Inflation Report

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Inflation Report

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Statistical Conventions:

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

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

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

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Foreword

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

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

Executive Summary

As the elections draw near and the international conjuncture deteriorates, the exchange market has become nervous, with unfavorable repercussions on domestic expectations. Credit conditions have therefore worsened, leading to greater rigor in the concession of credits, shorter maturities, and interruption of the downward path of interest rates. In this context, the sales of consumption goods with a higher unitary value have declined and there was a significant expansion in the sale of goods with a lower unitary value, a movement basically associated with the release of FGTS (Warranty Fund for Severance Pay) funds.

As regards investments, which constitute the most volatile component of demand, there was a reversion in the path of civil construction activities, which were recovering in the first months of the year, and a marked reduction in the level of production of capital goods. Long-term investments continue to benefit from the continuous growth of BNDES disbursements for infrastructure projects.

The GDP outcome in the second quarter confirmed that the economic activity has dropped. However, it should be highlighted that the recovery process observed since the end of 2001 has not been interrupted. A growth at a slower pace than the one pointed out in the first quarter was registered basically as a result of the performance of the primary sector and of the consumption of goods with a lower unitary value.

The projection for the level of economic activity in the next few months should consider the lingering uncertainties associated with the electoral process and the international conjuncture as restrictive factors. However, special mention should be made of some aspects tending to favor the recovery of economic activity, such as the actions of the Monetary Authority in the foreign exchange market, the agreement with the IMF, the funds made obtained from other international organizations, and the efforts being made to restore foreign credit lines, which, in addition to restrict increases in production costs associated with the exchange rate, are expected to have a positive impact on the domestic expectations and, consequently, on the level of demand.

The fiscal policy continues to play a key role in maintaining macroeconomic stability. In this sense, the increase in the target level of primary surplus, from 3.75% of GDP to 3.88% of GDP, representing about R$1.7 billion, may lead to an improved perception of the country risk, with positive effects on the evolution of domestic interest rates and on the recovery of sustainable growth.

The balance of payments has been reflecting important adjustments in the foreign sector of the Brazilian economy. The marked contraction observed in the current account deficit provides clear evidence of the import substitution process under way, of the positive response of external accounts to the depreciation of the domestic currency, enhancing the competitiveness of exports and paving the way for new markets to be accessed, and also of the slower pace of the economic activity. As a complement to the adjustment, the Financial Aid Program was strengthened through the new agreement that was signed with the International Monetary Fund, which will play a key role until the regular inflow of private capitals is resumed. Favorable conditions for an equilibrium in the balance of payments are therefore ensured both for 2002 and 2003 with comfortable levels of international reserves.

The volatility of the exchange rate and of the assets' market continues to be the main focus of uncertainty for inflation forecasts, particularly for 2003. The exchange rate depreciation has led to an upward review of the projected figures, in addition to increasing uncertainties in relation to the persistence of this depreciation and to the extent of its pass-through to market prices. According to the forecast models, the highest impact of the recent exchange rate depreciation on market price inflation is likely to be felt still in 2002. However, Copom believes that an additional pass-through will occur in 2003, even assuming that the exchange rate will remain at the same level observed on the eve of the Committee meeting.

The central path expected for the 12-month inflation declines steadily from 7.7% at the end of the third quarter of 2002 to 6.7% at the end of the year and to 4.5% in 2003. Prices administered by contract and monitored prices are the ones causing the highest inflationary pressure. For this group, inflation rates of 9.3% in 2002 and of 7.9% in 2003 have been projected. For market prices, which account for about 70% of the IPCA, growth rates of 5.6% in 2002 and of 2.9% in the next year are anticipated.

The central projection for output growth in 2002 is of approximately 1.4%. The decline of 0.6 p.p. observed since the last *Report* is particularly associated with the effects of the higher uncertainty that prevailed over the period.

1 – Activity level

The pace of economic activity in the second quarter of the year and beginning of the third reflected the increased exchange rate instability evident since May, principally as regards its impacts on expectations of future economic performance. The first result of this process was a spending cutback, mostly involving outlays related to investments and durable consumer goods, both of which are sensitive to decisions that involve longer term horizons. However, on the upside, such other factors as Employment Guaranty Fund (FGTS) disbursements and increased farm income have managed to sustain the level of consumption, particularly involving goods with low unit value.

1.1 – Retail sales

Sales volume index in the retail sector - Brazil

% accumulated in the year

Itemization	2001	2002				
		Mar	Apr	May	Jun	Jul
Retail sector	-1.6	-0.9	-1.1	-0.6	-0.8	-0.5
Fuel and lubricants	-2.8	5.3	5.1	4.5	3.3	3.9
Supermarkets	0.4	0.0	-1.6	-0.7	-0.9	-0.7
Textiles, clothing	1.6	-2.5	-2.2	-3.3	-4.1	-2.6
Furniture and white goods	-1.4	-1.4	1.0	1.2	1.3	1.1
Other domestic goods	-6.3	-4.6	-3.6	-2.9	-2.6	-2.0
Vehicles, motorcycles	-3.6	-23.4	-20.6	-21.1	-21.6	-21.4

Source: IBGE

According to the Retail Sales Volume Index, which is calculated by the Brazilian Institute of Geography and Statistics (IBGE), retail trade sales dropped by 0.5% in the first seven months of the year compared to the corresponding period of 2001. Quarterly comparisons indicate that the pace of the sales downturn was constant over the period, with reductions of 0.9% in the first quarter and of 0.8% in the second, when compared to the same periods of the previous year.

A breakdown of the results generated by the five activities encompassed by the general indicator shows that only fuels and lubricants (3.9%) and furniture and home appliances (1.1%) turned in positive results when the first seven months of the current year are compared to the same period of 2001. Sales

Real sales of the retail sector in São Paulo

Percentage change

Itemization	2002					
	Mar	Apr	May	Jun	Jul	Aug*
In the month[1/]						
General	2.3	-2.8	3.7	-0.2	-1.9	4.1
Consumer goods	4.0	-3.9	4.0	-0.5	-3.9	4.0
Durable	0.7	0.4	-0.4	-1.7	-7.1	-6.4
Semidurable	-1.4	-3.4	3.5	-0.9	5.3	2.9
Nondurable	10.3	-11.5	11.8	-0.1	-0.9	12.4
Automotive trade	-1.6	5.8	-9.6	1.5	-0.9	15.3
Vehicle concessionaries	-0.5	8.0	-12.0	2.2	0.1	15.1
Autoparts and accessories	-2.7	0.2	0.5	-5.8	5.9	1.6
Building materials	1.6	2.1	4.3	-1.3	3.4	7.6
Quarter/previous quarter[1/]						
General	2.2	1.6	2.4	1.2	1.8	1.4
Consumer goods	4.5	3.0	3.7	1.1	1.0	-0.5
Durable	1.1	0.3	0.6	-0.3	-3.3	-8.4
Semidurable	2.0	-0.8	-2.9	-2.5	1.9	4.9
Nondurable	5.2	3.6	6.1	1.9	5.9	6.8
Automotive trade	-11.2	-7.0	-5.4	-2.5	-6.0	0.9
Vehicle concessionaries	-14.4	-8.6	-5.9	-1.5	-6.2	1.1
Autoparts and accessories	-0.1	0.8	0.4	-2.8	-2.3	-1.2
Building materials	-0.8	2.6	6.8	5.9	6.6	7.2
In the year						
General	-4.6	-4.7	-2.5	-1.4	-0.5	0.8
Consumer goods	-0.9	-1.7	0.8	2.0	2.7	3.7
Durable	-5.6	-3.9	-2.2	-1.0	-1.1	-2.1
Semidurable	-21.9	-22.3	-23.3	-23.5	-20.9	-18.5
Nondurable	3.5	0.5	4.0	5.6	6.8	10.2
Automotive trade	-25.4	-21.8	-22.3	-22.7	-21.6	-18.5
Vehicle concessionaries	-30.2	-26.0	-26.6	-26.8	-25.6	-21.9
Autoparts and accessories	0.0	-0.2	-0.2	-1.6	-1.3	-1.7
Building materials	-24.2	-21.6	-19.3	-18.3	-15.9	-12.9

Source: Fecomercio SP

1/ Seasonally adjusted data.
* Preliminary.

of the groupings of fabrics, apparel and footwear, other articles of personal and domestic use, and sales of so-called mega-sized supermarket outlet, traditional supermarkets, foodstuffs, beverages and tobacco dropped by 2.6%, 2% and 0.7%, respectively, in the period. In the segment of automotive sales – a separate item in the IBGE survey since it is not included in the general index of commerce – the falloff came to 21.4%.

On a state-by-state basis, the best performances were generated in Amapá, Piauí, Tocantins and Maranhão, while the Acre, Alagoas, Rio Grande do Sul and Paraná closed with the most accentuated reductions.

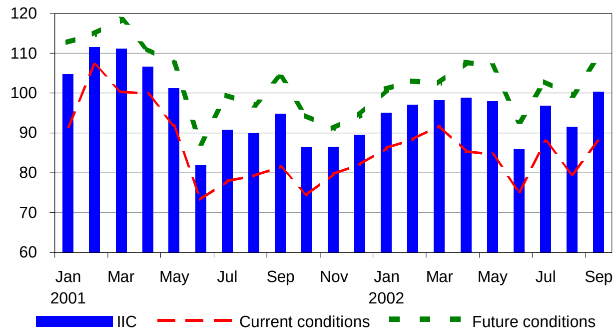
Data released by the Trade Federation of the State of São Paulo (Fecomercio SP) on the São Paulo Metropolitan Region (RMSP) with growth of 0.8% in revenues in the first eight months of the year. Based on the statistical series from which seasonal factors have been eliminated, making it possible to evaluate short-term growth, the pace of the sector's recovery lessened somewhat in the second quarter of the year when sales expanded by 1.2%, compared to 2.2% in the first quarter, compared to the immediately previous period. When July and August data are incorporated into the calculation, growth turned positive once again and was probably driven by releases of FGTS funds.

Basically, the downward trajectory was due to the performance of consumer goods. Thus, growth in sales of consumer durables moved from 1.1% in the first quarter to -0.3% in the second; while the results for semidurables shifted from 2% to -2.5%; and those of nondurables from 5.2% to 1.9%.

An evaluation of the results by retail segment shows that several specific factors have significantly impacted the performance of the trade sector during the year. In clearer terms, sales accumulated up to August in the automotive and building materials industries, both of which are highly sensitive to changes in interest rates and expectations, declined by 18.5% and 12.9%, respectively. On the other hand, sales of nondurable consumer goods, which mostly include items of lesser unit value, accumulated growth of 10.2% in the same period.

According to the São Paulo Trade Association (ACSP), consultations with the Usecheque system, which is an indicator of sales paid-in-full by check and small item sales, turned in growth of 7.9% up to July, while consultations with the Credit Protection Service (SPC), the indicator used for installment sales, dropped by 1.1% in the same period.

Consumer Intention Index (IIC)



Source: Fecomercio SP

Consumer expectations have fluctuated sharply since the end of the second quarter and have been impacted by exchange volatility and the uncertainties inherent to a pre-election period. In September, the Consumer Intentions Index (IIC), which is released by Fecomercio SP, expanded sharply and closed at its highest level since May 2001.

Average interest rates effective in the retail sector

% p.m.

Itemization	2002						
	Jan	Feb	Mar	Apr	May	Jun	Jul
Average interest rates	6.70	6.66	6.64	6.62	6.62	6.62	6.63
By segment							
Large stores	5.67	5.64	5.61	5.58	5.58	5.55	5.55
Medium stores	6.91	6.88	6.86	6.82	6.82	6.81	6.81
Small stores	7.54	7.52	7.50	7.47	7.47	7.44	7.44

Source: Anefac

According to the National Association of Finance, Management and Accounting Executives (Anefac), as far as financing operations are concerned, the gradual downward trajectory of the interest rates practiced in the retail trade sector since December 2001 was interrupted at the start of the second quarter of 2002, when rates increased to 6.62%, remaining stable in that range in the following months. When the analysis is based on company size, large commercial chains practiced lower rates (5.55% per month) than medium size networks (6.81% per month) and smaller companies (7.44% per month).

Default rates

Itemization	2001 Average	2002 I Q	Apr	May	Jun	Jul	Aug
SPC (SP)1/	7.5	6.0	9.4	8.8	8.0	7.2	4.7
Returned checks2/	4.7	5.2	5.0	4.9	5.0	4.6	4.3
Telecheque (RJ)3/	1.7	3.4	2.4	1.6	1.6	1.8	1.6
Telecheque (National)3/ 4/	2.1	2.7	2.4	1.9	1.8	1.9	1.7

Rate

Source: ACSP, Bacen and Teledata

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

In contrast to the negative performance of salaries and income and to high interest rate levels, default indicators – though still high – moved into a downward curve as of the end of the first quarter of 2002 and, more recently, intensified this trend. To some extent, this movement reflected the start of the process of FGTS disbursements.

With this trajectory, the net rate of default registered at the SPC and measured by the ACSP, closed at 4.7% in August, compared to 7.2% in the previous month. In September, continuation of the aforementioned disbursements is expected to push the default rate down even lower. From January to August 2002, the median default rate came to 7.2%, compared to 8.4% in the corresponding period of 2001.

The default indicator announced by Teledata, which is a system that is national in scope, suggests a similar trend, as the average rate dropped from 2.7% in the first three months of 2002 to 2% in the three subsequent months and 1.8% in the July-August period.

The drop in the default rate is also demonstrated by the reduction in the ratio between total checks returned due to insufficient backing and total checks cleared in the country from a level of 5.2% in the first quarter to 4.3% in August.

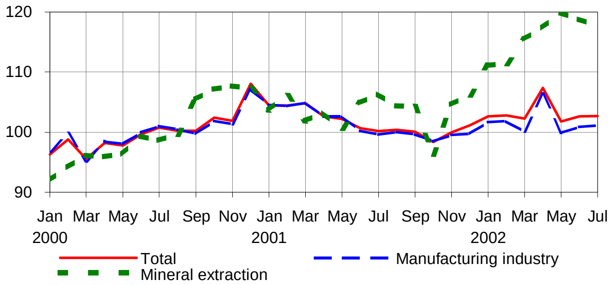
In summary, retail sales have followed a gradual upward curve since the end of 2001. For the most part, this movement has been sustained by sales of consumer goods of lesser unit value. However, recovery was less intense from April to June due to less favorable expectations in the period which, in turn, had an adverse impact on sales of consumer durables, particularly in the automotive sector.

Continued FGTS outlays – probably in a greater volume in September – coupled with some degree of recovery in consumer expectations, suggest a more positive outlook for sales in the coming months.

1.2 – Output and gross domestic product

1.2.1 – Industrial output

Industrial production
Seasonally adjusted data
2000=100



Source: IBGE

Industrial production

Percentage change

Itemization	2002				
	Mar	Apr	May	Jun	Jul
Industry (total)					
In the month[1/]	- 0.5	5.0	- 5.2	0.9	0.0
Quarter/previous quarter[1/]	2.7	2.9	1.6	1.3	- 1.7
Same month of the previous year	- 3.7	6.1	- 1.0	0.7	3.3
Accumulated in the year	- 2.1	0.0	- 0.2	- 0.1	0.4
Accumulated in 12 months	- 0.7	- 0.7	- 1.1	- 1.0	- 0.8
Manufacturing industry					
In the month[1/]	- 1.7	6.3	- 6.1	1.0	0.3
Quarter/previous quarter[1/]	2.0	2.4	1.0	1.2	- 2.1
Same month of the previous year	- 5.6	5.2	- 3.1	- 0.8	2.4
Accumulated in the year	- 3.4	- 1.2	- 1.6	- 1.5	- 0.9
Accumulated in 12 months	- 1.2	- 1.2	- 1.9	- 1.8	- 1.6
Mineral extraction					
In the month[1/]	3.7	1.6	2.2	- 0.9	- 1.0
Quarter/previous quarter[1/]	10.0	7.0	7.3	5.4	3.5
Same month of the previous year	13.2	13.7	18.8	13.4	10.4
Accumulated in the year	8.5	9.8	11.6	11.9	11.6
Accumulated in 12 months	3.2	3.7	4.9	5.5	5.8

Source: IBGE

1/ Seasonally adjusted data.

According to IBGE's Monthly Industrial Survey (PIM), following the upward movement registered in the early months of the year, industrial output dropped by 5.2% in May. Though one cannot disregard the fact that this result also reflects the impact of the occurrence of Easter week in March on the process of purging seasonal factors from the calculation, it still suggests a loss of dynamism in the manufacturing sector that continued into the two subsequent months. In the first seven months of this year, industrial output grew by 0.4% in relation to the same period of the preceding year.

Though industrial growth has not been positive, particularly since the month of May, sectors less affected by deteriorating expectations and driven by positive results in the crop/livestock sector took up some of the slack and managed to attenuate the deceleration that marked the period. At the same time, the highest growth level in the first half of the year was, once again, registered by the mineral extraction sector, which closed with its sharpest expansion since 1996. Basically, this performance reflected successive record levels of petroleum production.

Utilizing data up to July, a breakdown at the level of use categories indicates that growth occurred only in the output of intermediate goods and semidurable and nondurable consumer goods, with 0.7% and 0.5%, respectively. In both of these headings, these positive results – though modest – can be attributed to favorable performances in specific segments of activity. Thus, in the case of intermediate

Industrial production by category of use

Percentage change

Itemization	2001 Dec	2002 Apr	May	Jun	Jul
In the month[1/]					
Industrial production	1.1	5.0	- 5.2	0.9	0.0
Capital goods	- 0.6	7.3	- 9.6	3.3	0.8
Intermediate goods	1.3	3.0	- 2.4	0.3	- 0.2
Consumer goods	0.8	8.2	- 10.4	1.3	0.8
Durable	5.7	10.1	- 13.9	1.3	2.2
Semi and nondurable	- 0.7	7.0	- 8.4	0.6	0.3
Quarter/previous quarter[1/]					
Industrial production	- 0.4	2.9	1.6	1.3	- 1.7
Capital goods	- 6.1	6.9	2.7	1.4	- 3.7
Intermediate goods	- 1.3	3.9	1.8	1.2	- 0.6
Consumer goods	2.7	0.6	- 0.3	- 0.1	- 4.8
Durable	11.1	4.1	1.7	1.1	- 6.5
Semi and nondurable	0.8	0.1	- 0.6	- 0.3	- 4.2
In the year					
Industrial production	1.5	0.0	- 0.2	- 0.1	0.4
Capital goods	12.7	0.3	- 1.0	- 1.1	- 1.0
Intermediate goods	- 0.2	- 0.3	- 0.1	0.2	0.7
Consumer goods	1.3	0.6	- 0.5	- 1.0	- 0.4
Durable	- 0.6	- 3.8	- 5.2	- 5.3	- 3.4
Semi and nondurable	1.8	1.9	1.0	0.3	0.5

Source: IBGE

1/ Seasonally adjusted data.

Vehicles - production and sales

Percentage change

Itemization	2002 Mar	Apr	May	Jun	Jul
In the month[1/]					
Production	1.1	0.8	-7.0	3.7	-4.3
Sales	-2.1	1.3	-7.7	6.3	-2.5
Domestic sales	2.3	-3.8	-9.8	7.3	-4.5
External sales	-2.0	12.3	2.1	-5.3	0.6
Quarter/previous quarter[1/]					
Production	3.4	-3.0	-3.8	-4.1	-5.2
Sales	-5.2	-6.5	-6.0	-3.4	-4.5
Domestic sales	-11.3	-14.3	-12.4	-7.6	-8.5
External sales	-0.1	9.3	16.5	10.8	5.7
In the year					
Production	-8.8	-6.2	-9.2	-9.8	-9.4
Sales	-11.3	-9.9	-11.9	-12.4	-11.1
Domestic sales	-12.1	-11.2	-14.2	-14.6	-13.6
External sales	-7.6	-4.2	-2.5	-3.4	-1.6

Source: Anfavea

1/ Seasonally adjusted data.

goods, particular mention should be made of the output of petroleum derivatives in the period, coupled with efforts made by the industrial sector to substitute previously imported products. As a matter of fact, though manufacturing activity remained stable in the first half of the year when compared to the same period in 2001, imports of intermediate goods dropped by 8% using the same basis of comparison. Aside from this, growth in the production of semidurable and nondurable consumer goods was mostly due to the performance of the segments of food and tobacco products.

With respect to other headings, the negative results can be credited to the adverse factors that affected both expectations and credit conditions. Output of consumer durables dropped by 3.4% in the first seven months of the year, mostly due to the downturn in sales of the automotive sector. The decline would have been sharper still were it not for the home appliance segment, which registered sharp growth under sales of TV sets just prior to the World Cup and a subsequent sales increase under portable products of lesser unit value.

Insofar as the automobile sector is concerned, output fell by 9.4% in the month, up to July, as a result of a sales decline of 11.1%, based on a drop of 13.6% under internal market sales and a reduction of 1.6% under foreign sales.

Output of capital goods was also impacted by increased uncertainties and deteriorating credit conditions, as well as by a slowdown in the flow of investments into electricity generation and transmission projects. Here, the first seven months of the year witnessed a drop of 1%, in comparison to the same period of 2001.

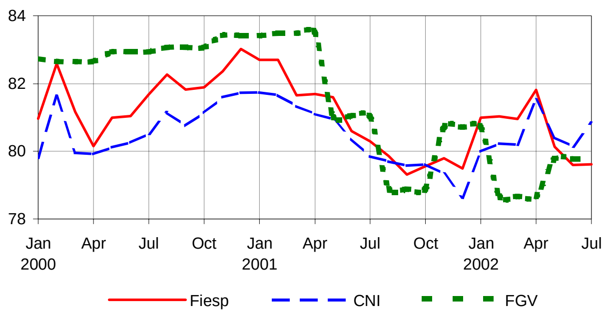
Industrial production by segment[1/]

Itemization	2001	2002			
		I Q	II Q	Jul	In the year
Industrial production	1.5	- 2.1	- 0.1	0.0	0.4
Mineral extraction	3.5	8.5	11.9	- 1.0	11.6
Manufacturing industry	1.2	- 3.4	- 1.5	0.3	- 0.9
Nonmetallic minerals	- 1.8	- 4.8	- 2.8	- 1.6	- 2.6
Metallurgy	0.7	- 4.0	- 2.5	0.7	- 1.5
Mechanics	5.2	- 0.9	2.5	3.6	3.3
Electric and comm. equip.	6.9	- 13.6	- 12.3	- 2.4	- 11.9
Transportation equipment	5.2	- 5.7	- 6.0	0.9	- 4.8
Wood	- 0.3	- 3.4	- 2.9	- 3.1	- 2.9
Furniture	- 1.1	2.8	1.7	1.0	1.5
Paper and cardboard	0.1	0.3	0.6	- 2.1	0.4
Rubber	- 4.5	- 6.2	- 3.1	9.9	- 2.0
Leather and hides	- 9.4	- 11.6	- 9.6	15.7	- 7.4
Chemicals	- 0.7	- 1.7	0.5	1.9	1.1
Pharmaceuticals	- 1.0	17.4	9.3	9.0	9.0
Perfumes, soaps, candles	- 1.1	- 5.2	- 3.8	- 0.9	- 4.4
Plastics	- 5.0	- 4.6	- 3.9	- 5.0	- 4.2
Textiles	- 5.5	- 4.6	- 2.5	- 1.6	- 1.8
Clothing, footwear, cloths	- 6.8	- 5.2	- 1.8	2.4	- 1.6
Food products	5.1	- 1.2	2.9	- 1.2	3.3
Beverages	0.3	- 7.0	- 4.7	- 1.6	- 3.6
Tobacco	- 4.7	34.3	26.4	- 17.5	24.2

Percentage change

Source: IBGE
1/ In July, seasonally adjusted change.

