDES disbursements dropped by 4.9%, as compared to negative rates of 3.2% and 16.4%, respectively, up to November. With these results, it is estimated that the rate of gross fixed capital formation in 1999 closed at 18.3% of GDP at current prices (19.9% in 1998).

Normally performing financial system loans to the private sector declined in December, mostly as a result of cutbacks in credits granted to industry (0.7%), housing (2.4%) and commerce (1%).

However, growth in the balances of loans to individuals (1.3%) and other services (3.5%) continued. Defaults in the private financial system closed December at 4.3% and have declined steadily from a May level of 5.4%.

Despite a December deficit of R$ 1.8 billion in the consolidated public sector primary fiscal result, the surplus for the year closed at R$ 31.1 billion, surpassing the R$ 30.2 billion target in the IMF agreement. In 1999, the consolidated public sector nominal deficit came to R$ 96.1 billion, equivalent to 10% of GDP. The net public sector debt totaled R$ 516.6 billion in December, or 47% of GDP.

In the month of January, the trade balance registered a deficit of US$ 94 million, the best performance for that month in the last three years. Exports expanded by 17.1% and imports dropped by 2.7% in relation to January 1999. Manufactured goods outstripped other foreign sales segments with growth of 22.4%, led by transmission and reception equipment and transportation goods, mostly automobiles, aircraft and engine chassis. Marketing of semimanufactured goods rose by 13.7%. The products that accounted for the major share of this growth were cellulose, semimanufactured iron and steel goods and aluminum. Primary products closed with the lowest growth rate (6.3%) with a substantial value increase in shipments of chicken meat, beef and iron ore. Insofar as markets for Brazilian goods are concerned, the country expanded its operations with Asia, the United States and the Laia countries, principally Mexico.

Supply indicators would seem to suggest a speedup of the growth process toward the end of 1999. Industrial production expanded by 3.1% in December in the seasonally adjusted series, with positive growth in all use categories. Output of capital goods increased by 4.6%, intermediate goods by 2.7% and consumer goods by 1.9%. The latter figure reflects growth of 0.4% in the production of consumer durables and 2.9% in semidurable and nondurable consumer goods.

The average level of utilization of installed production capacity in the manufacturing sector moved to 82% in January, practically the same level as in January 1995. The intermediate goods production sector is utilizing 85% of its output potential, an evident sign of the ongoing process of import substitution. Parallel to this, the consumer goods and capital goods sectors have been operating in the range of 75% and have positioned themselves to respond rapidly to upturns in demand.

Signs of a turnaround in labor market indicators have become increasingly evident. A good example of this trend is creation of 954 job positions in São Paulo industry in January, the first positive result in that month since 1995.

External environment

Spurred mostly by expanding internal demand, production in the United States has continued thriving. In the seasonally adjusted series, consumer credit expanded by an annualized rate of 9.7% in December, in comparison to the month of November, while retail sales increased by 1.25% in the final month of the year. At the same time, the balance of trade in goods registered a US$ 34.3 billion deficit in November, raising the accumulated deficit for the year to a level 39.1% above the 1998 result.

In the fourth quarter of the year, seasonally adjusted annualized figures indicate that GDP expanded by 5.8% in the United States in relation to the previous quarter, while industrial output grew by 0.4% in December and 1% in January in the series purged of seasonal factors. The growth trajectory has been sustained by absorbing available labor – unemployment closed January at just 4% - and increasing productivity. With this, labor market pressures have not engendered upward price movement. In the fourth quarter of 1999, productivity in the manufacturing sector increased by an annualized rate of 10.7%, when compared to the previous quarter, while the nonfarm sector managed to maintain a steady 5% pace, utilizing the same basis of comparison. In 1999, the productivity of the economy rose by 2.9%.

In 1999, the producer price index increased by 3%, while the index core - excluding increases in food and energy prices - moved upward by 0.9%. Increases in the prices of raw materials (15.8%) and intermediate goods (3.9%) suggest possible pressures further down the line. The consumer price index rose by 2.7% in 1999, with a core increase of 1.9%.

In Japan, sluggish recovery in private spending and cutbacks in public sector outlays resulted in diminishing aggregate demand at the end of 1999. It should be stressed that industrial growth has been sustained by exports. The trade surplus came to US$ 11 billion in December, raising the accumulated surplus to US$ 108.9 billion in the year, corresponding to an increase of 1.4% above the final 1998 figure. The gradual downward slide in the jobless rate was interrupted as December closed with 4.6%, compared to 4.5% in November.

The Euro Zone economy registered a consistently positive growth trajectory. In the third quarter, GDP increased at an annualized pace of 4.1% in the seasonally adjusted series, in comparison to the previous quarter, while industrial output expanded by 2.8% in November when set against the same month of the previous year. Unemployment moved steadily downward and closed December at 9.6%. The M3 monetary aggregate increased by 5.8% in October, 6.2% in November and 6.4% in December, as against the same months of 1998. By way of comparison, the European Central Bank had defined the three month moveable average reference rate at 4.5%. The harmonized consumer price index – IPC increased by 1.7% in 1999, as compared to an informal target of 2%.

In England, GDP expanded by an annualized rate of 3.1% in the third quarter, based on the series purged of seasonal factors, when viewed against the second quarter. Wariness with regard to the possibility of sustaining this growth pace led to adoption of a 0.25 percentage point increase in the basic interest rate to 6% per year in February. One should recall that an increase of the same magnitude was introduced in January 2000.

In Argentina, industrial production expanded by 3.8% in December, when compared to November, and 8.9% when seen against the December 1998 result, closing the year with an accumulated output sag of 6.9%. The trade deficit remained stable in December at US$ 279 million, as 1999 closed with an accumulated deficit of US$ 2.2 billion, a downturn of 55.9% when compared to 1998. One should note that exports declined by 11.7% in 1999 and imports dropped by 18.7%.

Prices

In January, the upward movement in general price indices shifted into a downward curve, reflecting lesser wholesale price pressures, particularly under farm products. The general price index – internal supply (IGP-DI) dropped from 1.23% in December to 1.02% in January, while its major components, the wholesale price index – internal supply (IPA-DI) and the consumer price index (IPC) increased by 1.02% and 1.01%, respectively.

Consumer price indices rose slightly in the month of January, as a result of seasonal pressures on *in natura* food products and, principally, school enrollments and monthly payments. The broad consumer price index (IPCA) rose by 0.62% in January as compared to 0.6% in December and the consumer price index – Fipe (IPC-Fipe) expanded by 0.57%, as against 0.49%.

According to a Banco Central survey, most analysts expect the major price indices to continue on a downward inflation trajectory in the first quarter of 2000.

Prospective assessment of inflation trends

An assessment of the inflation outlook must begin with identification of the shocks capable of impacting future price trends. The shocks identified are practically the same as those delineated at the previous Copom meeting. Consequently, the basic scenario reflects the federal fund rate implicit in futures contracts; an average 9.2% increase in government managed prices in 2000; farm sector neutrality as regards price pressures during the year, assuming that the seasonal growth in the supply of farm products expected in the first half of the year will effectively come about; and a fiscal policy fully in compliance with the R$ 36.7 billion target defined for the accumulated primary surplus of the consolidated public sector in 2000, a factor of overriding importance to price stability. Several scenarios involving increases in the minimum monthly wage were also analyzed.

Following presentation of the central scenario, simulations were performed using economic models based on alternative scenarios. The major differences in relation to the central scenario are found in the evolution of oil prices and the Brazil risk. Based on simulations that utilize the hypotheses of the central scenario, it was concluded that maintenance of interest rates at their current level will make it possible to comply with inflation targets for 2000 and 2001. Even though the simulations that utilize alternative hypotheses also demonstrate the feasibility of compliance with the stated targets, the probability of compliance would be lower than in the central scenario.