Utilization of installed capacity
Seasonally adjusted data
Average percentage

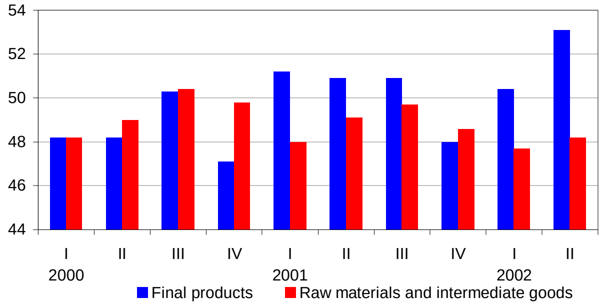


Once the first quarter of the year had ended, the loss of economic dynamism generated impacts on the utilization level of industrial output capacity and a strong rise in stock levels, both of which are factors that provoked adverse effects on third quarter results. In the manufacturing sector, the third quarter survey carried out by the Getulio Vargas Foundation (FGV) indicated an average level of utilization of installed industrial capacity of 79.6% in July, compared to 80.9% in the same month of 2001. The headings of building materials and consumer goods closed with the sharpest reductions in the utilization level, moving respectively from 84.3% to 77% and from 76.6% to 74.2%, in the period.

Monthly statistics on the utilization of installed output capacity released by the National Confederation of Industry (CNI) and the Federation of Industries of the State of São Paulo (Fiesp) reflected the recent change in the trajectory of manufacturing activity. Once seasonal factors are eliminated, the survey results indicate an upward curve through to April, when the curve reversed course. Sector-by-sector data available for São Paulo industry show that the sharpest drops in utilization levels in the period from April to July occurred under furniture (6.6%), chemicals (5%) and transportation equipment (4.8%).

With regard to stock levels, results drawn from the CNI industrial Survey carried out at the end of the second quarter of the year revealed increases in relation to the previous period. When one uses a scale of zero to one hundred, stocks of final goods climbed from 50.4 to 53.1, reflecting the second largest change registered by this survey, surpassed only by that registered at the end of the first quarter of 2001. Stocks of raw materials and intermediate goods increased from 47.7 to 48.2 in the

Manufacturing industry stocks[1/]



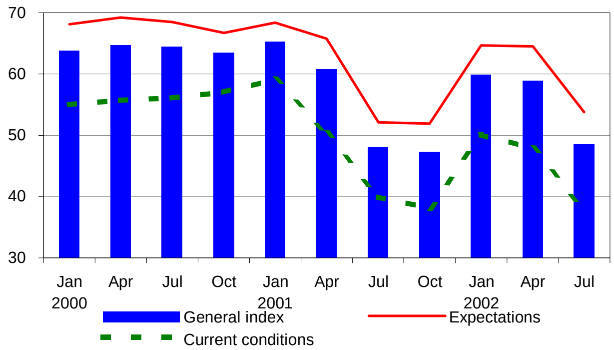
Source: CNI
1/ Values over 50 indicate stocks above the planned level.

Manufacturing industry stocks[1/]

Itemization	2001				2002	
	I	II	III	IV	I	II
Manufacturing industry						
Final products	51.2	50.9	50.9	48.0	50.4	53.1
Raw materials and interm. goods	48.0	49.1	49.7	48.6	47.7	48.2
Large companies						
Final products	52.7	52.3	52.4	47.8	50.4	53.7
Raw materials and interm. goods	48.4	51.7	53.4	50.5	49.5	50.7
Small and medium companies						
Final products	50.4	50.1	50.0	48.2	50.3	52.8
Raw materials and interm. goods	47.9	47.6	47.7	47.5	46.7	46.9

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

Industrial Business Confidence Index



Source: CNI

period. A breakdown of these figures by company size shows an across-the-board increase in the stock of final goods and intermediate goods. However, it is important to note that growth in the stocks of final goods was more prevalent among large scale companies than among small and medium businesses.

Aside from stock levels, another important variable in evaluating the performance of industrial activity is that of business expectations. In this sense, the Industrial Confidence Index (Icei), which is built upon the results of the CNI Industrial Survey, registered a level of 48.5 points in July compared to 58.9 in April, closing at the same level registered in July 2001. The drop in the period is comparable only to that registered at the start of the period of electricity rationing. Just as occurred with consumer expectations, perception of the business community's expectations of the future of the economy has been less pessimistic than in relation to current economic conditions. Another important point to be noted in the survey relates to the fact that businesspeople in general tend to state that the factor most responsible for the recent performance of expectations are the conditions of the economy as a whole and not the situation of their specific companies.

The FGV's July Manufacturing Industry Survey perceived a similar performance in the case of business expectations. According to this survey, there is a perception of deterioration in the current business situation and in the outlook for the next six months, when viewed against the April survey.

As a matter of fact, deteriorating current and future expectations, increased stock levels and recent cutbacks in export credit lines all point to a rather adverse situation in the nation's industrial sector in the third quarter of the year. However, several factors are capable of attenuating this rather somber outlook. In the first place, consumer and business expectation indicators were elaborated prior to the new agreement with the International Monetary Fund (IMF). Another important point refers to economic policy measures taken to stabilize the exchange market, including not only the aforementioned agreement but also efforts to reestablish credit lines. Finally, one should recall that the impact of FGTS disbursements on consumption were already evident in August and should increase sharply in the coming months.

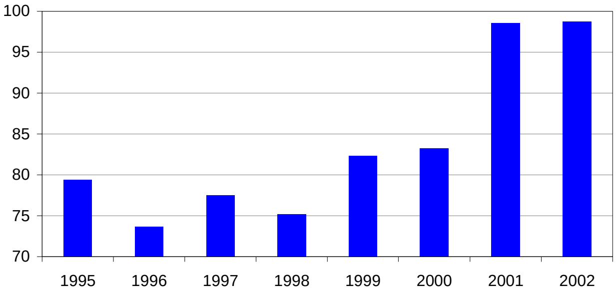
1.2.2 – Crop/livestock output

The primary sector of the economy turned in a positive performance in 2002. Crop output estimates point to a grain harvest that will be practically identical to the 2001 results, coupled with strong growth under other types of crops. Recently announced data on livestock output in the first quarter of 2002 confirmed the production increase suggested previously by indirect indicators of the sector's performance.

Crops

Grain production[1/]

In million of tons



Source: IBGE

1/ In 2002, estimate.

According to IBGE's Systematic Farm Production Survey for the month of July, total output of grains, legumes and oil-bearing crops is expected to reach 98.7 million tons in the current harvest, just 0.2% more than in 2001. This forecast is slightly below the previous estimate, particularly in light of the drought and high temperatures registered since December 2002 that have caused significant summer harvest losses in Rio Grande do Sul and Santa Catarina. Aside from these factors, low rainfall levels in Paraná, São Paulo, Mato Grosso do Sul and Goiás as of March 2002 provoked delays in preparation of the soil and planting of the second corn harvest and resulted in a considerably smaller volume of production.

Grain production

In thousands of tons

Itemization	Production 2001	Production 2002[1/]	Percentage change
Grain production	98 544	98 744	0.2
Cotton (seed)	1 718	1 487	-13.4
Rice (in husk)	10 195	10 508	3.1
Beans	2 436	3 165	29.9
Corn	41 439	35 612	-14.1
Soybean	37 683	41 824	11.0
Wheat	3 261	4 157	27.5
Others	1 812	1 991	10.0

Source: IBGE

1/ Estimate.

Crops in 2002

Percentage change

Itemization	Production	Area	Average production
Grain production	0.2	8.2	-7.4
Cotton (seed)	-13.4	-12.5	-1.1
Rice (in husk)	3.1	1.1	1.9
Beans	29.9	20.7	7.6
Corn	-14.1	-2.8	-11.6
Soybean	11.0	17.2	-5.3
Wheat	27.5	19.3	6.9
Others	10.0	-3.0	13.4
Other products			
Potatoes	-4.0	-2.7	-1.3
Coffee fruit	22.4	1.4	20.6
Oranges	10.3	-0.6	11.0
Sugar cane	4.4	1.7	2.7
Manioc roots	-1.1	-0.7	-0.4

Source: IBGE

Among the items that contributed significantly to the grain harvest result, mention should be made of growth under beans (29.9%), wheat (27.5%), coffee (22.4%) and soybeans (11%). The major negative results occurred under corn (14.1%) and herbaceous cotton (13.4%).

Wheat farming registered highly significant results with a total of 4.2 million tons in 2002, due mostly to the Rio Grande do Sul harvest, since output in Paraná and Mato Grosso do Sul was impacted by the long drought that occurred in both regions.

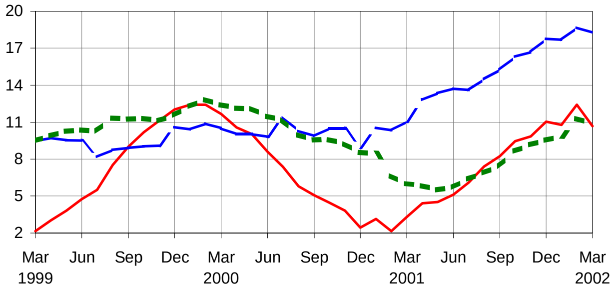
In the opposite sense, the corn crop is expected to reach 35.6 million tons, compared to 41.4 million in 2001. This reduction was due to a drop of 2.8% in the area under cultivation and a decrease of 11.6% in average yield per hectare. As a result, the price of the product increased by more than 50% on the São Paulo market between August of this year and 2002, generating upward pressure on the production costs of chickens and swine.

Among other crops, emphasis should be given to production increases under coffee beans (22.4%), oranges (10.3%) and sugar cane (4.4%), all of which are items of importance to the nation's exports.

Livestock

Based on IBGE's Farm Production Statistics for May 2002, 4.5 million head of cattle were slaughtered in the first quarter of 2002, for growth of 5.1% compared to the same period of 2001. The performance of hog farming also registered positive results, with slaughter of 5.1 million head in the first quarter, for growth of 16.7% over the same period of 2001.

Livestock production
Total weight
Percentage change in 12 months



Source: IBGE

In relation to poultry farming, slaughters totaled 744.5 million units in the first three months of the year, for expansion of 7.5% over the total for the same period of 2001. It is important to note that, despite this growth, prices moved upward in relation to the second half of 2001, mirroring higher costs for animal feed and the efforts made by producers to adjust the excess supply that marked the final months of 2001.

Crop/Livestock Harvest Plan 2002/2003

Agricultural plan - 2002/2003

In R$ million

Objective	Credit granted 2001/2002	Flow forecast 2002/2003	Percentage change
Total	17 205	21 670	26.0
At fixed interest rate	16 417	18 670	13.7
Current expenditures/flow	12 462	13 340	7.0
Investments	2 603	2 930	12.5
Constitutional funds	1 090	1 200	10.1
Agricultural Finame	119	500	318.8
Funcafé	142	700	393.3
At market interest rate	788	3 000	280.6

Source: Ministry of Agriculture

According to the Crop/Livestock Harvest Plan 2002/2003 elaborated by the Ministry of Agriculture, Livestock and Supply (Mapa), funding available to farmers in the 2002/2003 farm year will total R$21.7 billion, for growth of 26% over the total granted in the previous harvest. Of this total, R$13.3 billion will be targeted to current expenditures/marketing, R$2.9 billion to investment and R$2.4 billion to Constitutional Funds/Special Industrial Financing Agency - Agriculture (Finame Agriculture)/Coffee Economy Defense Fund (Funcafé). These resources do not include the amounts set aside for family farming programs.

Several alterations were introduced this year into the system of agricultural financing. Among these, as of the current harvest, the resources from the Worker Support Fund (FAT) channeled into the Program of Income Generation (Proger Rural) will be targeted to a larger number of workers. These resources will now be available to farmers with areas of up to 15 fiscal modules and annual gross income of up to R$60 thousand, instead of the previous limits of 6 fiscal modules and gross income of R$48 thousand.

Insofar as the Program of Support to Product Marketing and Stocking is concerned, utilization of bank funding earmarked to the discounting of Rural Promissory Notes (NPR) and Rural Trade Bills (DR) was authorized for the entire year in activities involving swine, fruit, shrimp and milk and its derivatives, including purchase of Rural Product Notes (CPR).

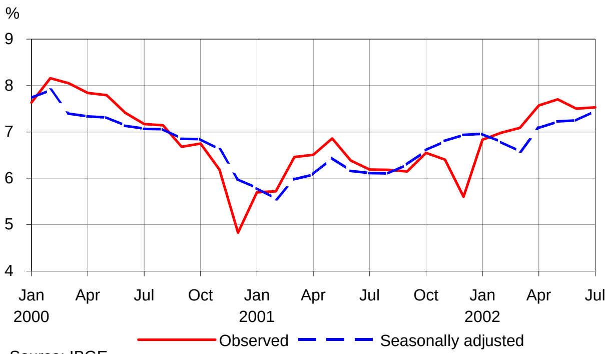
Starting with the 2002/2003 harvest, Rural Savings Account resources earmarked to the farm sector will also benefit agribusiness activities, including financing of marketing operations, processing or industrializing crop/livestock origin products and inputs utilized in these activities. The financing, previously reserved exclusively to producers and cooperatives, will be limited to R$2.5 billion and will be granted at interest freely negotiated among the parties.

Parallel to this, National Bank of Economic and Social Development resources (BNDES) were increased to R$2.83 billion for growth of 22.5% in relation to the total for the previous farm year.

1.2.3 – Labor market

Employment

Unemployment rate



Source: IBGE

According to Ministry of Labor and Employment (MTE) and IBGE statistics, the employment level has been expanding, particularly under the heading of formal employment. However, this performance was not enough to bring down the level of unemployment, which has remained above the previous year's level. In the manufacturing sector, there is a clear difference between the results for São Paulo, where the employment level has followed a downward curve since mid-2001, and the figures for the majority of states in which CNI applies this survey.

Open unemployment in 2002 has been consistently above the same period of 2001, as evinced by IBGE's Monthly Employment Survey (PME) in six metropolitan regions. However, growth registered in employment has not been sufficient to absorb the increase in the overall labor force. Consequently, when one considers the average from January to July of this year with the corresponding figures for 2001, total persons employed increased by 2.5% and the overall labor force expanded by 3.7%. With this, median unemployment in the latter month came to 7.5%. Once the series has been purged of seasonal impacts, growth in the percentage of unemployed persons has been continuous, moving from 6.6% in March to 7.5% in July.

Occupied people by activity and by categories of employment

% accumulated growth in year

Itemization	2002						
	Jan	Feb	Mar	Apr	May	Jun	Jul
Total of occupied people	1.2	1.8	2.1	2.3	2.4	2.4	2.5
By activity							
Manufacturing industry	-0.7	-0.6	-0.2	0.2	0.4	0.6	1.0
Building	-8.5	-7.9	-6.3	-6.3	-5.8	-6.5	-6.5
Commerce	2.5	3.5	3.5	3.0	2.8	2.9	3.5
Services	2.5	2.8	3.0	3.3	3.4	3.4	3.4
By categories of employment							
Registered	2.0	2.0	2.2	2.3	2.5	2.5	2.6
Nonregistered	4.6	4.8	5.0	5.1	5.1	4.9	5.1
Self-employed	-3.1	-1.6	-0.9	-0.8	-0.8	-0.6	-0.4
Employer	-1.5	-0.3	1.2	1.5	1.5	0.5	0.3

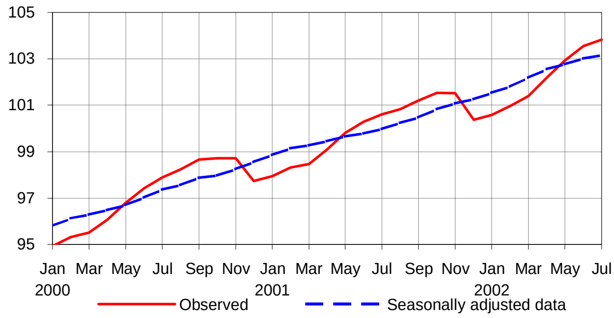
Source: IBGE

On a sector-by-sector basis, employment levels have recovered sharply in both commerce and industry, while the building industry and services have alternated positive and negative movements since the month of March. In July, all of the sectors analyzed turned in growth in the number of jobs. This was particularly strong under commerce, with 42 thousand new positions; services with 35 thousand; construction with 21 thousand; and manufacturing with 14 thousand. From 2001 to 2002, the number of vacancies in the building industry dropped in every month of the year, closing July with an accumulated loss of 6.5%, compared to the average in the first seven months of the previous year. In contrast to this result, the accumulated figures for commerce, services and manufacturing pointed to growth in the number of job openings at rates of 3.5%, 3.4% and 1%, respectively.

A breakdown of employment categories indicates that accumulated growth up to July totaled 5.1% in the segment of unregistered workers, 2.6% for registered workers and 0.3% for employers. The segment of the self-employed turned in a decrease of 0.4% in the period.

Based on MTE’s General File of the Employed and Unemployed (Caged), formal employment governed by the nation’s labor code set a growth record in the first seven months of the year, with generation of 742 thousand new positions in all parts of the country, representing growth of 15% compared to the result for

Formal employment



Source: Ministry of Labor and Employment

Formal employment

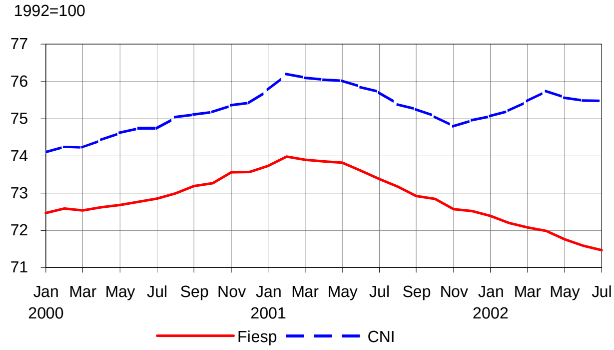
Itemization	New job openings (1,000 employees)				
	2001	2002			
		I Q	II Q	Jul	In the year
Total	591.1	216.5	464.2	61.2	742.0
Manufacturing industry	103.8	47.6	80.9	1.0	129.5
Commerce	209.8	24.2	63.7	19.1	107.1
Services	311.0	93.4	116.5	12.7	222.6
Building	-33.4	7.5	9.0	2.1	18.7
Public utilities	1.5	2.6	0.7	0.4	3.7
Others[1/]	-1.6	41.1	193.4	25.9	260.3

Source: Ministry of Labor and Employment

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

Industrial employment

Seasonally adjusted data



the same period of 2001. An analysis of this total shows that 68% were concentrated in the southeast region, 16% in the southern region and 11% in the central-west region. All of these figures were quite close to those of the previous year. The supply of new vacancies over the course of 2002 expanded steadily up to April, when the number of additional jobs came to 175 thousand. From that point forward, the pace of job generation declined to a total of 61 thousand in July. On a sector-by-sector basis, 232 thousand new jobs were created in the farm sector, 223 thousand in the service sector, 130 thousand in manufacturing and 107 thousand in commerce.

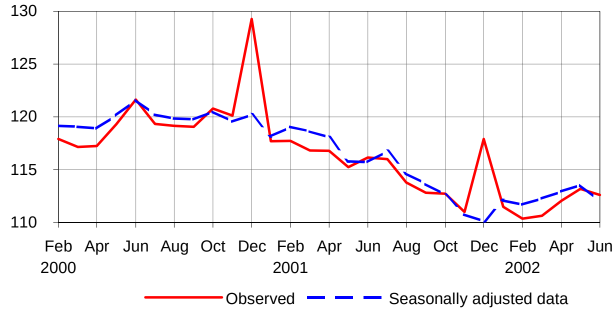
According to Fiesp figures from which seasonal factors have been eliminated, industrial employment in the State of São Paulo followed a downward trajectory over a period of seventeen months up to July. In the year, the reduction came to 2.5% when compared to the corresponding period of 2001. Analysis of this sector indicates that this percentage resulted principally from downward movement under electric and communications equipment (11.9%), transportation equipment (2.8%) and textiles (3.6%). According to IBGE's monthly industrial survey, which is national in scope, the first two of these subsectors, both of which are heavily concentrated in São Paulo, closed 2002 with sharply negative performances, with respective output declines of 11.9% and 4.8%, respectively, in the period.

The CNI survey at the level of twelve state federations pointed to stability in industrial employment in the month of July, following reductions of 0.2% and 0.1% in May and June, respectively. Up to the month of July, the employment level dropped by 0.7% compared to the corresponding period of 2001, mostly as a result of a 2.5%

falloff in the sector in São Paulo. In the other states, positive results predominated for the same period of comparison, with particularly good performances in Paraná (6.8%), Bahia (2.4%), Rio Grande do Sul (2.2%) and Minas Gerais (0.9%).

Income

Real average earnings
1993=100



Source: IBGE

Overall real wages and average real earnings

% accumulated growth in year

Itemization	2001	2002					
		Jan	Feb	Mar	Apr	May	Jun
Overall real wages	-3.2	-4.1	-4.1	-3.6	-3.0	-2.2	-1.9
Average real earnings	-3.8	-5.3	-5.8	-5.6	-5.2	-4.5	-4.3
By activity							
Manufacturing industry	-5.1	-4.5	-3.5	-4.1	-3.2	-2.9	-3.4
Building	-5.2	-13.0	-12.5	-12.0	-10.1	-8.9	-9.6
Commerce	-5.7	-8.5	-7.1	-8.5	-10.3	-9.5	-9.5
Services	-3.4	-5.4	-6.9	-6.2	-5.5	-4.9	-4.4
By categories of employment							
Registered	-4.8	-7.1	-6.8	-6.0	-5.7	-5.2	-4.9
Nonregistered	-2.1	-2.2	-1.6	-1.2	-0.6	0.3	0.6
Self-employed	-1.4	-6.7	-8.7	-8.7	-7.3	-5.8	-5.2
Employer	-2.6	-2.0	-6.1	-8.6	-9.4	-8.5	-8.9

Source: IBGE

In the second quarter of the year, the pace of recovery in median real worker income was less intense. Compared to 2001, income declines were registered in both sector-by-sector analyses and in the metropolitan regions analyzed by IBGE.

According to PME data released by IBGE and from which seasonal factors have been purged, the median earnings of workers expanded by 0.73% in the second quarter of the year, when compared to the previous quarter. In the first quarter of the year, growth had come to 0.86%. In the half-year period, average real earnings fell by 4.3% when compared to the same period of 2001. An analysis on the basis of job categories indicates that the loss among employers came to 8.9%, while that of the self-employed closed at 5.2% and the loss for registered workers totaled 4.9%. The only heading to turn in a gain was that of unregistered workers (0.6%). When one considers the sectors analyzed, the reduction in average earnings came to 9.6% in the construction industry, 9.5% under commerce, 4.4% under services and 3.4% in the manufacturing sector. Aside from this, the income drop was registered in all metropolitan regions in the period, with the sharpest occurring in Porto Alegre (6%) and Salvador (5.7%).

Looking only at the manufacturing sector, indicators point to recovery in buying power in São Paulo and stability in average real income levels for most of the country, according to figures released by both Fiesp and CNI. It seems reasonable to presume that the reduction in the job level in the São Paulo manufacturing sector was one of the elements underlying the rise in average earnings in the state. This is normal in periods of staff reductions, as companies tend to initiate layoff programs at the level of lower paid employees.

Real wages in the manufacturing industry

% accumulated growth in year

Itemization	2002						
	Jan	Feb	Mar	Apr	May	Jun	Jul
CNI							
Overall real wages	-0.8	-0.9	-0.8	-0.8	-0.8	-0.7	-0.6
Fiesp							
Overall real wages	2.4	2.2	2.6	2.7	2.6	2.7	2.9
Average real wages	4.7	4.9	5.4	5.6	5.5	5.6	5.8

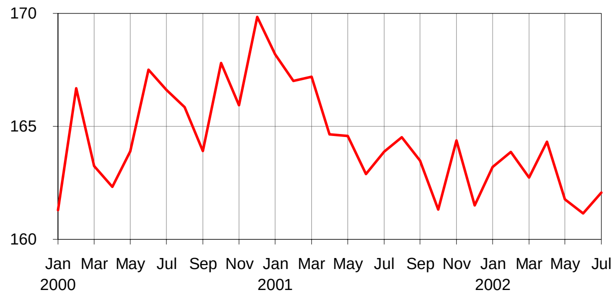
Source: CNI and Fiesp

Based on Fiesp statistics from which seasonal influences have been culled, real wages in the São Paulo manufacturing sector remained on a growth trajectory in the first six months of the year. The only month in which negative growth was registered was May, with -0.5%. Recovery in buying power came to 5.8% in the first seven months of the year, compared to the corresponding period of 2001. Reflecting the decline in the number of persons employed and the upturn in real average income, overall wages expanded by 2.9% in the period.

According to CNI figures involving twelve state federations, overall real wages in the national industrial segment closed with a loss of 0.6% in the first seven months of the year and did not keep pace with the trajectory followed in São Paulo. It should be noted that the 0.7% drop in the level of industrial employment in the period, as registered by the same CNI survey, points to a situation of stability in industrial sector average real wages.

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

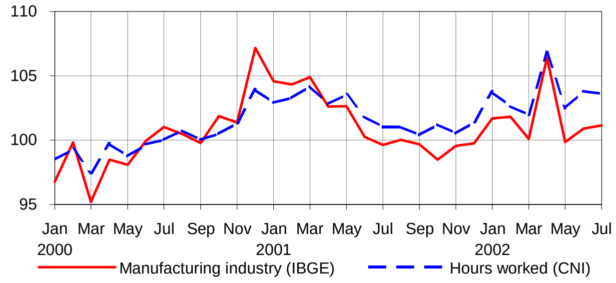
Productivity
Seasonally adjusted data
1992=100



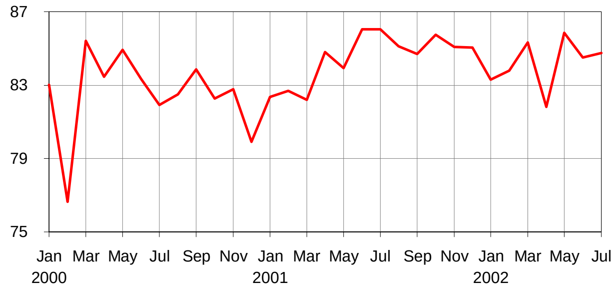
Source: IBGE, CNI and Banco Central do Brasil

Defined as the ratio between the index of the physical production of the manufacturing sector, as perceived by IBGE's PIM, and hours worked in production calculated by CNI, productivity dropped by 0.5% in the second quarter when compared to the first, based on statistical data from which seasonal factors have been excluded. Thus, after a brief respite of 0.5% growth in the first quarter of this year, productivity moved into

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



Unit Labor Cost
Seasonally adjusted data
1992=100



Source: IBGE, CNI and Banco Central do Brasil

a decline once again, just as had occurred during practically all of 2001. In comparison to the same period of the preceding year, the drop in productivity came to 1.7% based on data up to July. For the most part, this movement was attributed to the difference in production levels between the two periods which, in turn, was partly a result of electricity rationing.

CUT, understood as the ratio between total wages paid by the industries encompassed by the CNI and the physical output of the sector as calculated by IBGE, remained stable in the second quarter of the year when compared to the first quarter. This calculation is expressed as the real concept, in which wages are deflated by the National Consumer Price Index (INPC). In the month of July, the indicator registered monthly growth of 0.3% in the statistical series free of seasonal factors. In recent months, the CUT trajectory indicates that outlays on labor per unit produced remained at the July 2001 level.

1.2.4 – Gross Domestic Product (GDP)

Gross Domestic Product

Quarter/previous quarter seasonally adjusted

Itemization	2001				2002	
	I	II	III	IV	I	II
GDP at maket prices	1.2	-1.3	-0.4	-0.1	0.9	0.6
Crop and livestock	7.7	-1.7	-0.5	3.3	2.3	0.0
Industry	0.6	-3.2	-1.7	-1.1	2.1	1.1
Services	0.7	0.7	0.2	0.2	0.9	-0.3

Source: IBGE

According to IBGE data, GDP expanded by 0.61% in the second quarter of the year, when compared to the previous period. In the first quarter of the year, the corresponding figure came to 0.86%. These figures are based on data from which seasonal influences have been removed and clearly ratify the conclusion that the pace of economic activity declined in the period.

A comparison between the first half of the year and the same period of 2001 shows GDP growth of 0.14%. The industrial sector registered a drop of 1.8%, based on declines under construction (7.3%), public utility industrial services (7.3%) clearly one of the repercussions of

Gross Domestic Product

Itemization	2000	2001	2002 I Sem	2002 Year[1/]
			Percentage change in the year	
Crop and livestock	3.0	5.1	4.5	4.3
Industry	4.9	-0.6	-1.8	0.4
Mineral extraction	11.1	3.4	11.7	11.8
Manufacturing	5.4	0.6	-0.3	0.1
Construction	3.0	-2.6	-7.3	-3.8
Public utilities	4.1	-5.5	-7.3	3.2
Services	3.7	2.5	1.5	2.0
Commerce	4.7	0.7	-2.3	0.6
Transportation	5.6	1.0	0.5	1.2
Communications	16.5	11.9	6.7	7.1
Financial institutions	3.5	1.1	1.0	1.4
Other services	4.4	3.2	2.4	2.6
Rents	2.5	2.1	1.9	1.9
Public administration	1.1	1.8	1.4	1.4
Financial dummy	4.4	1.5	0.6	1.4
Value added at basic prices	4.0	1.6	0.7	1.7
Taxes on products	7.1	0.8	-3.9	-1.1
GDP at market prices	4.4	1.5	0.1	1.4

Source: IBGE
1/ Banco Central do Brasil estimates.

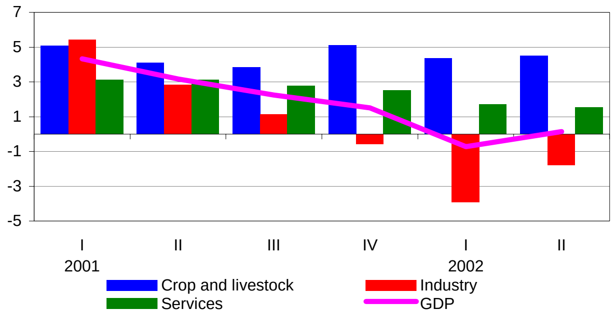
Gross Domestic Product

Percentage change

Itemization	2001 I	2001 II	2001 III	2001 IV	2002 I	2002 II
Accumulated in the year	4.3	3.2	2.3	1.5	-0.7	0.1
Accumulated in four quarters	4.1	3.6	2.6	1.5	0.3	0.0
Quarter/same quarter of the previous year	4.3	2.1	0.5	-0.7	-0.7	1.0
Quarter/previous quarter seasonally adjusted	1.2	-1.3	-0.4	-0.1	0.9	0.6

Source: IBGE

Gross Domestic Product
% growth accumulated in the year



Source: IBGE

the drop in power consumption occasioned by electricity rationing, and manufacturing (0.3%). The mining sector was the only subsector to registered growth (11.7%), mainly as a result of expanded petroleum extraction and refining.

The other two sectors registered positive growth in the first six months of the year. Crop and livestock production turned in a high of 4.5% and, among other factors, reflected the performance of the coffee, orange and sugar cane crops, as well as continued expansion of livestock output. The sector of services turned in growth of 1.5%, as a result of increases in all of the component subsectors, with the sole exception of commerce. Though growth has decelerated somewhat, communications (6.7%) and other services (2.4%) still managed to register positive growth. Commerce closed with a reduction of 2.3%, mirroring the performance of the wholesale and retail sectors, particularly under the headings of capital goods and consumer durables.

Once the second quarter 2002 result is incorporated, GDP growth accumulated in four quarters dropped from 0.29% in March to 0.03%, with sharp reductions in the industrial and service sectors and growth in crop/livestock output. It is important to note that the process of downward GDP movement registered over twelve month periods since the start of 2001 would seem to have changed direction in the second quarter of the year. Expectations are that this trend will start moving upward when the next results are calculated.

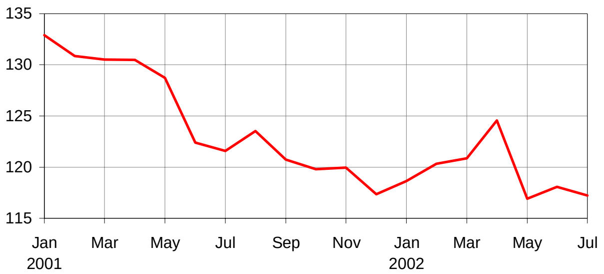
In this context, the GDP growth estimate for 2002 is 1.4%. On a sector-by-sector basis, expected growth of 4.3% in the crop/livestock segment is based on the fact that several of the most important crops have already been harvested and on the continued growth of the livestock sector. The latter hypothesis is quite realistic, particularly when one considers the current dynamics of the export market and highly favorable prices.

In the industrial sector, forecast expansion of 0.4% will depend on stability in the product of the building industry, recovery under public utility industrial services (Siup), albeit at a lesser level than normally attained prior to rationing, and moderate second half growth in manufacturing, when seasonal factors are duly considered. The latter item is based on the already low level of activity in this segment, together with the gradual though still only partial recovery in external credit lines and business expectations, as of August. One should not disregard the fact that the performance of the manufacturing sector has direct impact on such segments as commerce and transportation.

For the service sector, estimated 2% growth not only reflects the impacts of crop/livestock and industrial activities on transportation and commerce, but also the positive growth registered in such subsectors as communications and financial institutions. For items such as government and real estate rentals, which account for about 30% of GDP, the quarterly performance of recent years was used since growth rates have been quite stable. For activities classified as “other services”, the outlook for growth in formal employment was taken into account.

1.3 – Investment and output capacity

Production of construction inputs
Seasonally adjusted data
1992=100



Source: IBGE

The performance of investment indicators has reflected the turnaround in expectations that began in May. Thus, by the end of July, cpaital goods output declined by 3.7% comparing to the previous quarter, when it reached a level of 6.9%, using the same basis of comparison.

The loss of investment dynamism is also noted when one analyzes the performance of certain indicators in relation to the same period of 2001.

Investment indicators

% accumulated growth in year

Itemization	2001	2002		
	IV Q	I Q	II Q	Jul
Capital goods				
Production	12.7	-1.8	-1.1	-1.0
Imports	16.0	-19.6	-19.4	-11.7
Exports	-13.7	-10.2	-17.8	-14.8
Inputs for the building industry	-2.4	-8.8	-7.3	-6.7
BNDES financing	9.4	17.8	25.7	36.5

Source: IBGE, Funcex and BNDES

Production of capital goods

Percentage change

Itemization	2001	2002			
	Dec	Apr	May	Jun	Jul
Quarter/previous quarter[1/]					
Capital goods	-6.1	6.9	2.7	1.4	-3.7
Industrial	-12.1	7.4	4.2	-0.5	-3.1
Serial	-15.0	8.9	5.1	-1.1	-3.3
Nonserial	2.4	3.6	2.9	4.9	-1.7
Agricultural	17.7	-6.1	-3.8	0.7	0.7
Farm parts	-6.5	-3.8	-1.6	1.6	5.4
Building	-7.8	8.2	6.5	-1.0	-0.9
Electric energy	-19.2	16.4	-4.6	-10.2	-23.9
Transportation	2.8	3.0	0.4	-0.8	-0.2
Mixed	-8.0	9.6	5.3	8.6	5.9
In the year					
Capital goods	12.7	0.3	-1.0	-1.1	-1.0
Industrial	4.1	2.3	1.0	-0.4	-1.7
Serial	3.5	0.6	-0.8	-2.5	-3.8
Nonserial	6.6	9.9	8.9	9.3	8.6
Agricultural	20.0	12.5	12.3	12.2	13.4
Farm parts	3.4	-0.5	-1.7	-2.2	-1.7
Building	18.3	2.5	2.4	4.0	3.4
Electric energy	42.6	8.4	3.0	-2.4	-10.3
Transportation	12.2	4.4	2.5	3.1	5.2
Mixed	2.8	-11.5	-11.3	-8.7	-5.3

Source: IBGE

1/ Seasonally adjusted data.

In this sense, production of building inputs accumulated a 6.7% drop up to July. Aside from this, absorption of capital goods fell by 2.9% as a result of a 1% reduction in output, and downturns of 11.7% and 14.8%, respectively, under imports and exports of capital goods, when viewed under the prism of the quantum index.

It should be noted that such other indicators available up to July, as the increase in the level of idle industrial capacity in the capital goods sector, identified by the FGV Industrial Survey, and the reduction in the real sales of building materials, as demonstrated by Fecomercio SP, corroborate this conclusion.

With respect to capital goods output, a breakdown of IBGE data according to product destination shows that, in accumulated terms for the year, the reduction in investments generated impacts principally on capital goods produced in series, which are much more sensitive to changes in the overall economic situation, and parts for farm machinery and electricity systems, due to a basis of comparison that was much more favorable in the same period of the previous period. On the other hand, various sectors have registered relatively high investment growth, including agriculture (13.4%), reflecting not only the volume of the harvest but the increase in the sector's income; industrial equipment not produced in series (8.6%), given the maturation characteristics of orders placed; transportation (5.2%); and construction (3.4%).

Data on the mechanics industry released by the Association of Machinery and Equipment Industries (Abimaq) indicate that production of mechanical capital goods increased in the first five months of 2002. Compared to the same period of 2001, growth came to 1.5% in terms of the utilization of installed capacity and 3.2% in the number of employees in the sector. Deflated by the item Industrial Machines and Equipment of the Wholesale Price Index - Overall Supply (IPA-OG), real sales turned in growth of 9.4% up to May. The positive performance generated repercussions mainly on the behavior of products for the sectors of farming, packaging, foodstuffs, plastics and machine tools.

Production of automotive vehicles

Percentage change

Itemization	2002				
	Apr	May	Jun	Jul	Aug*
In the month1/					
Farm machines	9.5	-5.4	-0.4	11.7	-1.2
Buses	-6.9	-12.7	-4.5	-15.5	8.6
Trucks	3.1	-9.3	-3.8	1.5	-6.3
Quarter/previous quarter1/					
Farm machines	-6.3	-4.8	0.9	2.2	6.0
Buses	-4.3	-15.0	-21.9	-26.8	-21.9
Trucks	4.3	-0.5	-4.5	-10.1	-10.0
In the year					
Farm machines	18.2	16.1	15.7	16.4	16.8
Buses	19.7	12.8	9.5	5.7	1.7
Trucks	-10.2	-13.0	-14.8	-14.7	-15.8

Source: Anfavea
1/ Seasonally adjusted data.
* Preliminary.

In much the same way, Anfavea data on the output of farm machines and buses up to August 2002 pointed to growth of 16.8% and 1.7% compared to the first eight months of 2001. Insofar as the production of farm machines is concerned, all segments registered strong growth, with 30.4% under harvesters, 15.8% under wheeled tractors and 10.5% under others, which include motorized planters, caterpillar tractors and ditch diggers.

BNDES disbursement1/

Accumulated in the year (in R$ million)

Itemization	2001	2002			
		May	Jun	Jul	Aug
Total	25 217	10 370	13 226	16 103	20 921
Manufacturing industry	12 760	4 873	7 031	8 482	10 117
Commerce and services	9 298	3 948	4 340	5 390	8 207
Crop and livestock	2 762	1 479	1 773	2 133	2 494
Extraction industry	396	69	82	98	103

Source: IBGE

1/ Includes BNDES, Finame and BNDESpar.

With regard to total disbursements effected by the BNDES System, including BNDES, the Special Industrial Financing Agency (Finame) and BNDES Participações S.A. (BNDESpar), growth closed at 37.3% in the first eight months of the 2002, compared to the same period of 2001, and came to an overall amount of R$20.9 billion. Analysis of the major sectors that benefited from these figures, mining turned in the sharpest expansion in financing received, with approximately 87.3%, followed by commerce and services, 58.2%, crop/livestock farming (52%) and manufacturing (21.2%). As far as the costs of borrowing operations with the BNDES System are concerned, the Long-Term Interest Rate (TJLP) was set at 10% per year for the third quarter.

As a consequence of the cutback in outlays on building inputs and capital goods, the participation of investments in GDP moved into

Investment as proportion of GDP

GDP share

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

Source: IBGE

a downward curve. This conclusion can be inferred in light of the 0.14% growth rate under GDP in the first half of the year, compared to the same period of 2001, and reductions in the level of capital goods absorption (2.8%) and production of building inputs (7.3%) in the same period. Estimates based on monthly investment indicators demonstrate that the ratio between gross fixed capital formation, which excludes stock variations, and GDP fell from 19% in the first quarter of the year to 18.4% in the second quarter, as revealed by IBGE figures.

1.4 – Conclusion

The coming elections and the deteriorating international situation have generated a good deal of exchange market tension, with highly unfavorable impacts on internal expectations. In this case, indicators were equivalent to those registered in the periods prior to the Russian, Asian and electricity crises. Thus, credit conditions worsened as financing institutions became more selective, terms were shortened and the interest rate decline was halted.

As far as demand components are concerned, the factors cited provoked a rechanneling of spending into items of lesser unit value. And it is precisely this type of product that has been supporting retail sales activity. Basically, this movement was associated to FGTS fund releases, which have maintained retail sales high. In contrast, sales of consumer products of higher unit value dropped sharply. This is evident under consumer durables and, particularly, automotive sales. It is important to note that this downturn was somewhat attenuated in the second quarter by the World Cup games. An analysis of investments – the most volatile component of demand – indicates a reversal in the trajectory of the building industry, which had registered some degree of growth in the early months of the year, and a reduction in the output level of capital goods, as already described.

Both of these flows – spending on investment and durable consumer goods – were hard hit by deteriorating expectations in the period from April to August. If lasting, strong recovery in consumer confidence in September is expected to stimulate sales of these goods in the final quarter of the year.

Viewed under the prism of production, industrial indicators have accompanied demand growth, registering positive results – albeit quite moderate – only in the segments of nondurable and semidurable consumer goods and intermediate goods. Deceleration in the activity level has also impacted industrial employment levels which, following expansion up to April have turned downward once again, and the stock levels of the industrial sector. At the end of the second quarter, these levels had risen very sharply, particularly in the case of final goods.

Aside from these factors, not only does the GDP result for the second quarter of the year ratify the slowdown in the level of activity, it has also begun impacting such service segments as transportation, commerce and the financial sector, due to the enormous influence of industry in these areas. However, it is important to note that the recovery process, evident since the end of 2001, has not been halted. Growth has shifted into a lower gear than in the first quarter and has been sustained basically by the performance of the primary sector and consumption of products of lesser unit value.

The scenario for the activity level in the coming months must give due consideration to such restrictive factors as continued uncertainties rooted in the electoral process and the overall international situation. However, there are several aspects that are propitious to a consistent upturn in the activity level that certainly deserve mention, including the role assumed by the monetary authority on the exchange market, the agreement with the IMF, funding obtained from other international organizations and efforts to recoup the country’s external trade credit lines. Not only do these elements tend to restrict growth in production costs tied to exchange rates, they will also generate a favorable impact on internal expectations and, therefore, on the level of demand.

Finally, one should note the impact of the release of FGTS resources on consumption and the default level. These effects were evident in July and August and should become more intense in the following months. Another element of importance is growth in the employment level and its repercussions on overall wages. However, though these are aspects of importance to recovering the activity level, particularly under manufacturing, their impact will be somewhat attenuated by high stock levels. Evidently, this is a challenge that will demand finely honed adjustments by the nation’s companies.

2 – Prices

In the period from June to August, the inflation trajectory was impacted by three fundamental determinants. In the first place, sharp growth in the prices of government monitored items caused by a concentration of these increases in the period under consideration. Secondly, the effect of exchange depreciation as of the month of May, particularly on wholesale prices and commodity-related consumer products. Parallel to these points, the start of the off-season agricultural period tends to restrict the volume of supply of several essential food products, and traditionally marks the beginning of the period in which farm prices become the major source of inflationary pressures.

However, it is important to recognize that the most accentuated increases perceived by price indices in the last three months were concentrated under specific items, with no evidence whatsoever of across-the-board price increases or indexing.

2.1 – General price indices

General indices

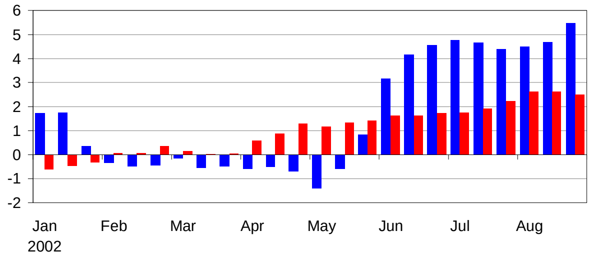
monthly % change

Itemization	2002							
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug
IGP - DI	0.2	0.2	0.1	0.7	1.1	1.7	2.1	2.4
IPA	-0.1	0.1	-0.1	0.8	1.3	2.5	2.8	3.3
IPC	0.8	0.1	0.4	0.7	0.3	0.6	1.0	0.8
INCC	0.4	0.6	0.6	0.3	2.5	0.6	0.3	1.0

Source: FGV

In the June-August period, the indices measured by the Getúlio Vargas Foundation (FGV) pointed to median inflation higher than in previous quarters and above the levels registered by other price indices in the period. When one analyzes the General Price Index – Internal Supply (IGP-DI), the average for the quarter came to 2.05%, compared to 0.64% from March to May and 0.18% from December to February. General price indices were pressured mainly by exchange

Evolution of IPA (10, M and DI) - agriculture and industrial
Monthly % change



Source: FGV

devaluation and the start of the off-season farm period, both of which had particularly strong impacts on wholesale prices. As a matter of fact, the prices of both industrial and farm products turned sharply upward at the wholesale level in the period from June to August. In the quarter, accumulated variation under these headings came to 6.61% and 15.14%, respectively, resulting in a rate of 8.89% for the Wholesale Price Index – Internal Availability (IPA-DI) in the period. In the case of farm products, mention should be made of the increases registered under such commodity prices as soybeans (45.8%), wheat (61.7%) and corn (17.4%). Among industrial products, the sharpest increases occurred under fertilizers (23.4%) and paper and cardboard (10.4%). With respect to consumer prices, just as occurred under the indices calculated by IBGE, the major influences were concentrated under government managed prices and foodstuffs, particularly in July and August.