Both short-term forecasts and the leading inflation indicators were presented. The results confirm the trend toward a reduction in the first quarter of 2000. More specifically, the leading indicators suggest a steady decline in the early part of the year. Though other short-term forecasts ratify this trend for the first quarter of 2000, they also point to a small increase in inflation in the second quarter of the year caused by seasonal factors.

Measured by the broad consumer price index (IPCA), the median inflation expectations perceived in the daily Banco Central survey on February 14 remained above the inflation target for 2000 (6.88% as against a target of 6%). However, in relation to the forecast median at the end of January (6.94%), the February figure indicated downward movement.

Money market and open market operations

At its most recent meeting held on January 19, COPOM resolved to maintain the Selic Rate target at 19% per year with no indication of a bias.

Between January 19 and February 15, definitive operations with Banco Central papers generated an expansionary monetary impact of R$ 0.4 billion. On the other hand, definitive operations with National Treasury securities produced a R$ 3.2 billion contractive impact. These results reflect ongoing implementation of the policy of gradually withdrawing Banco Central from the grouping of public security issuers, with the sole exception of papers updated according to exchange rate variations.

Between January 18 and February 14, the National Treasury sponsored nine LTN sale auctions totaling R$ 18.6 billion, as against R$ 17.5 billion in redemptions. Among these auctions, one should highlight the first firm offer of one year LTN on January 20 and 21. Offers of these papers had not occurred since July 1999 and their return to the market should be viewed in the context of the government's intention of lengthening the average term of the federal securities debt. On January 31, the National Treasury held two NTN-C uniform price auctions. Insofar as December auctions are concerned, the share of operations with financial liquidation through securitized credits moved from 20% to 26%.

Once again, definitive operations with Banco Central securities were restricted to sales of NBCE. The seven uniform price auctions were targeted at rolling over the maturing debt, since they resulted in R$ 155 million in net redemptions. In a total of 18 business days, Banco Central entered the money market on 11 occasions with the aim of managing the financing costs of public securities held by the market in situations of banking reserve imbalances.

Monetary policy guidelines

Since December 1999, aggregate demand indicators have been steadily converging, suggesting that the process of economic recovery is gaining in momentum. Parallel to this, an analysis of supply indicators (labor market, overall wages, utilization of production capacity) reveals no signs of imbalances capable of generating short-term inflationary pressures. Fiscal policy has made a major contribution to price stability. Since December, trade balance results have improved sharply, with a strong upturn under exports generated by increased demand. Net capital inflows confirmed improvement in foreign financing conditions in the early days of 2000. Growth in the farm harvest suggests that there will be no significant price pressures on this front during the current year.

More recent price indicators confirm the downward trend in consumer inflation in February. Nevertheless, with regard to future inflation, certain risk factors do exist and have either not been dissipated or have actually worsened since the most recent Copom meeting. Among these, one should stress the following: 1) uncertainties regarding the evolution of government managed prices and other cost pressures; 2) the trend toward sharper interest rate hikes in the developed countries; and 3) recent surges in international oil prices on both the spot and futures markets.

Following a detailed analysis of the overall economic situation and the outlook for 2000, Copom decided to hold the Selic rate target steady at 19% per year, with no indication of a bias.

At the close of the meeting, it was announced that, based on the Schedule of Ordinary Copom Meetings, released by Banco Central Communiqué no. 7,228, dated 01.19.2000, the Committee would meet again on March 21, 2000, at 3:00 PM, for technical presentations and on the following day, at 4:30 PM in order to discuss monetary policy guidelines.