2.2 – Consumer Price Indices

Broad National Consumer Price Index (IPCA)

Consumer prices

Percentage growth

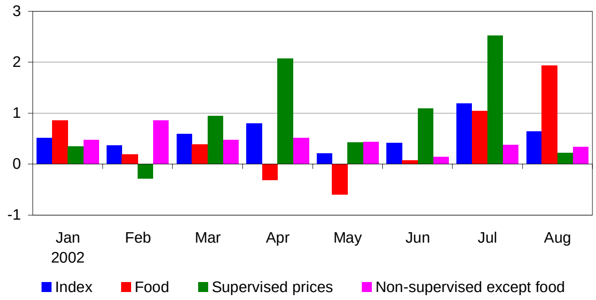
Itemization	2002							
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug
Monthly								
IPCA	0.5	0.4	0.6	0.8	0.2	0.4	1.2	0.7
IPC-Fipe	0.6	0.3	0.1	0.1	0.1	0.3	0.7	1.0
IPC-Br	0.8	0.1	0.4	0.7	0.3	0.6	1.0	0.8
Accumulated in the year (annualized)								
IPCA	6.4	5.4	6.1	7.1	6.1	6.0	7.3	7.4
IPC-Fipe	7.1	5.1	3.7	2.9	2.5	2.7	3.5	4.6
IPC-Br	9.9	5.7	5.5	6.4	5.8	5.9	6.9	7.2
12 months								
IPCA	7.6	7.5	7.7	8.0	7.8	7.7	7.5	7.5
IPC-Fipe	7.3	7.5	7.0	6.4	6.3	5.7	5.2	5.0
IPC-Br	8.1	7.8	7.7	7.5	7.4	7.4	7.1	7.3

Source: IBGE, Fipe and FGV

The IPCA accumulated 2.28% growth in the June-August quarter and, just as occurred under the general indices, closed with the highest quarterly median of the year. Following a decline in the March-May quarter, food prices turned upward once again and generated significant pressures on the index, especially in the months of July and August. Aside from these items, government monitored prices also generated price pressures, particularly under telephone and electricity rates, urban transportation and fuel prices. In the first eight months of the year, the IPCA accumulated growth of 4.85%.

Evolution of IPCA

Monthly % change



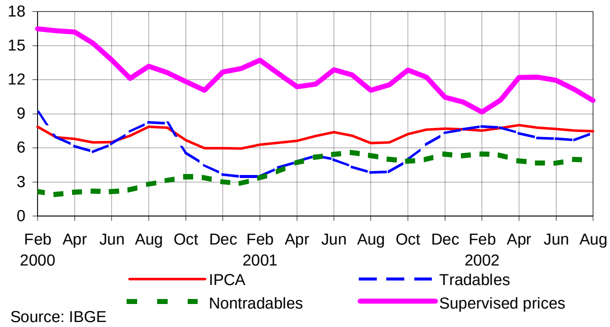
Source: IBGE

In the month of June, growth in government monitored prices, particularly the increases that occurred under urban bus fares in Salvador, Fortaleza and Rio de Janeiro, bottled gas and airline tickets, accounted for 80% of the growth registered and 0.42% of the index for the month. In July, the IPCA closed with a rate of 1.19%, registering the highest mark of the year just as occurred in both 2000 and 2001. This percentage reflected upward movement in the prices of petroleum derivatives, electricity rates in some regions of the country, fixed telephone rates throughout the country and the impact of the minimum wage increase which, for methodological reasons, was only perceived in the July result. In the month under analysis, government monitored prices accounted for 66% of the result. Aside from this, the index also perceived pressures generated by the grouping of foodstuffs, with growth of 1.05%, as products classified among the listing of basic staples, such as beans, milk, table bread and soybean oil turned in sharp growth, mainly as a consequence of the off-season harvest period and exchange devaluation. In the month of August, IPCA growth came to 0.65%. The decline in the growth rate was attributed to attenuation of the impact of increases in public service rates, though the heading of foodstuffs registered a persistently strong increase of 1.94%. Prices of animal derivatives, which had declined sharply during the course of the year, turned upward once again at the start of the off-season farm period. Here, one should also stress the upward pressure generated by the grouping of apparel, with price growth of 2.53% in the quarter ended in August.

Analysis of market determined prices indicates an upward trajectory during the entire quarter, with 0.12% in June, 0.59% in July and 0.85% in August. For the most part, these results are explained by rising food prices. In this grouping, it is important to note the impact of the rate of exchange on such product groupings as bakery goods, soybean oil and meat. When the heading of foodstuffs is eliminated from the calculation, the final rates are not only lower but more uniform, with 0.14%, 0.38% and 0.34% in the three months under consideration.

2.3 – Government monitored prices

Consumer prices
12 month % change



Source: IBGE

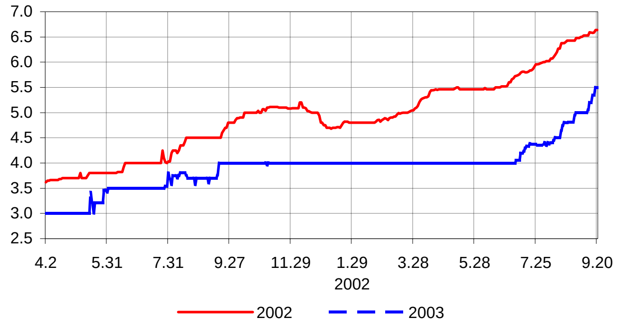
While market prices increased by 1.57% from June to August, government monitored prices grew by 3.86% and accounted for 1.19 p.p. of the IPCA rate in the quarter. Several items of importance to the overall index turned in strong growth: bottled gas, with growth of 9.2% on the first of June and 6.2% on the fifth of July, at the refinery level; and gasoline, with a 6.75% price rise on the final day of June. Electricity rates increased in four regions of the country: Curitiba, 10.96% in June, São Paulo, with 14.24% in July and Belém and Brasília, with respective rates of 11.01% and 14.5%, in the month of August. Urban bus fares increased by 9.09% in Rio de Janeiro, 10% in Fortaleza and 9.09% in Fortaleza. Parallel to these factors, the June 28 increase in fixed telephone rates in all parts of Brazil also contributed strongly to the result, with a median increase of 10.87%. Aside from this, airline tickets were increased by 17.17% in the quarter.

Notwithstanding the fact that, for the most part, increases in government managed prices followed predetermined criteria and government policy orientation, increases – particularly in recent months – have also been impacted by the rate of exchange. In this framework, it is important to note that the reference for the prices of petroleum derivatives are international market prices converted into national currency, while the indices used to correct most of the costs involved in electricity and telephone services are the IGP-DI and the General Price Index – Market (IGP-M), both of which are recognized as highly sensitive to exchange rate variations since they are also used to verify wholesale prices. Parallel to these factors, in the specific case of electricity, part of the costs paid by distributor companies refers to energy generated at the Itaipu hydroelectric plant, which is priced in dollars. Finally, in the case of transportation services, the major impact of exchange rates is rooted in their effects on fuel prices.

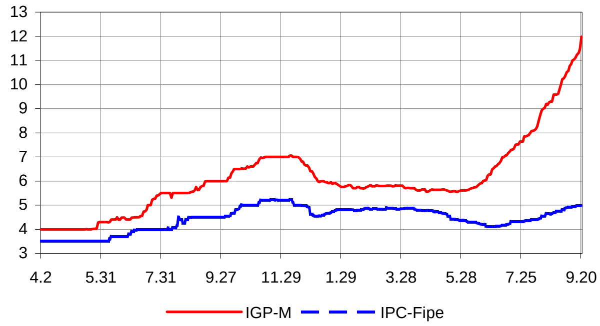
Almost all of the major increases in government monitored prices scheduled for 2002 have already been introduced. However, before the year is out, additional impacts will be felt in price indices as a result of electricity rate hikes in Goiânia, Porto Alegre and Rio de Janeiro. With respect to petroleum derivatives, the price of bottled cooking gas was reduced by 12.4% at the refinery level on August 19. Expectations are that this reduction will be felt as of the September inflation rate. Thus, the pressures generated by government monitored prices should be less accentuated in coming months, compared to the first eight months of the year. However, one cannot fail to recognize that the trajectory of petroleum prices would be enormously impacted were a new armed conflict to break out in the Middle East.

2.4 – Market expectations

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



Daily evolution of market expectations for inflation for 2002 (median)

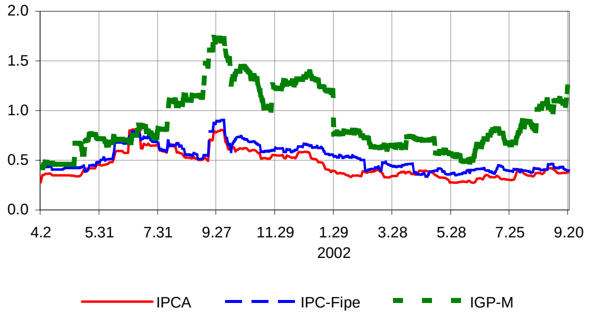


The Banco Central do Brasil Investor Relations Executive Management Staff (Gerin) carries out a daily survey involving an average of approximately 100 consulting firms and institutions, with the objective of detecting market expectations regarding the trajectory of the major economic variables.

For 2002, median expectations of inflation measured by the IPCA increased from 5.5% on June 21 to 6.64% on September 20. For 2003, expectations moved from 4% to 5.5% between these two dates. The Top Five short-term forecasts indicated an increase in median levels from 5.53% to 6.64% for 2002 and from 4% to 5.27% for the subsequent year.

With regard to IGP-M growth, median expectations for 2002 shifted from 6.03% on June 21 to 11.99% on September 20. For 2003, expectations rose from 4.61% to 7%. In the case of the Consumer Price Index, which is calculated by the Institute of Economic Research Foundation (IPC-Fipe), the forecast result for 2002 increased from 4.13% on June 21 to 5% on September 20. For 2003, expectations shifted from 4% to 4.5%, for the same dates.

Standard deviation of market expectations for inflation for 2002



With regard to the short-term expectations of the Top Five, the median result moved from 6.02% to 12.98% for 2002 and from 4.6% to 7% for 2003, in the case of the IGP-M.

The standard deviations of the price indices expected for 2002 moved to 0.28% for the IPCA, 0.62% for the IGP-M and 0.41% for the IPC-Fipe on September 20, 2002, following June 21, 2002 levels of 0.28%, 0.62% and 0.41%, in the same order.

2.5 – Conclusion

Among the determining factors underlying inflation in the June-August period, only government monitored price increases are expected to generate lesser pressures on price indices over the coming months. However, it is important to note that, even in this case, the basic supposition is that there will be no new significant increases in the prices of petroleum derivatives until a new exchange rate is determined and consolidated at that level.

Insofar as exchange rate pressures are concerned, it is important to stress that, in the framework of consumer prices, those of more sensitive products rose sharply in the last two months, particularly bakery goods, soybean oil and flours and pastas. Other items, particularly industrial goods such as electric-electronic apparatuses and medicines tend to reflect the same increases though with a considerably longer lag.

Though the rise in food prices was less intense than in the month of August, they will remain as a major source of pressure on inflation rates in the coming months. At the consumer level, the prices of beef and derivatives and poultry will tend to remain high, at least to the end of September.

Finally, one should stress that, despite these pressures, the indices for the coming months are expected to register less growth than at present. This outlook is based on several factors, including exhaustion of the impact of increases in government managed prices. When this is taken into consideration, it is clear that, as of the month of September, inflation rates will basically reflect changes in market determined prices.

3 – Credit, monetary and fiscal policies

3.1 – Credit

Moderate credit growth in the June-August quarter continued the trajectory that has characterized recent months, clearly reflecting prevailing adverse economic conditions. Above all else, the economic environment has undergone a loss of dynamism in productive activity, generated by deteriorating expectations both at home and abroad.

As a result, credit demand has remained low, at a level fully compatible with the performance of futures markets and declining external credit lines, creating a situation that convinced many businesses to postpone longer term indebtedness. At the same time, the supply of resources has been limited by a much more selective approach adopted by financial institutions in their loan operations. This decision was taken in light of the risk of default and has resulted in lower loan ceilings, cutbacks in credit lines and demand for greater guaranties. Thus, for the most part, the increased credit stock in the period reflected growth in operations contracted in foreign currency, as a result of exchange rate variations in the quarter, as well as financing for medium and long-term investments granted by BNDES.

Growth in credit operations

R$ billion

Itemization	2002				Growth	
	May	Jun	Jul	Aug	3 months	12 months
Total	343.7	351.6	358.6	354.5	3.1	9.3
Nonearmarked	204.2	209.5	213.1	208.2	2.0	8.0
Legal entities	127.7	133.0	137.3	132.0	3.4	5.6
Ref. to exchange	44.3	48.0	50.6	47.0	6.1	4.0
Individuals	76.5	76.5	75.9	76.2	-0.3	12.3
Earmarked	118.7	121.4	124.4	125.2	5.5	14.4
Housing	21.4	21.5	21.4	21.4	-0.3	5.7
Rural	27.7	27.9	27.4	27.9	0.9	16.4
BNDES	68.8	70.5	74.2	74.8	8.8	17.6
Others	0.8	1.4	1.4	1.1	30.9	-29.9
Leasing	10.8	10.7	10.6	10.6	-1.8	-15.9
Public sector	10.1	10.0	10.5	10.5	4.2	9.9
% participation:						
Total/ GDP	27.2	27.2	27.1	26.3		
Nonearm./GDP	16.1	16.2	16.1	15.4		
Earmarked/GDP	9.4	9.4	9.4	9.3		

Consequently, the overall balance of financial system credit operations, including leasing transactions, came to R$354.5 billion in August, with growth of 3.1% in the quarter and 9.3% in twelve months. As a result, the participation of loans in relation to GDP came to 26.3% compared to 27.2% in May.

The share of targeted credits came to R$125.2 billion, with expansion of 5.5% in the quarter. The result reflected growth of 8.8% in financing granted by the BNDES System, which came to an August balance of R$74.8 billion. It should be mentioned that financing channeled into the rural and housing sectors in the period remained stable.

From June to August, the volume of funding disbursed by BNDES totaled R$10.6 billion, with growth of 49.8% over the same period of the preceding year. For the most part, these funds have been concentrated in projects in the sectors of energy, electricity, petrochemicals and transportation.

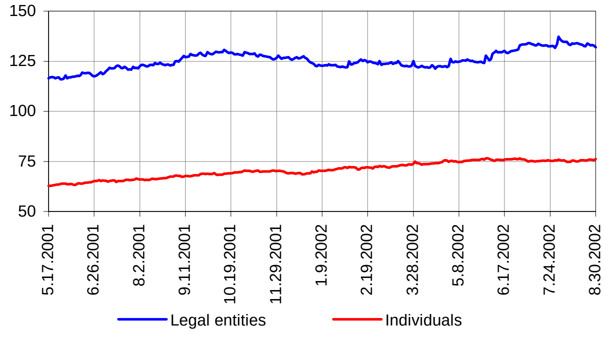
A sector-by-sector analysis shows that BNDES disbursements to the manufacturing sector totaled R$5.2 billion in the quarter, compared to R$2.9 billion in the same period of 2001. In terms of specific segments of activity, one should highlight the credits channeled into transportation, foodstuffs and beverages, chemical products and metallurgy. Going on to the service and commerce sectors, the disbursement flow closed at R$4.3 billion, for growth of 26.1%. With this, the accumulated January to August figure indicated a volume of R$8.2 billion, with growth of 59% over the same period of the previous year. Here, the most important operations involved financing for infrastructure projects contracted by electricity, gas and land transport companies. Credit operations targeted to micro, small and medium businesses accounted for 22% of total disbursements, channeled for the most part into crop/livestock farming, infrastructure and industry.

In the quarter under analysis, the number of consultations with BNDES – considered an indicator of the future medium and long-term investments of the productive sector – corresponded to R$11.4 billion, for a drop of 10.2% compared to the same period of the previous year. However, it should be clarified that the cutback was influenced by a concentration of the number of consultations in the first half of this year. In contrast to this tendency, requests in 2001 were heavily concentrated in the final six months of the year as a result of the impact of electricity rationing.

Insofar as the rural sector is concerned, the credit volume expanded by 0.9% in the quarter as a result of a seasonal decline in credits contracted to cover current outlays. The balance of housing financing remained stable in the quarter at a level of R$21.4 billion.

Loans to the public sector expanded by 4.2% in the quarter, reaching an August total of R$10.5 billion, while operations in the form of leasing came to R$10.6 billion, for a reduction of 1.8% in relation to May. This movement was caused by liquidation of contracts by individual persons.

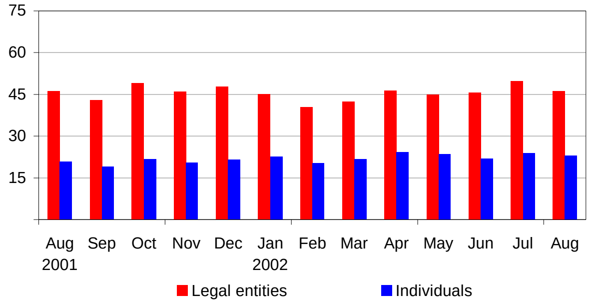
Credits with nonearmarked resources - stock
R$ billion



In the month of August, the volume of credit operations with nonearmarked resources totaled R$208.2 billion, for expansion of 2% in the quarter, compared to 6.1% in the same period of the previous year. Consequently, the participation of these operations in the total financial system credit stock remained in the range of 59%.

The volume contracted by legal entities moved to R$132 billion, for quarterly growth of 3.4%. Emphasis should be given here to the credit modalities tied to foreign currency, due to the accounting effect of the process of exchange devaluation that occurred in the period. In this sense, one should stress expansion of 5% in the balance of external onlending operations, despite the 15.3% reduction in demand. Considering exchange rate volatility, this figure is based on the quarterly average in relation to the previous period. Stimulated by the performance of exchange rates, contracting of Advances on Exchange Contracts (ACC) reached highly significant levels and generated increased revenues in reals to exporters. However, in July and August, the scarcity of external trade credit lines forced a sharp drop in disbursements of this type of operation. As a result, the quarterly median increased by 8.9%.

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

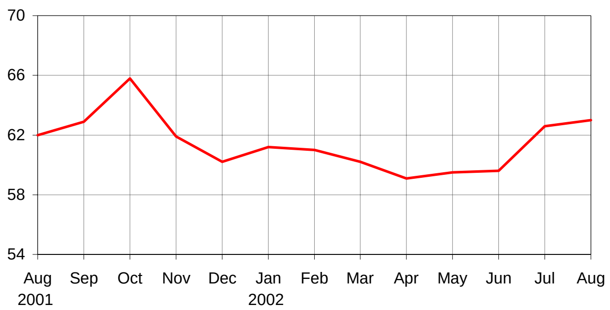


The stock of credit operations backed by internal resources reached a level of R$85.1 billion in August, for growth of 1.9% in the quarter. Working capital operations represented an internal financing alternative for businesses and indicated a process of migration to loans tied to domestic rates of interest. In this context, mention should be made of the strong 13.2% and 13.6% growth in the volume and quarterly average of this portfolio, respectively. With the instability of the economic scenario, company demand was concentrated under short-term operations to meet immediate funding needs. Consequently, the quarterly median of disbursements against guarantied overdraft accounts increased by 3.2% in the period.

Operations with individual persons were affected by restrictions imposed by financial institutions, including both shorter maturities and higher credit costs. Viewed from the angle of borrowers, consumers adopted a more cautious stance and became considerably more wary before assuming new financial commitments or making new purchases. At the same time, there was a clear trend toward the use of tax refunds and FGTS resources to settle bank debts.

With this climate of wariness, the volume of this portfolio dropped by 0.3% in the quarter and closed the month of August at R$76.2 billion. Here, stress should be given to the reductions registered under personal credits, with falloffs of 0.3% under stocks and 10.1% in the quarterly average of credits granted and vehicle financing, with 0.2% in the balance and 24% in the median value of disbursements. The latter item, evidently, was a result of decreased automotive sector sales.

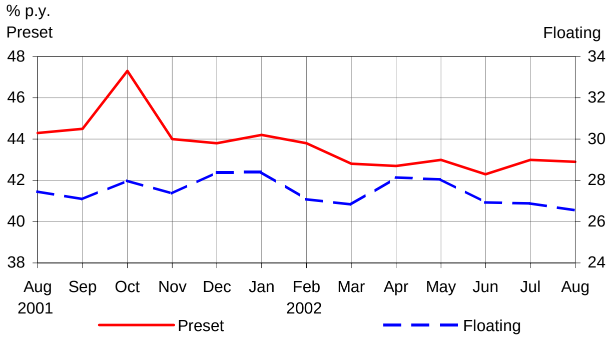
Interest rates of credit operations preset rates - Market average
% p.y.



The average rate on credit operations based on nonearmarked resources negotiated at preset interest rates increased by 3.4 p.p. in the last three months, closing August at 62.9% per year. This growth was due to a partial passthrough of the increase in funding costs, principally for medium and long-term loans. In July, the reduction of 0.5 p.p. in the Special System of Clearance and

Custody (Selic) rate aided in stabilizing interest on short-term loans, while market volatility and rising futures market interest rates generated pressures on long-term operations, principally those involving the financing of vehicle acquisitions.

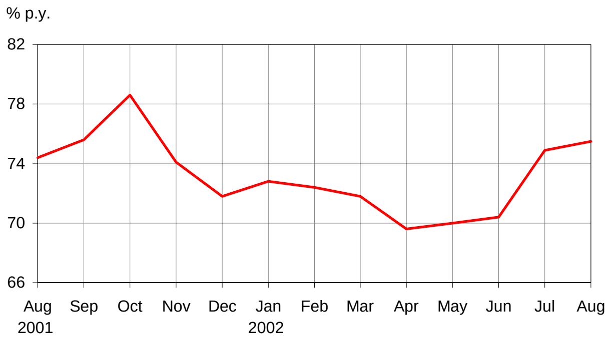
Interest rates of credit operations - Legal entities



In the segment of legal entities, the average preset rate of interest varied little over the course of the quarter under analysis, closing August at 42.8% per year, the same level as in May. Despite the unfavorable situation, short-term loan rates dropped in the period and were impacted by low interest operations carried out by large companies as an alternative to more restricted external financing. On the other hand, longer term operations, such as acquisitions of goods and vendor operations, turned in the largest increases in this segment, with respective upturns of 6.3 p.p. and 2.2 p.p., respectively.

Rates on operations contracted at floating interest and channeled mostly to large companies dropped by 1.5 p.p. since May and closed the month of August at 26.5% per year. This movement was impacted by a reduction of 0.3 p.p. in the Interbank Deposit rate (DI), which is the major reference base for these contracts. In the case of floating interest operations, the lesser degree of financial institution market risk makes it possible for them to offer credit at sharply lower rates than in preset operations and this has obviously stimulated demand for this type of loan. In this framework, participation of this segment in the business portfolio over the last twelve months increased from 20.2% to 26.8%, in operations based on internal resources. In that period, the participation of working capital operations contracted at floating rates of interest evolved from 30.3% to 40.2% of the segment's total.

Interest rates of credit operations preset rates - Individuals



The average rate on loans to individual persons moved to 75.3% per year, reflecting an increase of 5.3 p.p. in the quarter. The most significant growth occurred under vehicle financing, with a high of 11.1 p.p., caused by the end of the so-called “zero interest” sales campaigns sponsored by banks connected to the large automobile factories and by increases in long-term funding costs passed through to consumers in June and July. On the other hand, rates on special overdraft checks dropped by 0.3 p.p., more or less following the tendency of short-term interest rates.

Spread between lending and funding interest rates in operations with preset rates

p.p.

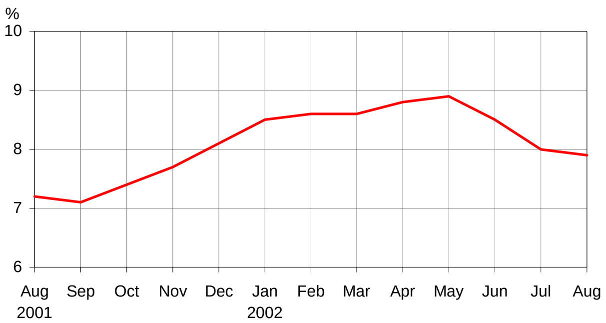
Period		Market average	Legal entities	Individuals
2001	Aug	38.9	23.0	50.2
	Sep	39.6	23.3	51.0
	Oct	42.7	26.2	54.3
	Nov	41.5	24.5	53.1
	Dec	39.9	24.4	51.0
2002	Jan	41.6	25.3	52.7
	Feb	41.8	25.2	52.9
	Mar	41.9	24.7	53.4
	Apr	40.6	24.6	50.8
	May	40.3	24.9	50.2
	Jun	37.1	22.1	46.6
	Jul	38.6	22.0	49.2
	Aug	39.5	22.0	50.5

The banking spread, defined as the difference between lending and funding rates, dropped by 0.8 p.p. in the last three months, coming to a level of 39.5 p.p. in August. This reduction was a consequence of only partial transfer of the increase in funding costs, principally in the segment of business loans.