Economic policy measures

Measures related to the financial system and credit market

Resolution no. 2,673, dated 12.21.1999 - Defined new characteristics for Banco Central do Brasil Notes - Special Series (NBCE). The purpose of the change was to make it possible for Banco Central to set the annual rate of interest to be applied to these papers, with each issue, together with the change in the sale value of the United States dollar in the free rate exchange market. According to the previous norm, interest was set at 6% per year. The greater flexibility now adopted is aimed at adjusting interest rates according to market demands and, consequently, breathing new life into competitive operations with these papers.

Resolution no. 2,675, dated 12.21.1999 - Altered the norms that discipline operations and commitments involving fixed income securities. One should also cite the obligatory nature of registration of these papers in Selic or Cetip, the possibility of carrying out purchase operations with resale commitments with a future maturity date prior to or coincidental with the maturity date of these papers. The terms of this Resolution were targeted to operations with agrarian debt securities, debentures, certificates of real estate receivables and bank credit bills. It also permits committed operations without differentiating between financial and nonfinancial clients. Parallel to this, the norm also defines operation limits for committed operations.

Resolution no. 2,682, dated 12.21.1999 - This measure defined new classification criteria applicable to credit operations and constitution of provisions for hard-to-recover credits. The classification of risk operations is divided into nine levels and will depend on consistent and verifiable criteria, encompassing aspects related to the debtor in question, the debtor's guarantors and the operation itself. A periodic review of the classification will also have to be made. This alteration with respect to the criteria for evaluating the risk of credit operations is designed to measure potential risk. Another reason underlying this change is the need for standardizing national procedures on the basis of internationally adopted standards as a consequence of the process of market globalization. The overall aim, of course, is to deepen integration with other countries and stress the importance of further strengthening the process of banking supervision.

Circular no. 2,957, dated 12.30.1999 - Targeted at stimulating competition and transparency in the financial market, while enhancing information on credit operations, with non-earmarked resources. This is to be done through imposition of an obligation to remit information on weighted average rates, minimum and maximum rates, the amount released on the base date, the balance of credit, respective levels of arrears and average terms of operations.

Resolution no. 2,685, dated 1.26.2000 - Authorized Banco Central do Brasil to institute and regulate the granting of rediscounts - with resale commitment - in the modalities of rediscount and purchase modalities of securities, credits and credit rights that are part of the assets of multiple banks with commercial portfolios, commercial banks and savings banks. This rediscount model seeks to minimize the credit risk for Banco Central do Brasil at the time in which resources are to be granted to an institution that is immersed in liquidity problems, since the title to the assets at that point is transferred to the Banco Central do Brasil portfolio. Another objective is expansion of the secondary securities market upon utilization of the purchase option, with resale commitment.

Resolution no. 2,686, dated 1.26.2000 - Altered Resolution no. 2,493, dated 5.7.1998, making it possible for institutions authorized to operate by Banco Central do Brasil to assume co-liability at the time of credit right assigns to corporations. It was possible to implement this change as a result of the scenario of stability in Brazil and of the increased effectiveness of prudential supervision. The alteration is aimed at stimulating the secondary credit market through securitization of receivables.

Resolution no. 2,692, dated 2.24.2000 - Determined that the calculation of the Net Worth required of institutions authorized to operate by Banco Central is to encompass the risk of alterations in the interest rates practiced by the market as a consequence of the exposure of the institutions' assets. This measure had the objective of complementing two measure issued in 1999 in the framework of the Basle rules. These measures determined increases in the minimum limits of paid-in capital and inclusion of the market risk related to exposure in foreign currency and gold. The new norm unified the factor applicable to assets weighted by risk to 0.11, independently of the period in which the institution is in operation. One should also note that article 3 confirms that, for purposes of calculating the credit risk, guarantied operations carried out on stock exchanges and commodity and futures exchanges and those in which the institution acts exclusively in intermediation, without assuming any rights or obligations on the part of the institution, are not included in the calculation base of required net worth.

Circular no. 2,969, dated 3.14.2000 - Reduced the compulsory reserve/ obligatory reserve from 65% to 55% on demand resources of the multiple banks with commercial portfolios, commercial banks and savings banks. The measure has the purpose of expanding funding available for loans and should have a direct impact on the interest rates practiced by banks. I - Group "A" institutions: on 3.23.2000, with calculation and operation periods from 3.23 to 3.29.2000 and from 3.31 to 4.6.2000; II - Group "B" institutions: on 3.20.2000, with calculation and operation periods from 3.20 to 3.24.2000 and 3.28 to 4.3.2000.

Fiscal policy measures

Law no. 9,887, dated 12.7.1999 - Extended the validity of the 27.5% individual income tax rate from 12.31.1999 to 12.31.2002. At the end of that period, the rate will drop back to 25%.

Decree no. 3,342, dated 1.25.2000 - Regulated execution of the Fiscal Recovery Program instituted by Provisional Measure no. 1,923, dated 10.6.1999. The program in question is targeted at fostering normalization of federal government credits originating in the debts of legal entities related to taxes and contributions managed by the Federal Revenue Secretariat and National Social Security Institute (INSS).

Constitutional Amendment no. 25, dated 2.14.2000 - Defined ceilings on the earnings of municipal councilpersons and disciplines spending by the municipal legislative branch.

Law no. 9,962, dated 2.22.2000 - Determined that, as of the date on which this law goes into effect, the labor relations of personnel admitted to public sector employment in the direct federal administration, semi-autonomous agencies and foundations will be governed by Consolidated Labor Legislation.

Constitutional Amendment no. 27, dated 3.21.2000 - Defined that 20% of the federal tax and social contributions inflows shall not be earmarked to agency, fund or expenditure in the period from 2000 to 2003. This will not lower the base for calculating transfers to states, municipalities and the Federal District.

Measures related to the foreign sector

MF Directive no. 458, dated 12.9.1999 - Reduced the IOF rate from 2.5% to 2% on exchange operations involved in credit card management company operations aimed at paying liabilities consequent upon acquisitions of goods and services abroad by their users, effective as of February 2000.

MDIC Secex Directive no. 12, dated 12.15.1999 - Determined that export and import operations may be carried out only by individuals and legal entities registered in the Exporter and Importer Reference File (REI). At the moment of the operation, registration is automatic. Imports by individuals may not be registered as having commercial purposes.

Circular no. 2,955, dated 12.15.1999 - Altered the regulations on the Reciprocal Payments and Credit Agreement (CCR). Deposit of 100% of the total value of the operation in Banco Central do Brasil is required as payment of imports originating in or proceeding from Argentina, at the moment of the registration of the operation in Sisbacen, when the value of the operation is greater than US$ 100 thousand or its equivalent value.

MDIC Directive no. 374, dated 12.21.1999 - Listed the merchandise eligible for the Export Financing Program (Proex) - Equalization modality. Sets the maximum payment periods of Equalization according to the unit value of the merchandise at the point of shipment.

MDIC Directive no. 375, dated 12.21.1999 - Listed the merchandise eligible for the Export Financing Program (Proex) - Financing modality. Sets the maximum payment periods of Financing according to the unit value of the merchandise at the point of shipment

SRF/MF Normative Instruction no. 153, dated 12.22.1999 - Consolidated and instituted the Express System of Customs Clearance (Blue Line), which had operated experimentally in five different localities in the country, for customs locations authorized by the SRF. In order to qualify for accreditation, companies must have exported or imported an amount equivalent to at least US$ 30 million in the last year. In the case of import companies, they must have exported a minimum value equivalent to 50% of the volume imported. In this way, the measure seeks to prioritize exports. With this measure, the period of customs clearance will tend to decline from two to three business days on average to just four hours.

Decree no. 3,312, dated 12.24.1999 - Instituted the special customs system for imports of crude oil and its derivatives for purposes of export or re-export. In imports of crude oil and its derivatives, payment of the import tax and industrialized products tax is suspended until such time as the company demonstrates that it has exported an equivalent amount of petroleum derivatives. The period of the suspension is 90 days and may be extended a single time for an additional ninety days.