The spread in operations with legal entities diminished by 2.9 p.p., particularly in the modalities of guarantied overdraft accounts and working capital operations, with 5.8 p.p. and 4.8 p.p., respectively. In loan operations targeted to individual persons, the spread soared by 0.3 p.p., with reductions in the case of personal credit and growth under vehicle financing.

The average term of the credit portfolio based on nonearmarked resources was relatively stable over the last eleven months, closing August at 230 days. In the segment of legal entities, the average term dropped by one day in the quarter and closed at 181 days. To some extent, this was a consequence of a drop of six days in the average term of the working capital portfolio. The portfolio of operations with individual persons registered an average term of 314 days, with no significant variations since October 2001.

Default rate of credit[1/]



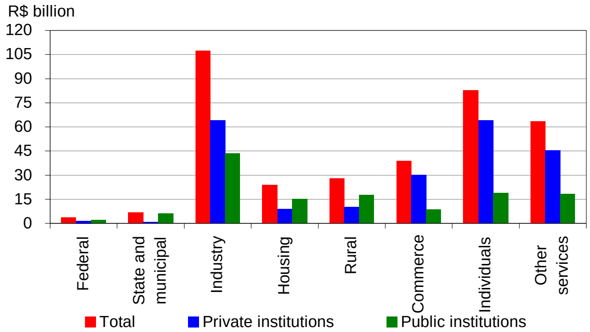
1/ Portfolio's percentage share of nonearmarked funds in arrears of more than 15 days.

The default rate on loans backed by nonearmarked resources dropped by 1 p.p. in the quarter and closed the month of August at 7.9%, the lowest level since November 2001. The factors most responsible for the rate decline were utilization of income tax refunds and FGTS resources, coupled with more restrictive credit policies adopted in recent months. In operations with the business sector, default rates dropped by 0.9 p.p. to 4.1%. In the segment of operations with individual persons, the drop closed at 0.8 p.p., reaching an August level of 14.4%.

Sector-by-sector distribution and credit quality

Total credit operations targeted to the private sector came to R$344 billion in August, for growth of 3.1% in the quarter. Here, the most important segment was that of operations referenced to foreign currency and carried out with industry and other services. A breakdown of this volume indicates that the asset portfolio of private financial institutions, which accounted for 64.6% of the total, came to R$222.2 billion, for growth of 2.6%. At the same time, loans granted by the government financial system came to a volume of R$121.8 billion, for growth of 4.1% in the quarter.

Credit operations in the financial system by borrowers - August 2002



With regard to credits targeted to the productive sector, operations with industry came to R$107.3 billion, for growth of 5.4% in the quarter. To a great extent, growth in the period was impacted by exchange indexing, as well as by disbursements to manufacturing and financing of programmed investments in the energy sector. The balance of loans to the trade sector came to R$38.6 billion, corresponding to a quarterly increase of 5.5%, mostly as a result of growth in the revenues of the retail trade sector.

With respect to the segment of other services, the volume of credits came to R$63.4 billion, with growth of 4.7% in the quarter. Basically, this performance was a result of exchange indexing of operations based on government funding, as well as disbursements to energy and transportation concession companies.

The balance of financing to the housing sector, which includes 10.7% of operations with nonearmarked resources, totaled R$23.9 billion in August, reflecting a drop of 0.6% in the quarter.

In the quarter ended in June, credits granted to the housing sector closed at R$395 million, compared to R$441 million in the same period of 2001. Of this total, 80.5% were targeted to real estate acquisitions and the remainder to construction. With respect to financial charges, new operations contracted at interest rates defined according to Housing Finance System (SFH) norms totaled R$330 million, while financing granted at market rates closed at R$65 million.

In order to expand the supply of resources to the housing market, alterations were introduced into the calculation of banking sector investments in housing financing, particularly credits with the Wage Variation Compensation Fund (FCVS), which include assigns specified in the Program of Incentives to the Restructuring and Strengthening of the National Financial System (Proer). In this framework, the amounts previously computed for purposes of compliance with investment requirements are to be converted into new home acquisitions or construction operations. Conversion of these credits is effected in a proportion of 1% of the total each month, from September 2002 to December 2010 and has the purpose of preserving market equilibrium while avoiding funding shortfalls or deterioration in housing portfolios. If the resources are not invested, institutions are permitted to deposit them with Banco Central at earnings equivalent to savings accounts.

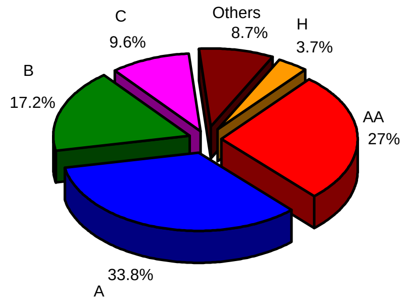
The balance of rural sector financing came to R$27.9 billion, for growth of 0.9% in the quarter ended in August. The participation of current expenditure financing dropped from 37.8% in May to 37.5%. Credits for rural investment purposes reached 55% of the total. Here, mention should be made of the significant volume of funding channeled into the Program of Modernization of the Farm Tractor Fleet and Like Instruments and Harvesters (Moderfrota), based on funding transferred by BNDES and Finame.

It is also important to note that an additional R$1 billion has been set aside for investment through Moderfrota to be used as of July 2002. Furthermore, incentive programs have been instituted involving irrigation, cocoa farming, reforestation and development of cooperatives, with BNDES resources totaling R$690 million, and interest rates of 8.75% per year, with National Treasury equalization. These activities are aimed at stimulated productivity and contributed to increases in rural sector income.

State and municipal debts with the financial system totaled R$6.9 billion, for quarterly growth of 12.8%. For the most part, this performance was due to financial system acquisitions of electricity concession credits with local government administrations, as well as financing granted for purposes of municipal tax modernization.

The stock of federal government debts in August came to R$3.6 billion, for a reduction of 9% in the quarter. This movement reflects securitization of state debts previously renegotiated with the Federal Government, plus transfers of the risk in operations contracted with public sector banks for the Social Integration Plan Fund (PIS)/ Program of Civil Service Asset Formation (Pasep).

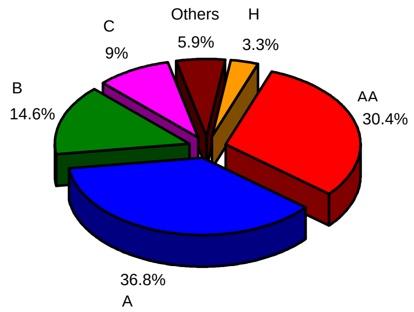
Credit operations in the financial system by levels of risk - August 2002



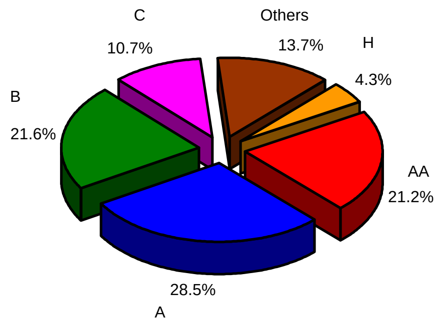
Looking at the quality and distribution of total financial system credits by risk level, August results indicate R$310.6 billion concentrated under normal risk (levels AA to C), with relative participation of 87.6%. This result represented 3.3% growth in relation to the May figure and, for the most part, mirrored the impact of exchange depreciation. The participation of credits classified under risk level 1 (D to G) came to R$30.9 billion, with growth of 7.6%. In the case of risk level 2 (H), which requires a total set aside of provisions, participation in the total granted came to 3.7%, with negative growth of 8.9% in the period.

Normal risk credit operations in the private financial system framework registered a balance of R$204 billion, for growth of 2.9% in the quarter and relative participation of 90.8%, compared

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



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

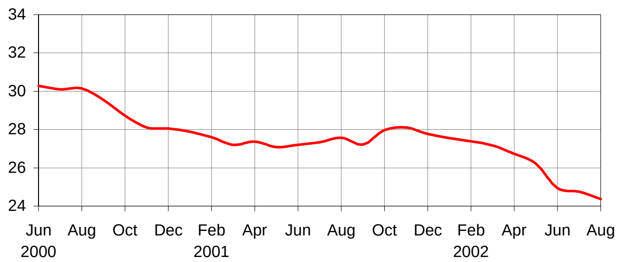


to 90.6% in May. Risk level 1 turned in a reduction of 1.9% in the period, as relative participation closed at 5.8%. Credits classified at risk level 2 totaled R$7.5 billion, accounting for 3.3% of total credits in the period.

With regard to the public financial system, the volume of credits in August totaled R$129.9 billion, for growth of 4% in the quarter. The credit portfolio profile indicates that the participation of normal risk operations closed at 82%, an increase of 4% in the quarter. With respect to operations classified under risk levels 1 and 2, relative participation came to 13.7% and 4.3%, respectively.

In the quarter, provisions made by the financial system declined by 3% and closed at R$25.2 billion, with relative participation in total credits granted dropping from 7.5% in May to 7.1%. This trajectory was compatible with that of credits in arrears matured more than fifteen days previously. The participation of these credits in the portfolios total came to 7.7% and 8.5% in the two periods under consideration, respectively. In August, the public financial system constituted provisions of R$10.8 billion, corresponding to 8.3% of total credits granted. The relative participation of private financial system provisions came to 6.4% or R$14.3 billion.

Demand deposits seasonally adjusted - income-velocity[1/]



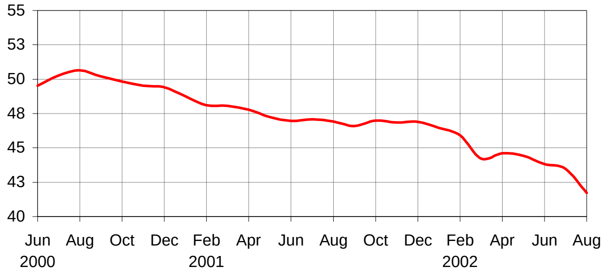
1/ Defined as the ratio between 12 month accumulated GDP (valuated by IGP-DI) and the monthly average balance of the seasonally adjusted monetary aggregate.

3.2 – Monetary policy

Monetary aggregates

At the end of August, the median daily money supply balance totaled R$84.5 billion in the restricted M1 concept, representing growth of 24.6% in the last twelve months. This result corresponds to growth of 23.5% under currency held by the public and 25.3% under demand deposits. The income velocity

Currency outside banks seasonally adjusted - income-velocity[1/]

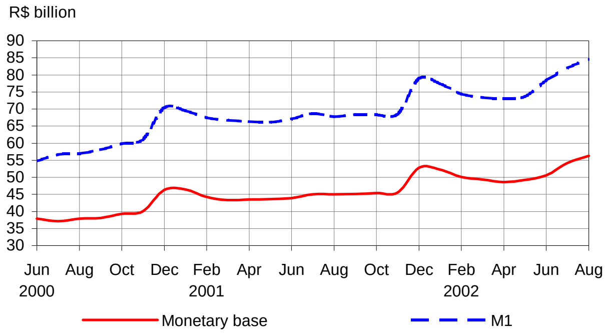


1/ Defined as the ratio between 12 month accumulated GDP (valued by IGP-DI) and the monthly average balance of the seasonally adjusted monetary aggregate.

of its components has tended downward in the course of 2002, reflecting the rather moderate pace of growth in economic activity.

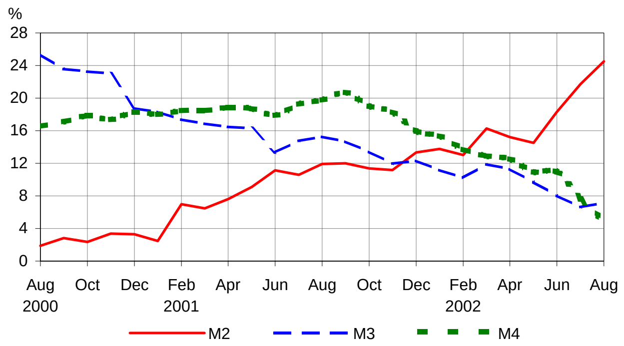
As of the month of June, atypical growth was registered in money supply components, indicating public preference for liquidity due, mostly, to migration of resources out of fixed income funds as of the month of May and to disbursements of about R$4.1 billion in releases of FGTS balances in the June to August period, as a consequence of the agreement specified in Complementary Law 110, dated June 29, 2001. With this, average daily balances of currency held by the public and demand deposits came to respective August levels of R$30.6 billion and R$53.9 billion.

Monetary base and M1 - average daily balances



Average daily monetary base balances were consistent with demand for cash deposits in the same period and closed at R$56.3 billion, for growth of 3.8% in the year. The average balance of currency issued totaled R$36.8 billion and banking reserves came to R$19.5 billion, for respective twelve month growth rates of 27.4% and 20.8%.

Broad money supply - 12 month percentage growth



Basically, the behavior of the broad money supply reflected migration of fund's resources out of financial investment funds into other assets in the June-August quarter, with growth below the capitalization level of its components. The M2 concept, which encompasses M1 plus savings deposits and papers issued by financial institutions, turned in growth of 13.4% in the period, with expansion of 13.2% in funding operations through savings accounts and 13.3% in private securities. M3, which aggregates M2 plus the share of the fixed income funds portfolio not included in the more restricted concepts and committed operations with federal securities, closed with expansion of 1.9%. In the quarter, it is worth noting that the balance of investment fund quotas declined by 10.5%. The M4 concept, composed of M3 plus public securities held by the nonfinancial sector, expanded by 0.3%, reaching a volume of R$766.9 billion at the end of August.

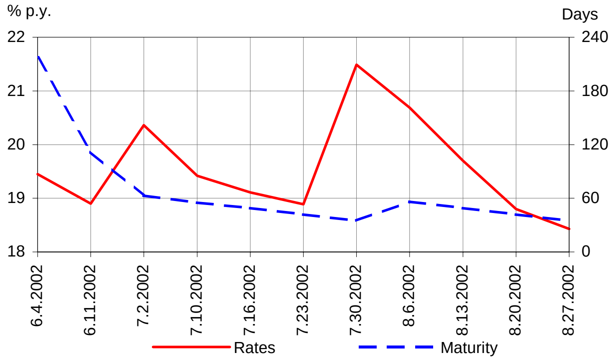
In order to avoid pressures on monetary liquidity, Banco Central introduced alterations into compulsory reserves on bank deposits. Circular 3,127, issued on 6.14.2002, raised the compulsory reserve rate on time deposits from 10% to 15%. This measure resulted in a reduction in financial institution portfolios of nonearmarked federal securities, since compliance with the new level is achieved by earmarking these papers in Selic and, consequently, making them unavailable for other forms of utilization. In the same sense, Circular 3,128, dated 6.24.2002, altered the rate of obligatory reserves on savings deposits from 15% to 20%.

Aside from this, Circular 3,144, dated 8.14.2002, instituted reserve requirements on deposits, which encompass the sum total of the shares remaining after application of the rates of 3% on demand resources and time deposits and 5% on savings deposits. Compliance with the additional demand must be in cash and is entitled to earnings based on the Selic rate.

Public securities

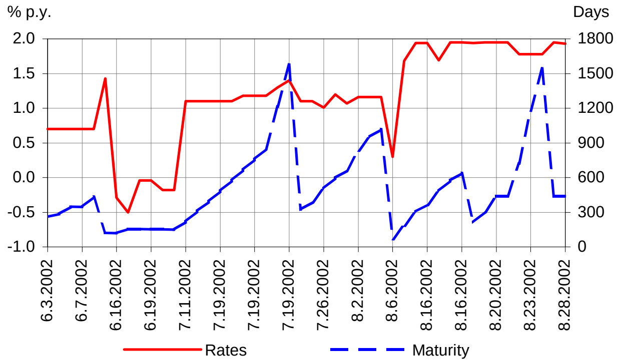
Banco Central and the National Treasury acted to minimize the impacts of uncertainties generated by sharp market volatility on the real variables of the economy.

LTN - rates x maturity

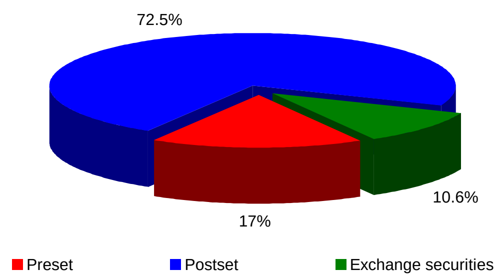


In the case of National Treasury operations, the increase in futures market interest rates as of May imposed restrictions on primary market placements of preset public securities (National Treasury Bills – LTN). Expectations of a rise in the basic interest rate generated an increase in the rate required by institutions, as well as a shortening of the maturity periods of these papers, to respective levels in the range of 20% per year for papers with terms of less than two months.

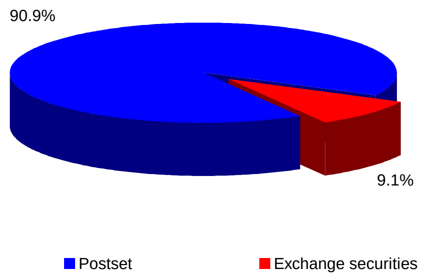
LFT - rates x maturity



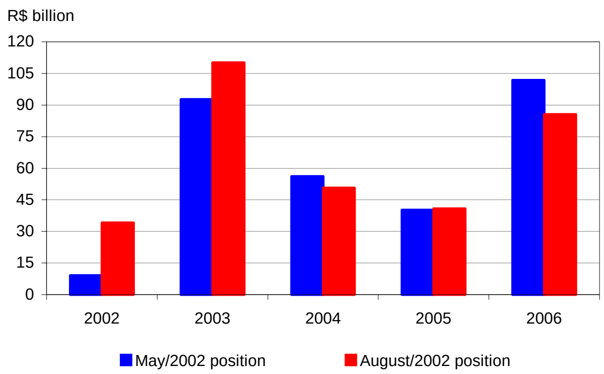
Placement on the primary market
6.3.2002 to 8.30.2002



Placement on the secondary market
6.3.2002 to 8.30.2002



Redemptions of postset securities



In the same manner, the discounts practiced in the market for papers tied to the Selic rate (Treasury Financing Bills – LFT) registered upward movement from 1.1% per year on average at the start of July to 1.8% per year in August.

From June to August 2002, approximately 15.6% of the papers placed with the primary market were referenced to preset rates, 74.6% to postset rates (LFT and National Treasury Notes – Series C – NTN-C) and 9.7% were indexed to the dollar (National Treasury Notes – Series D – NTN-D).

In the light of the restrictions imposed as of May 2002 by the Fiscal Responsibility Law (LRF) on Banco Central issues of public securities, it became imperative to create new instruments that would make it possible to implement monetary and exchange policy in a framework of autonomy and transparency.

It is in this framework that the measures taken by the Monetary Authority in the derivatives market should be viewed. These operations involved the offer of exchange swap contracts and intensification of secondary market operations through public security purchase/exchange transactions, as well as sale of National Treasury papers belonging to the Banco Central portfolio.

In the June-August quarter, Banco Central carried out auctions involving exchange of postset securities with maturity in 2003 and 2004 for papers scheduled to mature in 2002. These operations reflected Banco Central's commitment to reduce the market's exposure to security price volatility by offering papers compatible with the new rules that allow marking according to the interest curve for papers with maturities of up to

Exchange swap contract auctions

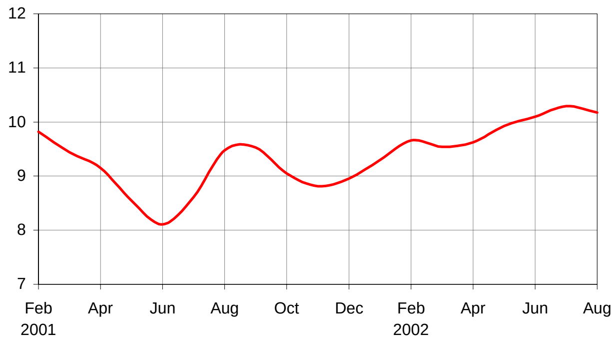
US$ million

Date of auction	Term	Lowest rate (%)	Highest rate (%)	Volume[1/]
June	2002	9.88	13.00	1 255
	2003	6.70	15.15	2 555
	2004	9.67	17.83	-2 616
	2005	13.66	14.99	1 087
	2007	15.69	21.13	909
	2008	15.79	-	76
July	2002	13.05	19.99	4 047
	2003	15.01	20.50	-1 634
	2004	17.90	19.91	- 605
	2007	20.99	-	87
August	2002	25.00	42.96	3 238
	2003	26.30	32.63	- 237

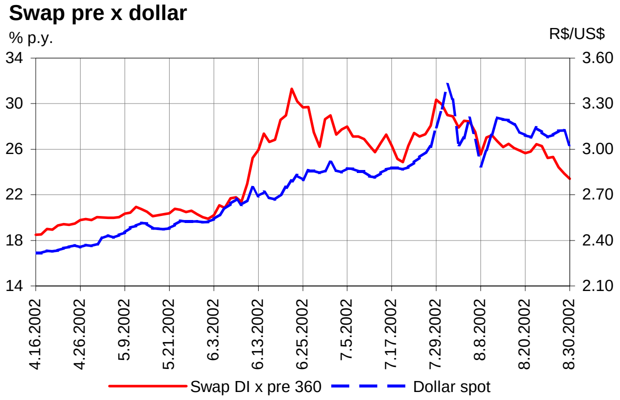
1/ Positive values: Banco Central pays exchange rate variation and receives DI rate; negative values: Banco Central pays DI rate and receives exchange rate variation.

Real interest rate deflated by IPCA

% accumulated in 12 months



Swap pre x dollar



365 days. Other operations were carried out with the same objective in mind and were targeted at exchanges of exchange securities (NTN-D and Banco Central Notes – Special Series – NBCE) for LFT conjugated with exchange swaps.

Exchange swap auctions with maturities distributed from 2002 to 2008 were used to roll papers indexed to the dollar, at rates that mirrored the exchange coupon rate of up to 43% per year.

Real interest rates and market expectations

The Selic rate accumulated over twelve months and deflated by the IPCA closed August at 10.2% per year, for growth of 2.1 p.p. since June of the previous year. The major determinant underlying this increase was the rise in the Selic rate as of the first half of 2001.

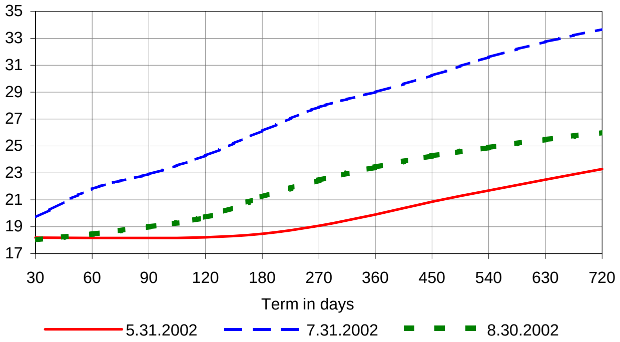
Market uncertainties increased in the last three months as a result of such internal factors as the upcoming elections and, externally, increased investor aversion to risk which, to some extent, is a reflection of the accounting frauds found to exist among a number of American and European corporations, as well as the ongoing downslide of the United States stock market.

Added pressures were exerted on futures market exchange and interest rates by the rising Brazil risk and a shortage of the external credit lines needed to finance exports and roll company debts denominated in foreign currency. At the end of July, the rate of exchange of the dollar came to R$3.43 and the 1 year DI swap rate x pre to 30% per year.

In August, the dollar rate turned downward. Initially this was caused by market reaction in the face of the inordinately high exchange rate level and, later, by the new agreement formalized with the IMF. The volatility of asset prices began to settle back and produced important impacts on the Brazil risk and exchange and interest rates on the futures market. At the end of August, the dollar was quoted at R$3.00 and futures interest rates for one year were negotiated at 23.4% per year.

Yield curve - swap pre

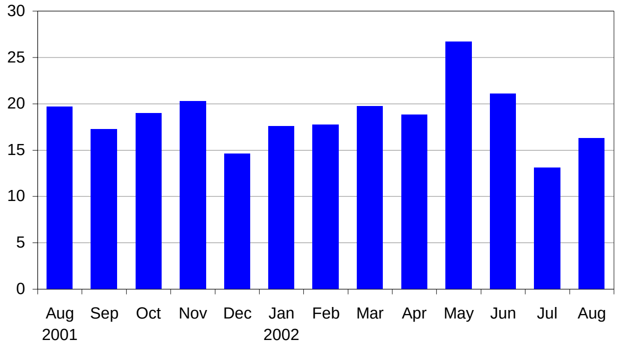
% p.y.



At the end of the month of August, the interest curve, defined by DI swap x pre reference rates indicated a decline in relation to the previous month as rates on contracts with terms of 360 and 720 days dropped by 5.6 p.p. and 7.7 p.p., respectively. However, the curve is still higher than at the end of May, particularly for contracts with terms of more than 120 days.

One day DI - average negotiated volume

R$ billion

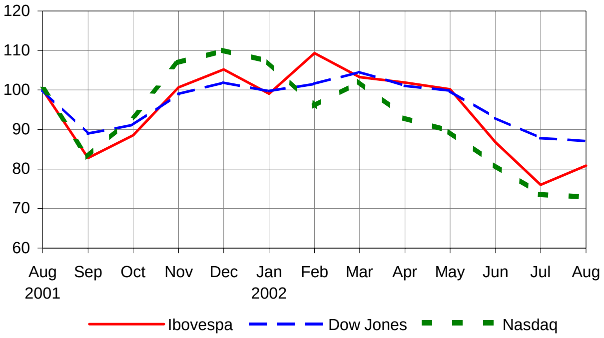


The average daily volume negotiated in one day DI futures in August came to a level of R$16 billion, after having reached a May plateau of R$26.7 billion. Among the factors that contributed to the reduction in the daily turnover, one should cite the lesser number of days available as of June for negotiations with maturities in the current year, as well as the high level of volatility that marked the month of July.

Capital market

Stock exchange

2001, August = 100

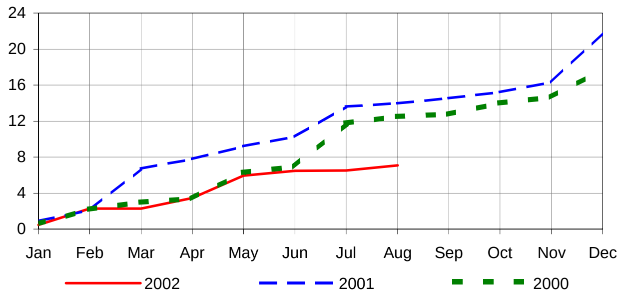


The outlook for lackluster growth in the American economy after the second quarter and ongoing revisions in the accounting results of a number of large corporations shifting from once heralded gains to significant losses clearly jeopardized United States stock exchanges and produced a ripple effect that tended to push exchanges across the world downward.

Risk aversion among international investors reduced the flow of capital to emerging countries and heightened interest and exchange market volatility. In Brazil, the São Paulo Stock Exchange (Bovespa) registered foreign capital outflows since May of this year through to the beginning of September when the results showed net inflows.

Primary issues - Stocks, corporate bonds and commercial papers

R$ billion - accumulated in the year



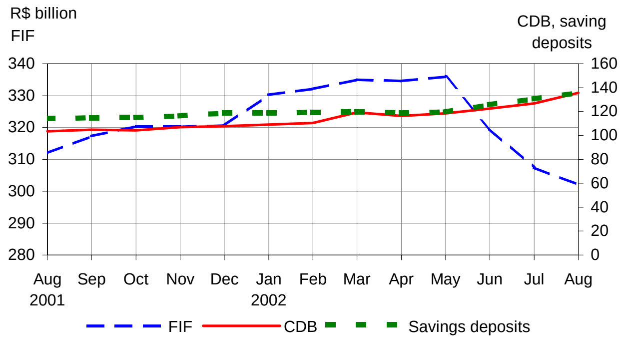
Source: CVM

In the last three months, exchanges have registered strong downturns, as the São Paulo Stock Exchange Index (Ibovespa), as well as the National Association of Securities Dealers Automated (Nasdaq) and Dow Jones indices, surpassed the lower limit registered in the wake of the September 2001 terrorist attacks. Though August turned in a positive result, the Ibovespa still closed with a reduction of 19.3% when compared to May, closing the month with 10,382 points. In that period, the Nasdaq and Dow Jones indices dropped by 18.6% and 12.7% in that order.

The negative Ibovespa performance and excessive market volatility made it very difficult to obtain funding through stock issues. In the last three months, companies registered R$1.2 billion in issues of stocks, debentures and promissory notes. This figure corresponds to approximately 50% of the volume obtained in the same period of 2001 and just 32% of that registered in the previous quarter.

Financial investments

Portfolio evolution of time deposits, FIF and savings deposits

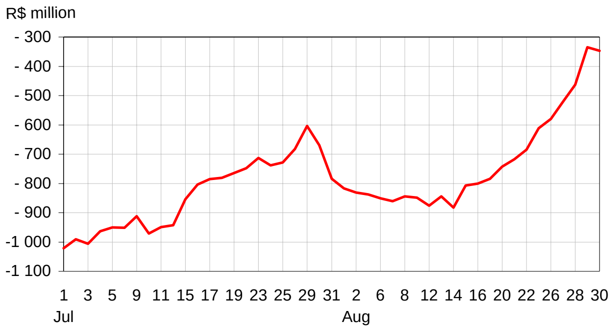


Growth in the balances of the major financial investments in the June-August quarter indicate an atypical migration among these assets, particularly in June and July. In this context, one should highlight growth of R$15.9 billion and R$17.4 billion, respectively, in the stocks of savings accounts and time deposits, which closed with balances of R$135.5 billion and R$135.7 billion, while the stocks of Financial Investment Funds (FIF) registered equity of

R$302 billion in August, corresponding to a loss of R$32.5 billion in relation to May 2002.

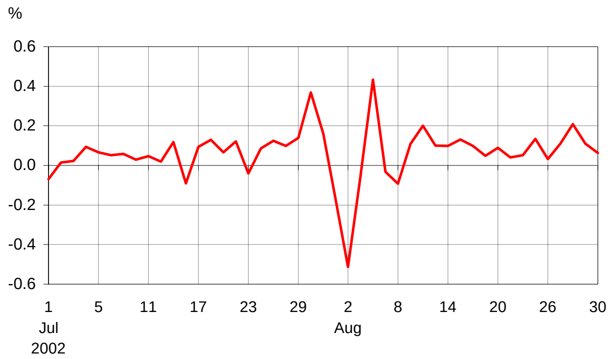
The net worth of Stock Funds closed at R$23.8 billion in August, reflecting a loss of R$2.3 billion in the quarter. Basically, this is explained by stock market volatility and investor preference for lesser risk investments.

FIF - Daily net inflow
Moving average 21 working days



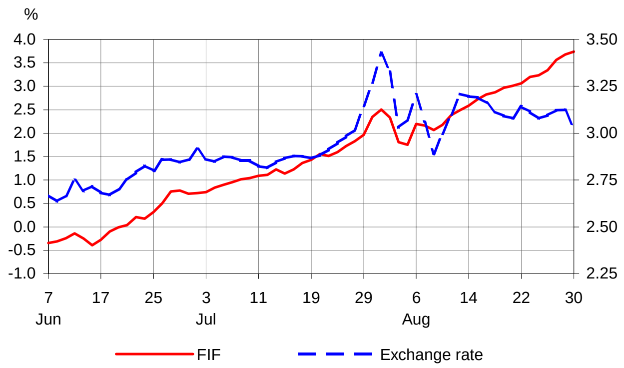
On 8.14.2002, the Securities and Exchange Commission (CVM) issued Instruction 375 with the aim of reducing volatility and the volume of investment redemptions. This norm allowed FIF, investment funds that operate with financial investment fund quotas and investment funds abroad to register papers with maturities up to 365 days according to the paper's interest curve, in the cases of securities acquired as of issue of this Instruction. The terms of this Instruction may also be applied to already existent papers, provided that they be maintained through to maturity and the fund's financial capacity is duly corroborated.

FIF daily earnings



The impacts of this measure were clearly felt during the month of August, as the volume of redemptions gradually diminished. That month ended with a loss of R$5.4 billion in relation to July, which had ended with a decline of R$12.2 billion. It should be noted that the attractiveness of other financial investments compared to FIF losses was not caused by a pursuit of greater profitability, but rather by the volatility of the securities market.

FIF earnings and exchange rate



As of the second half of August, the daily profitability of the FIF became less volatile, with an asymptotic tendency to positive values.

Over the course of the quarter, earnings on FIF rose sharply in June and July by respective rates

Growth of the fund industry and marking-to-market

In the wake of the introduction of the Real Plan, important changes occurred in the national financial market, including development of the investment fund industry. Financial Investment Funds (FIF) with short-term 30, 60 and 90 days portfolios were created in August 1995. These funds replaced the former Financial Application Funds (FAF), Fixed Income Funds (FRF), Short-Term Fixed Income Funds (FRF-CP) and commodity funds.

Despite the fact that the former funds were important as investments and as instruments for protecting small scale savers in periods of high inflation, there was truly very little difference from one to the other as practically all were concentrated in short-term investments. Aside from this, investors had very little access to information on investment policy and investment management decisions.

In terms of the rules covering investment of the assets of these funds, the FIF represented an important step forward in terms of deregulation and enhanced flexibility. Consequently, these funds have been marked by enhanced competitiveness and portfolio diversification and are even permitted to channel resources into the derivatives market. Aside from these factors, creation of the FIF also had the objective of lengthening investment periods by penalizing systems based on daily earnings. This was done by creating a noninterest-bearing mechanism of compulsory deposits based on a system of proportionality between earnings and maturity terms.

In August 1999, the investment fund industry entered a new phase of activity, in which quotas could be redeemed at any time whatsoever with earnings. This step eliminated the compulsory deposit on FIF and, consequently, did away with the division into varied maturity terms. The possibility of daily liquidity, with profitability since day one, led the market to offer three options for redemption with earnings: no grace period, an initial grace period and a grace period tied to the anniversary of the deposit. Parallel to this, the regressive IOF on investments of up to thirty days was instituted for the purpose of discouraging very short-term investments.

With daily liquidity and portfolio diversification, these funds soon came to reflect the fluctuations that marked the economy’s interest rates, to the extent in which the assets of these funds tended to shift to progressively longer maturity terms.

Since creation of the FIF, Banco Central do Brasil has demanded that funds evaluate their assets according to market prices. On February 15, 2002, the institution issued Circular

3,086, clearly defining the methodology to be used in pricing fund assets. The same instrument gave the funds a period of up to September 30, 2002 to adjust their operations to the requirements it had set down. The final term was later altered to May 31, 2002 in order to avoid the possibility of potential redemptions by better informed investors generating losses to investors at the retail level. At the same time, several funds had already adjusted their operations to the new requirements as regards evaluation of their assets. As a result, they were losing net resources due to erroneous comparisons of their profitability with that of the funds that had not yet adjusted to the new demands.

The process of marking-to-market required by Banco Central and the Securities and Exchange Commission (CVM) as of the end of May 2002, according to the terms of Instruction 365, is based on the idea that, if a reduction in the value of investment fund quotas occurs as a result of an unfavorable economic scenario, this decline must be incorporated into accounting so as to avoid distortions in the prices of the assets that constitute fund portfolios. With this, investors are assured of more transparent information and greater investment security since the prices practiced by those responsible for fund management must faithfully reflect market reality.

On 8.14.2002, the CVM issued Instruction 375, with the aim of reducing the volatility of investment fund quotas. This instrument allows financial investment funds, funds that operate with financial investment fund quotas and investment funds abroad to register securities with maturity terms of up to 365 days according to the paper's interest rate curve. The terms of this instrument are applicable to securities acquired as of the issue date of the Instruction and to those already in portfolio provided that they be maintained to maturity and the fund demonstrate its financial capacity to do so. Longer term papers are to continue complying with the accounting rules set down in Instruction 365.

In the case of papers with maturities of up to 365 days and already in portfolio, the funds are to consider the value of these papers through the system of marking-to-market and, from that point forward, use this calculation as the new cost base. This change affects only papers with postset earnings contracted on the basis of the Selic rate or at interbank deposit rates (DI).

The fund's financial capacity to maintain the short-term papers to maturity is to be corroborated through a cash flow projection elaborated according to liquidity needs, duly considering the liabilities contracted, investor profile and the fund's record of investments and redemptions.

Considering potential growth in fund demand for short-term papers, Banco Central will use the auction system to make a gradual offer of exchange of papers with terms of more than 365 days for shorter term securities.

At the same time, Banco Central issued Circular 3,144 defining additional compulsory reserves on demand deposits (3%), time deposits (3%) and savings accounts (5%), effective as of August 12. Compliance with the additional reserve requirement is to be made in cash at the initial value of approximately R$11 billion, with earnings at the Selic rate. Banco Central will utilize these resources to repurchase longer term papers from the funds and, in this way, increase secondary market demand with the objective of reducing the discount practiced in operations with longer term papers.

In practical terms, the more flexible marking-to-market approach taken to short-term papers will lead to the gradual formation of a new system of investment fund industry segregation: those specialized in short-term papers, with lesser volatility (risk) but lower estimated returns, and funds targeted to longer term papers that, though more volatile, do offer higher earnings to investors.

Analysis of the consolidation of financial investment flows indicates that withdrawals against FIF in the period from May 31 to September 10, 2002, were basically reallocated into other traditional financial investments (savings accounts and time deposits), into remittances abroad or demand deposits and currency held by the public (PMPP).

FIF registered net redemptions of R$50.5 billion, while savings accounts closed with net positive inflows of R$14.6 billion and CDB with R$17.6 billion. In the period under consideration, the balance of the M1 monetary aggregate expanded by R$13.7 billion and, therefore, moved beyond seasonal standards. The increase of R$7.4 billion in the balance of demand deposits and R$6.2 billion in the PMPP balance indicates that economic agents are still in the transition stage in terms of their decisions as to the reallocation of their resources, particularly in the case of those with less access to market information. In the case of the contracted exchange flow, the financial system met market demand that, converted according to the median rate of exchange in each month, represents an outflow of R$12.1 billion.

Financial savings

Accumulated net inflow in the month

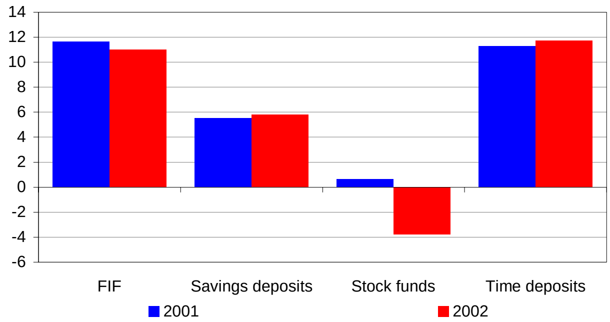
R$ million

Period	Domestic savings			Overnight deposits		Currency held by the public		External flow	Others
	Investment funds (FIF)	Savings accounts	Time deposits (CDB)	Balance	Average	Balance	Average	Foreign exchange operations[1/]	
2002 May (31)	-1 797	75	3 675	- 928	15	293	- 8	- 426	892
Jun	-21 181	5 293	2 834	4 560	3 682	1 328	1 016	4 256	-2 910
Jul	-17 526	4 121	2 102	2 503	2 503	628	1 174	4 130	-4 041
Aug	-9 039	3 962	7 886	- 17	1 267	1 350	1 208	5 464	9 606
Sep (untill 10)	- 956	1 153	1 054	1 303	935	2 638	1 644	-1 292	3 900
Accumulated in the period	**-50 498**	**14 605**	**17 551**	**7 421**	**8 402**	**6 237**	**5 034**	**12 131**	**7 447**

1/ Flow in the foreign exchange operation market position, converted into reals based on the average exchange rate in the period.

of 1.49% and 1.73%, basically as a result of upward movement in the value of exchange funds. In August, however, the growing distance between the profitability of FIF and the upward movement in the rate of exchange indicated greater influence generated by the upward movement in the value of the funds referenced in DI.

Financial investments earnings
% accumulated until August



Comparing the accumulated profitability of investments up to August, time deposits registered the highest levels, with average earnings in the range of 11.7%, followed by FIF, with 11%. Savings accounts with anniversary on the first day of the month earned 5.8%, while stock funds produced negative profitability of 3.8%.

3.3 – Fiscal policy

Public sector borrowing requirements (PSBR)

The consolidated public sector registered a primary surplus of R$4 billion in July, raising the accumulated surplus for the year to R$32.9 billion, or 4.54% of GDP, compared to R$33.1 billion, or 4.99% of GDP, in the first seven months of 2001. For the month of September, the target for the surplus as specified in the IMF agreement totals R$41 billion, indicating the need for an average surplus of R$4 billion in August and September. These results should be facilitated by growth in federal revenues generated by waivers of judicial suits based on the terms of Provisional Measure 38/2002. In August, these waivers generated R$1.1 billion for the Treasury.

Comparing the first seven months of the year with the same period of the preceding year, the central government (Federal Government, Banco Central do Brasil and the National Social Security Institute) and the states turned in improvements in their accounts. The municipalities (including their companies) and, principally, federal government companies registered deterioration in their results. Companies belonging to state governments maintained their performance level.

In the case of the central government, the primary surplus moved from R$20.7 billion (3.12% of GDP) to R$22.9 billion (3.19% of GDP). For the most part, this result is derived from growth of 15.8% in total revenues, which came to R$178.2 billion, and 16.5% in spending (including transfers to states and municipalities), which closed with a total of R$155.9 billion.

Basically, National Treasury revenues were impacted by inflows of extraordinary revenues and an increase in the rates of the Provisional Contribution on Financial Operations or Transmission of Valuables and Credits and Rights of a Financial Nature (CPMF). In this context, the following deserve mention:

a) payment of tax arrears by pension funds (R$7.4 billion);
b) taxation of exchanges involving Petróleo Brasileiro S.A. (Petrobras) public securities (R$1.1 billion);
c) waiver of judicial suits and consequent payment of tax arrears (Corporate Income Tax - IRPJ, Social Contribution on Net Profits - CSLL, Social Contribution for Social Security Financing - Cofins and PIS), based on the terms of Provisional Measure 38/2002 (R$1.1 billion);
d) gains resulting from increases in the CPMF rate from 0.30% to 0.38%, as of 3.19.2001 (R$1.9 billion).

With respect to Treasury outlays, transfers to the states and municipalities closed at R$32.1 billion, with nominal growth of 20.8%, and disbursements on personnel and social charges added up to R$41.6 billion, with expansion of 12.9%. The results registered under transfers are explained by the 34.7% increase in the income tax inflow in the period. It is important to note that 44% of this inflow is incorporated into the volume of transfers to the states and municipalities. Aside from this, the Social Security deficit expanded by 0.3% of GDP. Outlays on social security benefits increased by R$6.3 billion in relation to the January-July 2001 figure, which came to R$39.2 billion, for growth of 0.4 p.p. of GDP. In the period, the average value of the benefits paid increased by 11.8% while the quantity of benefits rose by 3.32%.

With regard to state governments, the surplus accumulated up to July 2002 came to R$6 billion or 0.84% of GDP when compared to

R$5.3 billion or 0.79% of GDP in 2001. This result was driven by the increase in federal revenues and, to some extent, offset the rather weak growth in state taxes, principally in the case of the Tax on Operations involving the Circulation of Merchandise and the Rendering of Interstate and Intermunicipal Transportation Services (ICMS). As far as expenditures are concerned, it is important to note that government spending has been brought under control. This conclusion is significant, particularly when one considers that it is an election year.

Federal government companies registered a less favorable result, closing with a deficit of R$156 million (0.04% of GDP), compared to a surplus of R$2.2 billion or 0.33% of GDP from January to July 2001. This result demonstrates the weak first quarter performance, when fuel price reductions and larger investments had a negative impact on Petrobras accounts. Consequently, state companies turned in a deficit of R$4.8 billion in the period, compared to a surplus of R$2.1 billion in the first quarter of 2001. On the other hand, evident improvement was achieved in the April to July period, as the surplus closed at a level of R$4.6 billion, compared to R$140 million in 2001.

With respect to the primary surplus, these figures lead to the conclusion that continuity of the performance achieved by the central government and states and maintenance of the results attained by government companies at the level of recent months will make it possible to achieve a primary result consistent with the target agreed upon with the IMF which is R$50.3 billion for the year or an average of R$3.5 billion over the next five months. One positive contribution to this result will be the inflow of tax arrears resulting from waivers of judicial suits under the terms of Provisional Measure 38/2002.

In the first seven months of the year, appropriation of nominal interest came to R$51.5 billion or 7.12% of GDP compared to R$47.3 billion or 7.09% of GDP in the previous year. Of this total, R$20.1 billion or 2.85% of GDP were appropriated by the Central Government, R$22.9 billion, or 3.12% of GDP, by state and municipal governments, and R$8.5 billion, or 1.15% of GDP, by government companies. In the corresponding period of 2001, interest appropriations as a percentage of GDP came to 3.59%, 2.9% and 0.6%, in the same order.

Basically, the increase in interest appropriated by regional governments and state companies resulted from 47.8% exchange depreciation in the January-July 2002 period, compared to 24.4% in the same period of 2001. This indexing factor is used to adjust the external debts negotiated by the various states (MF-30 Notification, Brazil Investment Bonds – BIB, Paris Club, Sanitation Sector Modernization Program – PMSS). Interest appropriated on state and municipal renegotiations remained at the same level, to the extent that growth in the IGP-DI, which is the indexing factor used to adjust this item, did not change significantly in the period.

In the nominal concept, PSBR totaled R$18.6 billion, or 2.58% of GDP, in the period from January to July 2002, compared to R$14.2 billion or 2.1% of GDP, in the same period of 2001. Given the lesser volume of interest appropriations, the Central Government registered a surplus of 0.34% of GDP, while the increase in the nominal deficit of state companies resulted from a worsening of the primary result and an increase in interest appropriations.

Federal securities debt

Evaluated in terms of its portfolio position, the federal securities debt increased from R$633.3 billion in April to R$674.4 billion in July, despite net redemptions of R$44.8 billion in the period. The major underlying cause of this result was depreciation of the real against the dollar.

The share of the federal securities debt indexed to the rate of exchange increased from R$175.8 billion in April to R$192.2 billion in July, despite net redemptions of R$52.5 billion. In the period, the participation of exchange securities in the total federal securities debt increased from 27.8% to 28.5%, while the participation of the preset debt moved from 9.8% to 7.7% and that referenced to the Selic rate increased from 51.2% to 53%.