MF Directive no. 492, dated 12.29.1999 - Increased the IOF from 0% to 5% on amounts entering the country in financial loan operations with minimum average amortization terms of up to 90 days, effective as of 1.3.2000. The others remained at 0%.

Resolution no. 2,683, dated 12.29.1999 - Permitted contracting of resources abroad for freely chosen investments on the domestic market by financial institutions and leasing companies, and eliminates the demand for a minimum term in external loan operations, effective as of 1.3.2000.

Circular no. 2,956, dated 12.29.1999 - Altered the system and form of preparing prior authorization requests and foreign loan registrations. Consolidates the requests for authorization and registration of foreign loan operations in a single form.

MF Directive no. 3, dated 1.12.2000 - Reduced the ad valorem rate of the import tax on 407 items (ex-tariff) to 5%. Excluded 55 products, of which 28 are items from Appendix B of MF Directive no. 339, dated 12.18.1997; 26 from MF Directive no. 202, dated 8.12.1998 and one item from MF Directive no. 343, dated 12.23.1998. The sectors that drew the greatest benefits from this measure were chemicals, followed by electric-electronic, food, hygiene and cleaning products.

Resolution no. 2,687, dated 1.26.2000 - Permits nonresidents in the country to carry out operations with forward, futures and options contracts, involving crop and livestock products.

Resolution no. 2,689, dated 1.26.2000 - Determined demands for nonresident investors to invest foreign resources entering the country in the financial and capital markets.

Circular no. 2,963, dated 1.26.2000 - Determined conditions for the electronic declaratory registration and for operations carried out by nonresident investors, as defined in Resolution no. 2,689, dated 1.26.2000.

Circular no. 2,967, dated 2.8.2000 - Introduced alterations into the exchange regulations consequent upon introduction of the Simplified Export Declaration (DSE) and Simplified Import Declaration (DSI) at Siscomex. With this measure, the importer is able to close a single exchange contract for several different operations, provided the limit of US$ 10 thousand is not exceeded. Another change is permission for the exchange contracts consequent upon international orders to be formalized on the free rate exchange market, thus reducing the costs of the operation for both the bank and the importer.

Resolution no. 2,694, dated 2.24.2000 - Permitted opening and maintenance of foreign currency accounts by insurance companies, local reinsurance institutions, admitted reinsurance institutions or reinsurance brokerage companies at banks authorized to operate in exchange in the country.

Circular no. 2,968, dated 2.24.2000 - Treats of the carrying out of exchange operations related to payments of premiums and indemnities when such insurance policies are denominated in foreign currency.

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

Daniel Luiz Gleizer
Deputy Governor

Edison Bernardes dos Santos
Deputy Governor

Luiz Fernando Figueiredo
Deputy Governor

Sérgio Darcy da Silva Alves
Deputy Governor

Sérgio Ribeiro da Costa Werlang
Deputy Governor

Members of the Monetary Policy Committee (Copom)

Voting members

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Governor

Carlos Eduardo de Freitas
Deputy Governor

Daniel Luiz Gleizer
Deputy Governor

Edison Bernardes dos Santos
Deputy Governor

Luiz Fernando Figueiredo
Deputy Governor

Sérgio Darcy da Silva Alves
Deputy Governor

Sérgio Ribeiro da Costa Werlang
Deputy Governor

Non-voting members

Alexandre Antonio Tombini
Head of the Research Department (Depep)

Altamir Lopes
Head of the Department of Economics (Depec)

Daso Maranhão Coimbra
Head of the Department of International Reserve Operations (Depin)

Eduardo Hitiro Nakao
Head of the Department of Open Market Operations (Demab)

Luis Gustavo da Matta Machado
Head of the Department of Banking Operations (Deban)

Sérgio Goldenstein
Board of Directors Consultant