Exchange swap operations, which had come to an April total of R$6.9 billion, closed July at R$57.7 billion. The result of these operations, which is defined as the difference between the profitability of DI and exchange variation, represented a loss to Banco Central of R$1.9 billion, on an accrual basis, and R$2.5 billion in the cash concept.

The average duration of the federal public securities issued in public offers dropped from 10.51 months in April to 9.98 months in July. This result reflected the rise from 14.96 months to 15.17 months in the average duration of the papers issued by Banco Central and the reduction from 8.97 months to 8.67 months in the duration of securities issued in the same period by the National Treasury.

Net debt evolution

Conditioning factors

Itemization	2001 December R$ million	2001 December % GDP	2002 July R$ million	2002 July % GDP	2002 July R$ million	2002 July % GDP
Total net debt - balance	660 867	53.25	819 376	61.93	819 376	61.93
Flows	**Accumulated in the year**				**Month**	
Net debt - growth accumulated in the year	97 703	3.82	158 509	8.67	69 118	4.03
Conditioning factors	97 703	7.87	158 509	11.98	69 116	5.23
Public sector borrowing requirements	42 788	3.45	18 616	1.41	1 243	0.10
Primary	-43 655	-3.52	-32 882	-2.49	-3 982	-0.31
Nominal interest	86 443	6.97	51 498	3.89	5 224	0.39
Exchange adjustment	37 814	3.05	135 226	10.22	67 985	5.14
Domestic securities debt indexed to exchange rate	19 182	1.55	72 193	5.46	34 317	2.60
External debt	18 633	1.50	63 033	4.76	33 668	2.54
External debt adjustment - others	- 383	-0.03	-3 408	-0.26	2 003	0.15
Acknowledge-ment of debt	18 465	1.49	10 847	0.82	-2 115	-0.16
Privatizations	- 980	-0.08	-2 773	-0.21	0	0.00
GDP Growfh effect - debt		-4.05		-3.31	0	-1.20

Net public sector debt

In July 2002, the net public sector debt came to R$819.4 billion or 61.9% of GDP, compared to R$750.3 billion or 57.9% of GDP in the previous month, and R$660.9 billion or 53.3% of GDP in December 2001. Exchange depreciation explains the debt growth that occurred in the month and in accumulated totals for the year.

As a matter of fact, while monthly growth in the net debt came to 4.03% of GDP in July, growth in the debt tied to exchange accounted for 5.14% of GDP in the same period. In much the same manner, the impact of exchange rate variations in the year is estimated at 10.22% of GDP, surpassing the growth mark of 8.67% of GDP registered by the debt in the period. Withdrawing this impact from the calculation, the debt/GDP ratio would come to 51.71% in July, reflecting a decline of 1.54 p.p. in comparison to December 2001, despite acknowledgement of approximately 0.82% of GDP.

Are there reasons to doubt the sustainability of the Brazilian public debt? – Principal results

In July, Banco Central do Brasil published a technical note[1] that analyzes the trajectory of the debt/GDP ratio in the coming months, based on the probability of a variety of premises. The result points with greatest probability to stabilization or a decline in the debt/GDP ratio and, even in an adverse context, the study concludes that, given the institutional framework developed over recent years, the country has the capacity needed to adjust its fiscal policy course and maintain the debt within sustainable boundaries.

The principal variables used to analyze debt solvency and sustainability were: GDP growth, real interest rates, real exchange rates and the level of the primary result. These are the variables that define the performance of the debt/GDP ratio over the course of time, but with differing impacts.

Based on these variables, part of the study utilizes a series of simulation exercises to evaluate the consistency of the fiscal policy adopted as of 1999 and the impact of exchange and acknowledgement of liabilities (“skeletons”) in the current debt level. In the first case, it is important to highlight that the debt in May 2002 would be equivalent to 27.8% of GDP (compared to the announced value of 56% of GDP) if fiscal policy had generated annual primary surpluses of 3.5% of GDP (less than those currently adopted) in the 1995/1998 period. Aside from this, if this policy had been adopted in a context in which interest rates were 5% lower, the debt would have come to 23% of GDP in May 2002, a fact that clearly indicates the medium-term efficiency of the fiscal policy adopted as of 1999. With regard to the effect of exchange and debt acknowledgement on the debt/GDP ratio, the exercises indicate that the debt would be 42.5% of GDP had exchange remained stable since the end of 1994 and 43.2% of GDP were the government not to have acknowledged any liabilities in the period from 1994 to 2002. These results demonstrate that current growth in the debt/GDP ratio does not represent a medium and long-term trend.

Hypotheses	Debt/GDP ratio								
	1994 Dec	1995 Dec	1996 Dec	1997 Dec	1998 Dec	1999 Dec	2000 Dec	2001 Dec	2002 May
Occurred	30.0	30.6	33.3	34.3	41.7	49.2	49.4	53.3	56.0
Hypothesis 1	30.0	26.8	25.3	20.6	20.6	25.8	24.1	26.0	27.8
Hypothesis 2	30.0	26.2	23.9	18.4	17.4	22.2	20.3	21.8	23.0
Hypothesis 3	30.0	29.6	32.3	33.0	39.7	40.8	40.1	41.6	42.5
Hypothesis 4	30.0	30.6	30.8	31.4	35.8	41.7	41.1	41.8	43.2

Hypothesis 1 considers the occurrence of primary surpluses of 3.5% of GDP between 1995 and 1998.
Hypothesis 2 considers the occurrence of primary surpluses of 3.5% of GDP between 1995 and 1998 and annual interest that is 5 p.p. lower.
Hypothesis 3 considers a constant rate of exchange at December 1994 level.
Hypothesis 4 considers that no acknowledgements of liabilities occurred.

1/ Available at the Banco Central do Brasil web site as BCB Technical Note - number 25 (http://www.bcb.gov.br/htms/public/notastecnicas/2002nt25fiscalsustainabilityi.pdf).

In the final part of the study, debt sensitivity exercises were carried out for various possible scenarios up to 2011. As a rule, higher real interest rates generally reduce the pace of decline in the debt/GDP ratio. Real GDP growth and larger primary surpluses create virtuous cycles with consistent debt reductions. Here, it is important to note the highly significant role of the impact of primary surpluses. The real exchange rate has an important role in determining the debt level but little influence on its dynamics.

The basic scenario considered for these projections utilized conservative hypotheses: (i) annual growth rate of 3.5%, less than Brazil's potential product growth, which is estimated at approximately 4.5% based on recent data on productivity and growth of the labor force; (ii) high and conservative real rate of interest of 9%; (iii) nominal but not real depreciation of the currency; (iv) stable primary surplus of 3.75% of GDP and (v) acknowledgement of "skeletons" equivalent to between 0.65% and 0.75% of GDP from 2003 and 2007. Assuming these hypotheses, the net debt follows a declining trajectory to a level of 47.9% of GDP at the end of 2011.

The exercise involving the exchange effect considered that it is not reasonable to presume a continuous real trajectory of exchange depreciation. Aside from this, the alteration in the real rate of exchange would only have a permanent impact on the debt stock if the entire exchange debt were to mature and be redeemed at the less favorable rate or, in other words, eliminating any debt rolling or refinancing of the debt through instruments not indexed to exchange. On the contrary, the fiscal loss is partially or totally reversed whenever the real rate of exchange appreciates. The effect of a gradual return of the real rate of exchange to its median level of the past fifteen years is shown in the table below, in comparison to the basic scenario. The effect is substantial: the debt/GDP ratio drops by approximately 25 percentage points in ten years.

Scenario	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Base scenario	58.88	58.27	57.54	56.77	55.94	55.07	53.42	51.69	49.86	47.95
Real median exchange (1999/2002)	58.88	55.89	52.97	52.07	51.11	50.11	48.33	46.46	44.50	42.45
Real median exchange (1988/2002)	58.88	52.14	46.64	45.57	44.45	43.27	41.30	39.25	37.10	34.85

Another exercise was based on the supposition that different primary surpluses could lead to different real interest rate trajectories, due to the inclusion of a premium related to the perception of risk in the dynamics of the debt. The combination of these conditioning factors has important impacts for the dynamics of the debt. Combining primary surpluses (0% or 5%) with real interest rates (10.5% or 7.5%), we come to the result shown below. In the analysis horizon, a reduction of 1.5 percentage points in interest rates is reflected in a debt/GDP ratio that is ten percentage points lower than that generated in a scenario in which the higher primary surplus does not lead to lower rates of interest.

Scenario	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Base scenario	58.88	58.27	57.54	56.77	55.94	55.07	53.42	51.69	49.86	47.95
Real interest of 7.5%; Primary 5%	58.88	56.52	53.99	51.33	48.54	45.61	41.80	37.82	33.66	29.32
Real interest of 10.5%; Primary 0%	58.88	62.68	66.60	70.74	75.11	79.74	83.92	88.35	93.04	98.02

In terms of GDP growth and the real rate of interest, it was evident that there is a greater decline in the debt/GDP ratio in the combination of lesser interest and higher growth. In the opposite case, the debt/GDP ratio remains relatively stable, presuming GDP growth of 2.4%, with expansion up to 2007 and a drop as of 2008 when, in this hypothesis, there will be no more acknowledgements of liabilities.

Scenario	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Base scenario	58.88	58.27	57.54	56.77	55.94	55.07	53.42	51.69	49.86	47.95
Real interest 7.5%; Potential growth 4.5%	58.88	57.23	55.44	53.57	51.61	49.57	46.75	43.83	40.81	37.69
Real interest 10.5%; Growth 2.4%	58.88	59.39	59.86	60.37	60.93	61.55	61.45	61.36	61.28	61.22

The debt sensitivity exercises showed that, even in some of the more unfavorable scenarios, the debt/GDP trajectory is stable. However, it is always possible to construct a negative (stress) scenario with unfavorable performances under the major variables. In this sense, a scenario was constructed up to 2011 in which the rate of GDP growth is low (1.5%) and the real rate of interest exceeds 11%. In this case, the debt/GDP ratio would follow an upward trajectory from 60% in 2002 to 81% of GDP in 2011. A primary surplus of 3.75% of GDP would not be sufficient to ensure the sustainability of the debt/GDP ratio.

Scenario	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Stress scenario	60.26	62.08	63.95	66.00	67.84	69.90	72.44	75.28	78.43	80.87
Base scenario	58.88	58.27	57.54	56.77	55.94	55.07	53.42	51.69	49.86	47.95

What is important is to evaluate the probability of this sequence of unfavorable events persisting during an entire decade. In the first place, real interest rates over the 11% level are patently improbable when one observes the pattern of rates below this level as of 1999, even considering that this was a period of high interest rates. Insofar as the rate of exchange is concerned, there is little reason to expect a rise in real terms. With respect to growth, it is quite probable that an upturn in world economic expansion and financial market stabilization will reduce external restrictions with positive impacts on the nation's growth. Aside from this, the start of a new government administration would tend to diminish political risk with evident benefits for investment and consumption decisions, particularly involving consumer durables.

Consequently, there is very little probability of any one of the worst case scenarios coming about. Furthermore, if such were to occur, reasonable course corrections in future fiscal efforts are feasible. This level of comfort is rooted in recent institutional progress in the fiscal system in Brazil, particularly the Fiscal Responsibility Law (LRF) and agreements formalized with the states and municipalities.

Thus, the recent rise in the debt is an exclusive result of real exchange rate depreciation which, in terms of the dynamics of the debt, has an impact that is different from the debt growth generated by high real interest, an insufficient primary surplus and modest GDP growth. In the first case, while it is not reasonable to presume recurrent exchange depreciation, in the second, mistaken policies can generate a vicious circle, placing the debt on a trajectory that is not sustainable.

However, debt simulation exercises have demonstrated that even in several of the less favorable scenarios the debt follows a sustainable trajectory. Furthermore, these exercises show that the level of the primary surplus is the determining variable for debt sustainability and that surpluses of 3.75% of GDP only generate unstable dynamics in the case of recurrent real deprecations and a highly unfavorable scenario. Though these hypotheses are remote, even in this case, the institutional framework created in recent years makes it possible to adjust fiscal policy in such a way as to maintain the dynamics of the debt on a sustainable trajectory.

At the same time, due to the impact of exchange devaluation, the gross general government debt, which encompasses federal, state and municipal governments, closed at R$1.1 trillion in July or 82.9 of GDP compared to R$885.9 billion or 71.4% of GDP in December 2001.

3.4 – Conclusion

In the June-August quarter, credit operations followed the moderate growth trajectory that has characterized the year, reflecting the uncertainties that have prevailed on the economic scenario. While demand was impacted by rising interest rates, particularly in longer term operations which tend to accompany financial market fluctuations, and by more restrictive credit lines, the supply of credit was marked by a highly conservative stance adopted by financial institutions as they become far selective and sharply more restrictive in their operations. Thus, growth in the credit stock resulted mostly from the effects of exchange depreciation on operations contracted in foreign currency.

However, in this scenario of a restricted credit market, longer term investments benefited from steady growth in BNDES disbursements to infrastructure projects. At the same time, mention should be made of the effects of releases of FGTS resources, which aided in reducing demand for banking credits as a result of the expanded income provided to the families involved.

Fiscal policy has been decisive to preservation of macroeconomic stability. In this sense, the increase in the 2002 primary surplus target from 3.75% of GDP to 3.88% of GDP, representing approximately R$1.7 billion, could benefit the perception of country risk, with positive impacts on internal interest rates and renewed sustainable growth. It is worth emphasizing that public accounts have been adjusted at the three levels of government and been further strengthened by the Fiscal Responsibility Law and debt renegotiation. Taken together, these elements are expected to guaranty continued compliance with fiscal targets.

With regard to the net public sector debt, the increase that occurred during the course of 2002 is an exclusive consequence of real exchange depreciation. Thus, reduction in the debt/GDP ratio is expected to occur if the rate of exchange begins reversing course.

4 – International economy

Introduction

The dominant economic cycles in the world's three major regions – slowdown in the United States economy, a sluggish pace of activity in the Euro zone countries and the Japanese depression – have occurred almost simultaneously and could well mean that international economic recovery will be even slower than initially imagined. Parallel to this, the threat of an American attack on Iraq has deepened the uncertainty surrounding the future trajectory of oil prices.

In the wake of a stock market upturn, particularly in the United States, relations among the world's three major currencies changed slightly in August and, to some extent, aided in recouping the value of the dollar against the yen and euro. However, there are some doubts regarding the sustainability of this recovery, since the dollar is still overvalued in relation to the historic median. At the same time, the strong second quarter downturn in the American economy will certainly dampen expectations of profit, in an environment already disconcerted by denunciations of accounting frauds at several major American corporations. Finally, the United States current transactions deficit remains quite large, particularly as a result of the growing fiscal deficit.

In Latin America, the long and ongoing negotiating process between the Argentine government and the IMF has not yet made it possible to envisage a solution to that country's moratorium. On the other hand, the support provided by the American Treasury and renewed Stand-by Agreements with Uruguay, Paraguay and Brazil allayed tensions in the region, albeit not to the extent needed to fully regain the confidence of international financial markets. Increased global aversion to risk was reflected in rapidly deteriorating conditions in private financing operations with emerging markets, making it quite difficult for such countries – including Brazil – to roll their trade credit lines in their entirety.

In the case of the emerging Asian economies, projections point to product growth above the world average despite a somewhat slower pace of economic activity. In more specific terms, the region's steadily growing internal demand and rising external demand have converged to sustain a more vigorous growth trajectory, in contrast to the downturn that has marked much of the rest of the world.

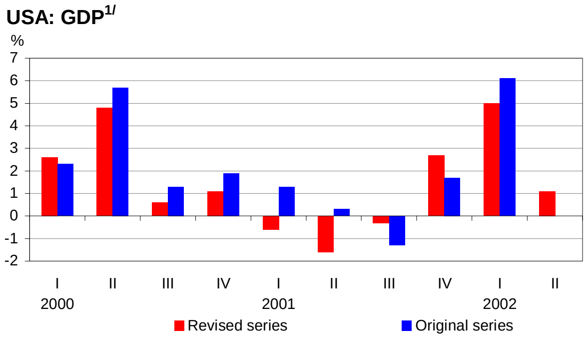
4.1 – United States

Analysis of the GDP statistical series eliminated any lingering doubts regarding last year's recession in the United States. Parallel to this, preliminary data indicate that the American economy decelerated sharply in the second quarter of the current year. This performance kindled growing fears of a double-dip recession and further worsened both business and consumer expectations.

More recent data demonstrate that consumer demand has continued expanding, albeit at a rather languid pace. It is important to note that this growth has been driven by factors of an exceptional nature, such as no-interest financing on automotive sales. Real estate prices remained high, though there is a risk that the price spiral may in fact reflect a portfolio shift from risk assets to real assets, a process considered characteristic of periods of heightened economic incertitude.

Both stock exchanges and the dollar turned upward in August, somewhat offsetting the strong reductions registered earlier in the year. With this performance, stock prices and the effective value of the dollar closed well above historical levels. On the other hand, it is still much too early to grasp the full extent and depth of the negative impact on investment and financing decisions generated by the sudden jolt to society's confidence in large American corporations. In this context, the enormous United States current account deficit has given rise to growing concerns. It is important to note that any attempt to reverse this trajectory in an abrupt and uncoordinated manner would only trigger even more intense pressures on the dollar.

Though economic and financial indicators have been transmitting somewhat conflicting signals, there is a growing perception among investors and analysts that there is little probability that the American economy will be able to repeat the high economic growth and productivity rates that marked the 1990s.



Source: Bureau of Labor Statistics
1/ Seasonally adjusted annual rates.

According to revised GDP data issued by the Bureau of Economic Analysis (BEA) for the 1999-2001 period, American economic growth was considerably weaker than expected in most of 2000 and the first half of 2001. Proof of this is that the first three quarters of 2001 turned in negative annualized rates of -0.6%, -1.6% and -0.3%, respectively. In contrast to this performance, only the third quarter closed with a negative result. At the same time, growth in the first quarter of 2002 was revised downward from 6.1% to 5%, while preliminary data for the second quarter indicate deceleration to 1.1% as a result of increased imports and reduced consumption growth.

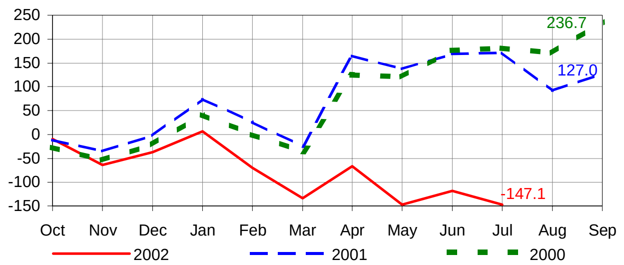
Once seasonal factors are disregarded, the pace of retail sales growth declined slightly from 1.5% in June to 1.2% in July. When automotive sales are excluded, the growth rate closed July at 0.2%.

In keeping with the previous month's performance, the number of new housing starts in July dropped by 2.7%, compared to growth of 11.2% in May. In the quarter ended in July, new housing starts increased by 1.1% when viewed against the same period of last year.

The United States budget deficit for the fiscal year ended in September grew to US$147.2 billion in July. More recent data point to a deficit of 1.5% of GDP in the current fiscal year.

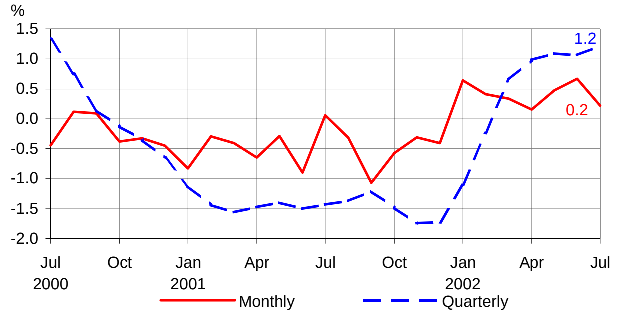
Fiscal balance in the fiscal year[1/]

US$ billion



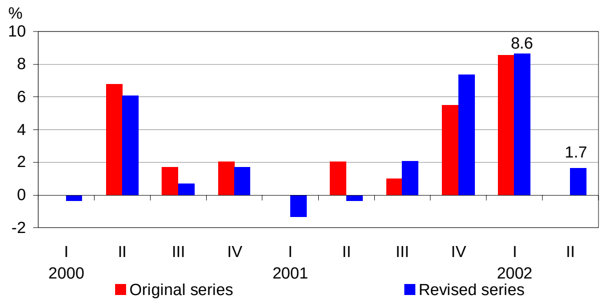
Source: Department of the Treasury
1/ Fiscal year = Oct-1 - Sep.

Industrial production[1/]



Source: Federal Reserve
1/ Seasonally adjusted data.

Productivity of the nonfarm business sector[1/]



Source: Bureau of Labor Statistics
1/ Seasonally adjusted quarterly growth in annual terms.

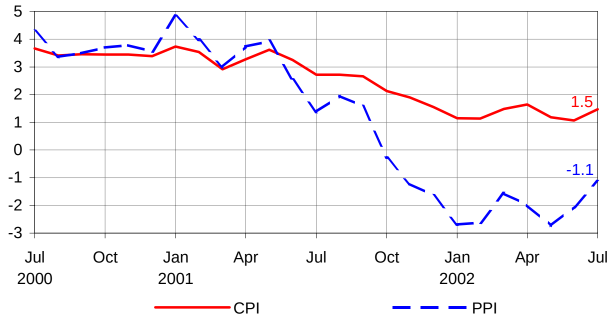
The foreign trade deficit came to US$40.8 billion in June, reflecting a 2.2% drop in the month and expansion of 15.2% in the second quarter, compared to the immediately previous period. For the most part, growth in the trade deficit was generated by a sharper increase under imports than under exports since the start of the year.

Industrial output has been expanding slowly but steadily since the beginning of 2002. In July, industrial production grew by 0.2%, mirroring some degree of deceleration when viewed against the 0.7% growth figure for June. With the steady growth registered under industrial production, utilization of output capacity has increased gradually month-by-month, reaching 75.6% in the month of July.

United States productivity gains for the 1999-2001 period were also revised downward, reflecting not only BEA's periodic GDP analyses, but also the annual Bureau of Labor Statistics (BLS) review of job market statistics. Nonfarm sector productivity dipped sharply in the second quarter of 2002, closing with expansion of 1.7% in the annualized series. Parallel to this performance, productivity of the manufacturing sector in the second quarter fell to just half of the first quarter rate. Nonetheless, when the same basis of comparison is used, the annualized 4.3% gain registered in the second quarter was the sector's best result in the past twenty years.

Labor market conditions remained practically stable in recent months. Unemployment in the nonfarm sector stabilized in July at 5.9%, registering growth of just six thousand new job opportunities in the month. The number of hours worked in the week dropped in July to the lowest level since October of last year.

Prices
12-month variation



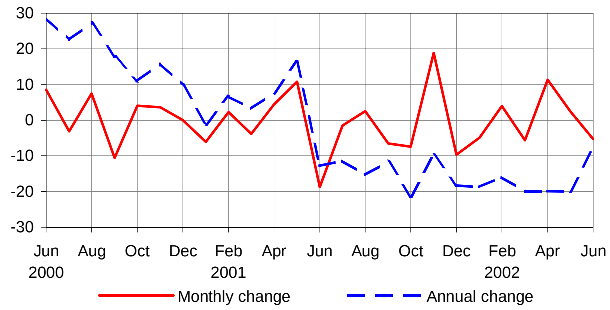
Source: Bureau of Labor Statistics

At its August 13 meeting, the Federal Reserve decided to maintain the fed fund interest rate target unchanged at 1.75% per year. The factors underlying this decision were evolution of demand, deteriorating financial market conditions, loss of confidence in major corporations and less robust productivity gains. At the same time, the Federal Reserve adopted a downward bias in light of the now evident risks of an economic decline. This interpretation reflects price stabilization at both the consumer and producer levels.

4.2 – Japan

Perceptions of Japanese economic performance in the second quarter of 2002 improved somewhat, though they still contrasted sharply with the nation's internal environment of continued deflation, despite a strongly expansionary monetary policy, private consumption that has yet to register any really consistent signs of recovery and stubbornly high unemployment. In the external sector, despite valuation of the yen, recovery in the United States and a number of East Asian nations reversed the trade balance downturn. However, the nation's economy remains strongly dependent on external demand and implementation of structural reforms, particularly in the banking sector.

Factory orders
%



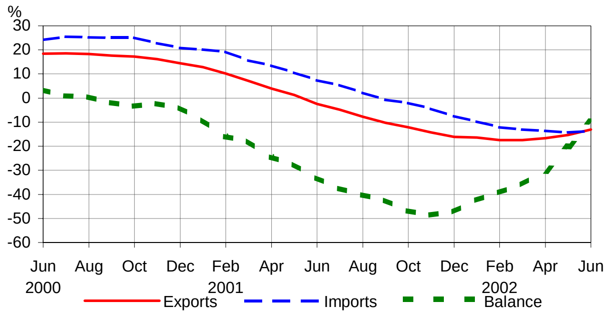
Source: Statistic Bureau and Statistic Center

Orders placed with factories have been at a standstill since June 2001, though the core index – excluding volatile orders – expanded during the entire first half of 2002. New building starts came to an average of 102.2 thousand units in the second quarter of the year, compared to 86.3 thousand in the first quarter. Private consumption flattened out as a result of ongoing deterioration of income levels and labor market uncertainties.

In the second quarter of the year, foreign sales came to US$104.9 billion, for growth of 10.4% over the previous quarter and 3.4% in

Trade balance

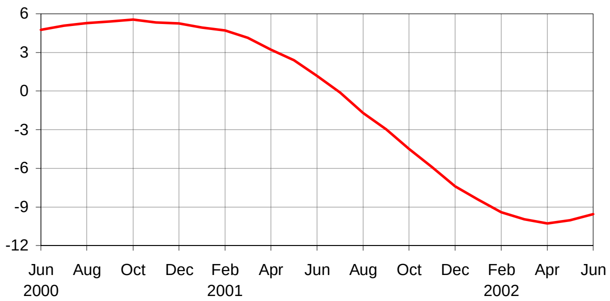
Accumulated change in 12 months



Source: Bank of Japan and Bloomberg

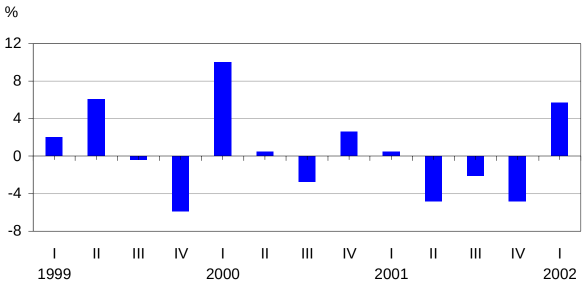
Industrial production

Accumulated change in 12 months



Source: Ministry of Economy, Trade and Industry

Gross domestic product[1/]



Source: Economic Planning Agency

1/ Growth over previous quarter seasonally adjusted, annualized.

relation to the same 2001 period. Using the same reference base, imports totaled US$82.6 billion, for growth of 7.4% and a drop of 7.1%, in the same order.

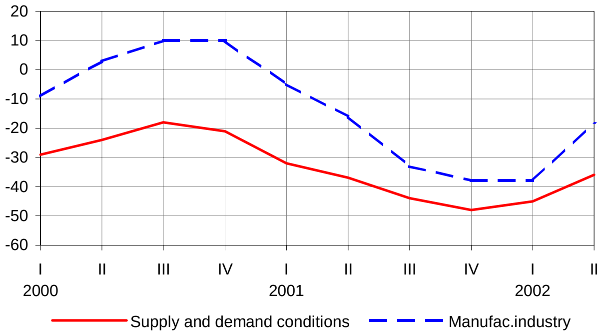
In the period from February to May, 2002, industrial output expanded and was driven mainly by external demand for capital goods. In June, the rate of unemployment came to 5.4%. This was equivalent to the May rate and very close to the postwar record of 5.5%. The increase in the number of persons unemployed reflects the ongoing process of corporate restructuring as large scale companies have laid off workers as a way of cutting costs.

In the first estimate issued by the Bank of Japan, GDP growth in the first quarter of the current year was forecast at 1.4% or 5.7% in annualized terms, following three consecutive quarters of declining figures. For the most part, growth has been powered by net exports, which accounted for more than half the positive result. In comparison to the same period of the preceding year, GDP dropped by 1.6%. Based on forecasts of insufficient growth in external demand and weak internal demand, the Central Bank of Japan revised its growth expectations for fiscal years 2002 and 2003 downward from -0.1% to -0.3% and from 1.6% to 0.8%, respectively.

For the 33rd consecutive month, the June Consumer Price Index (IPC) was subjected to deflationary pressures and closed with negative annual growth. The government's position is that this is due to weak demand, falling land prices and competition from imported goods. In much the same manner, the Wholesale Price Index (IPA) has registered negative annual growth since September 2001. In its attempt to halt this trend, the government has followed a strong expansionary monetary policy targeted at the excess liquidity represented by the Banco Central current account balance which has varied between ¥10 trillion and ¥15 trillion (US$83 billion and US$124 billion). At the same time, the institution continued purchasing a monthly total of ¥1 trillion in public securities as a way of preserving the liquidity of the banking market.

In April of this year, the government abolished the deposit insurance guaranty for savings accounts with balances of more than ¥10 million, while maintaining the unlimited guaranty for deposit accounts until April 2003. This measure generated a strong shift of resources away from savings accounts and into deposit accounts as the balance of the first heading plunged from ¥145 trillion to ¥93 trillion.

Business confidence index - Tankan



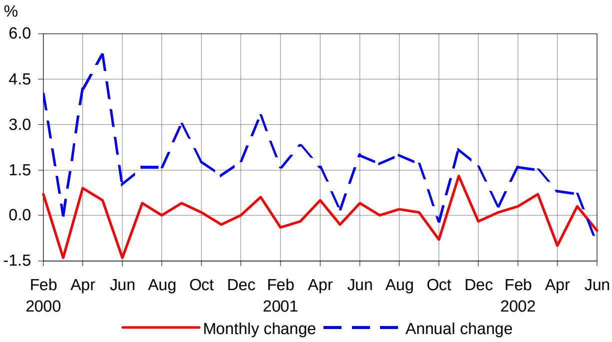
Source: Bank of Japan

Business confidence, which is measured by the Tankan index and verifies the short-term expectations of large scale industries, closed at -18 points in the second quarter of the year, as compared to -38 points in the previous period. This was the first period since the second quarter of 2000 to register positive growth. Though the same index for supply and demand conditions moved from -45 to -36, any recovery in corporate profits that may occur in the second half of the year will most probably be more a consequence of restructuring efforts and cost cutbacks than of increased sales.

4.3 – Euro Zone

Analysis of GDP and supply and demand performance indicators demonstrates that the pace of economic expansion is only slightly better than stagnation. The results of industrial output and retail sales have been weak, at the same time in which unemployment totals have been rising. Uncertainties regarding the question of American economic recovery, the insecurity generated by the risk of unemployment and deteriorating prices for variable income assets have cast a pall of pessimism over business and consumer expectations, as is evident in the major confidence indicators. In the framework of activity levels, the only truly positive sign is concentrated in the trade balance, which produced a series of high and expanding surpluses over the second quarter of the year.

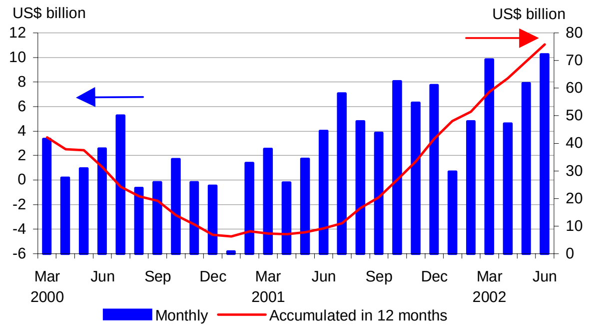
Retail sales



Source: Eurostat

Internal demand has in fact not been sufficient to sustain the growth upturn. The behavior of retail sales has varied greatly since the end of 2001, registering very low – albeit positive – rates of annual growth. In June, sales dropped by 0.9% following increases of 0.8% and 0.7% in April and May, respectively. The monthly growth figures for April, May and June closed at -1%, 0.3% and -0.5%, in that order.

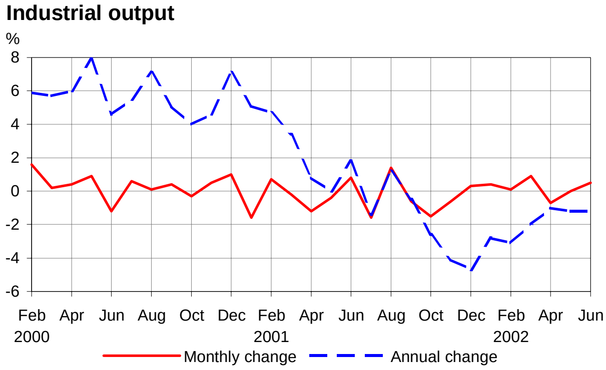
Trade balance



Source: Eurostat

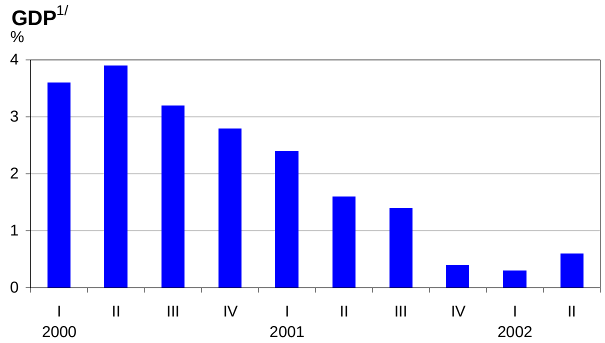
Despite the accentuated rise in the value of the euro against the dollar, trade balance surpluses continued on a strong growth curve. In the second quarter, this performance was mostly a result of increased foreign sales, which have been recovering steadily since February when they closed at the lowest level since August 2000. Imports have expanded since December, though they are still well below the level registered at the start of 2001. In May, the trade surplus came to US$7.9 billion, followed by US$10.2 billion in June. In these two periods, exports came to respective levels of US$82.6 billion and US$86.9 billion, while imports closed at US$74.7 billion and US$76.7 billion.

Industrial output



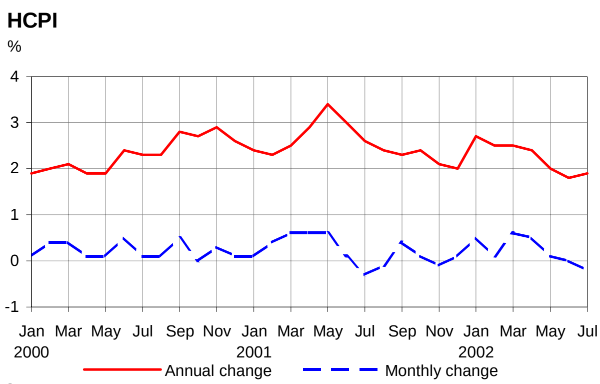
Source: Eurostat

Industrial output registered negative annual growth rates over the course of the second quarter of the year, with 1.2% declines in both May and June. In monthly terms, industrial output dropped by 0.7% in April, stabilized in May and expanded by 0.5% in June. Labor market data are also negative. Unemployment held fast at 8.3% in the period from May to July following a steady 8.2% in the first four months of the year. In comparison to the same month of the previous year, the July rate reflected increases in ten of the twelve countries of the region.



Source: Eurostat
1/ Change from corresponding quarter of preceding year.

In the second quarter, the euro zone GDP expanded by 0.6% compared to the second quarter of 2001, following a rise of 0.3% in the first quarter of the year, using the same basis of reference. A breakdown by economic sectors indicates that the largest increases were registered under financial services and other services, with respective rates of 1.6% and 1.8%, while the strongest downturns occurred under construction and industry, with 1.7% and 0.9%, in that order. Seasonally adjusted annualized GDP growth in relation to the previous quarter closed at 1.4%. Private consumption, which corresponds to 57% of GDP, increased by 0.3% in the second quarter of the year, while gross fixed capital formation corresponded to 21% of GDP and dropped by 2.9% in relation to the same quarter of 2001.

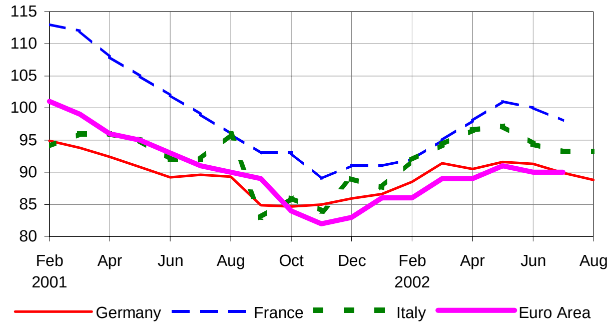


Source: Eurostat

The drop in inflation that marked the second half of the year made it possible for the European Central Bank (ECB) to maintain the basic interest rate at 3.25% per year, the level at which it has been situated since November 2001. The Harmonized Consumer Price Index (HCPI), which turned in annual results of more than 2.5% in the first quarter of the year, shifted to a new plateau, closing May, June and July at respective levels of 2%, 1.8% and 1.9%. If this process of reduced inflationary pressures witnessed in the early part of the year is confirmed, the ECB will have the leeway needed to reduce interest and avoid further cutbacks in the pace of economic activity.

The fragile process of economic recovery threatens to jeopardize the fiscal targets of several euro zone countries, since these nations are signatories of the 1997 Stability and Growth Pact which demands that annual public deficits be held consistently below the ceiling of 3% of GDP. In this sense, in the particular case of Germany, the deficit came to 3.5% of GDP in the first half of the year and may well exceed the 3% ceiling for the year, particularly as a result of the additional spending caused by recent floods in that country. France is expected to have a difficult time holding its deficit below the ceiling in 2003, especially if some new dynamics are not injected into current economic doldrums. The same thing could happen in Italy, where the government intends to reduce the tax burden next year.

Business confidence indicators



Source: IFO, Insee, Isae and European Comission

Starting in the month of May, business and consumer expectations began declining, following a positive growth process dating back to November 2001. This conclusion is based on major confidence indicators calculated for the euro zone as a whole and for each of the member countries. The index issued by the Institute of Economic Research (IFO), which verifies expectations in the German business sector, dropped from 91.6 points in May to 91.3 points and 89.9 points in the two following months, closing August at 88.8 points. In Italy, the equivalent indicator calculated by the *Instituto di Studi e Analisi Economica* (Isac) declined from 97.2 points to 93.2 points from May to July. In France, the index published by the *Institut National de la Statistique et des Études Économiques* (Insee) slipped from 101 to 98 points in the same time span. The euro zone index, which is calculated by the European Commission, registered a drop from -9 to -10. A similar performance can be noted in the case of the consumer confidence indicators calculated in those countries. Among these, that which encompasses Italian consumers turned in the strongest decline, moving from 119 to 113.3 points from May to July, while the German indicator rose from 89 to 92 in the same time period. The European Commission index dropped from -8 to -10.

4.4 – Emerging economies

4.4.1 – China

In the second quarter of 2002, GDP turned in annual growth of 8%. This figure was driven by highs of 8.6% in retail sales and 21.5% in investment flows.

July witnessed a particularly intense pace of economic activity, clearly leveraged by export growth, particularly strong sales of electric and electronic goods, coupled with rising investments, concentrated mostly in the sector responsible for building construction. This performance reflects adoption of a fiscal incentive package in early 2002. With regard to the previous month, seasonally adjusted growth in these aggregate spending components came to 5.3% and 1.9%, respectively. In comparison to the corresponding month of 2001, exports grew by 28.2% and investments by 22.9%.

Retail sales in July remained high and were sustained by outlays on foodstuffs, a segment that turned in seasonally adjusted monthly growth of 0.8%. In comparison to the same month of the previous year, sales grew by 8.6%. In July, the Consumer Price Index (CPI) closed at a negative 0.1%, reflecting lower food prices and relative stability in the segment of nonfood prices. Viewed under the prism of twelve month growth, the CPI also turned in a negative result of 0.9%.

4.4.2 – South Korea

In the second quarter of 2002, GDP registered growth of 7.8% at constant prices, when compared to the previous quarter. This figure reflected partial recovery from the 10.2% falloff that marked the first quarter of the year, compared to the final quarter of the previous year. In relation to the same quarter of 2001, real GDP expanded by 6.3%. Recovery in the pace of economic activity was mostly a consequence of more intense industrial output, which expanded by 8.1% in the second quarter of the year, when viewed against the previous period. For the most part, this process was sustained by the export sector, which turned in growth of 12.9% in the period. Using the same reference base, gross fixed capital formation rose by 12.4% and building activity increased by 25.1%.

Once seasonal factors have been eliminated, industrial output expanded by 1.9% in July, compared to the previous month, and by 8.9% when seen against the same month of 2001. With this performance, unemployment closed at 2.7% in both June and July, compared to 3.4% in July of the previous year.

In the same month, annual inflation, measured by the CPI, closed at 2.1% as against 2.6% in the month of June. Also in annual terms, producer prices rose by 0.9% and the prices of imported goods dropped by 7.2%, reflecting one of the major factors underlying downward CPI movement. The basic interest rate was defined by the South Korean Central Bank at 4.27% per year, compared to 4.35% per year in June. The reference framework used for defining this interest rate level was composed of expanding industrial output, increasingly larger investments, lesser price growth and expectations of a strengthening of the won against the dollar, a fact that would certainly attenuate demand side inflationary pressures.

Recovery in the pace of activity would seem to point to a more favorable economic performance in general. This conclusion is confirmed by the Consumer Confidence Index (CCI), which is valid for a six month horizon. The result for this index was 107.8 in July as compared to 98.4 in the corresponding month of 2001.

4.4.3 – Russia

Russian industrial output increased by 3.3% in July in relation to the previous month. The rise in the pace of industrial activity was a consequence of increased output of fuels, nonferrous metals, chemicals and petrochemicals, and machinery for industry and food production. Consequently, employment closed at 7.7%, reflecting the third consecutive month of stability at the lowest level registered in the year.

Measured by the CPI, twelve month inflation came to 15% in July, compared to 14.7% in the preceding month. To some extent, this growth reflected the upward trend under producer prices that has been evident since April. This is demonstrated by the fact that, in the April-July period, annual inflation at the producer level shifted from 6.8% to 11.4%.

With regard to the foreign trade sector, exports totaled US$8.2 billion and imports closed at US$4.8 billion in July. Continued positive monthly balances over the course of the year resulted in an accumulated surplus of US$21 billion in the first half of 2002. The accumulated twelve month surplus up to June came to US$42.4 billion or 2.5% less than the surplus accumulated up to May.

At the end of July, the nation's international reserves came to US$43.3 billion, compared to US$43.6 billion in the previous month and US$36.5 billion at the end of July 2001. The gradual increase in the reserve level has clearly contributed to the stability of the national currency at a level of 30 rubles to the dollar over the course of the year. In July, the interbank interest rate increased to 13.4% per year, compared to 6.4% per year in June and 5.2% in May, a figure that was, once again, quite close to the February result.

4.4.4 – Turkey

Parliamentary approval of the reforms required to initiate negotiations in preparation for the nation's entry into the European Union (EU), the harnessing of inflation and a solid fiscal performance were the factors underlying the recovery of confidence, particularly in light of the uncertainties of a political nature related to the upcoming November elections. Once these conditions had been met, the IMF gave its approval to the third revision of the agreement signed in February, thus making it possible to effect an additional disbursement of US$1.15 billion.

The decline in the rate of inflation has made it possible to curb overnight interest rates, which were set at 46% per year at the beginning of August. The central bank reduced the interest rate on six different occasions since the start of the year, accumulating a reduction of 13 p.p. Annual growth in the consumer price index, which had reached a level of 52.7% in April, fell to 42.6% in June, 41.3% in July and 40.2% in August, suggesting that it will be possible to comply with the 35% inflation target defined for 2002.

In the first quarter of the year, GDP expanded by 2.3% in relation to the same quarter of 2001. Using the same basis of comparison, estimates point to growth of more than 7% in the second quarter, driven mostly by the performance of industry and commerce.

Industrial output has been decelerating since March, though monthly results still reflect strong positive expansion. Following March growth of 19.2%, the annual increase dropped to 14.6% and 11% in the two following months, before dipping to 6.6% in June.

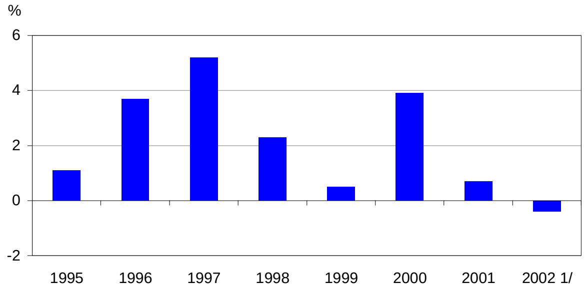
In real terms, the public debt registered a decline of 6.1% in the first seven months of the year, falling from US$84.4 billion to US$77.2 billion. This growth made it possible to achieve a primary surplus in the first six months of the year that was higher than the target of 0.4% of GDP. The target for 2002 was set at 6.5% of GDP.

The balance of trade has accumulated negative results since the month of March and closed the first half of the year with a deficit of US$5.6 billion. In June, the deficit dropped to US$1.1 billion, compared to US$1.3 billion in May, based on US$2.6 billion in exports and US$3.7 billion in imports.

4.4.5 – Latin America

Deceleration of world economic activity from 4.7% in 2000 to 2.2% in 2001 had highly adverse impacts on the performance of Latin American economies. The major consequence of this process was sluggish GDP growth in a context of declining international capital flows.

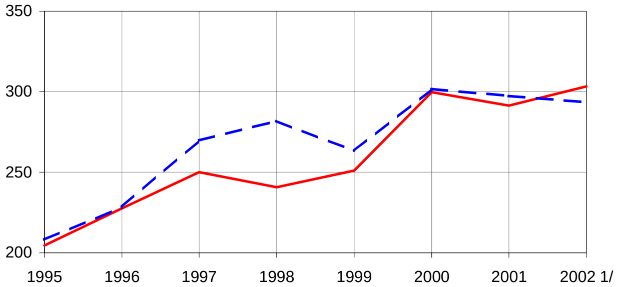
Gross domestic product



Source: ECLAC and IMF
1/ IMF forecast.

Economic growth projections for Latin America and the Caribbean in 2002 have been revised downward. The IMF forecast a regional product decline of 0.4%, following growth of 0.7% in 2001. The result was strongly impacted by the collapse of productive activity in Argentina and its regional repercussions. Aside from Argentina, output in Paraguay, Uruguay and Venezuela is also expected to decline. Mexico and Brazil, the countries of greatest relative economic clout in the region, will expand by about 1.5%, as will Colombia. In the case of Chile, growth is forecast at 2.6%. However, to a great extent, these predictions depend on events in the world's major developed economies. Most of the countries of the region have only very restricted possibilities of adopting anticyclical macroeconomic policies since they are either highly dependent on external financing or are mired in situations of serious fiscal imbalances that thwart their efforts to adopt expansionary fiscal policies.

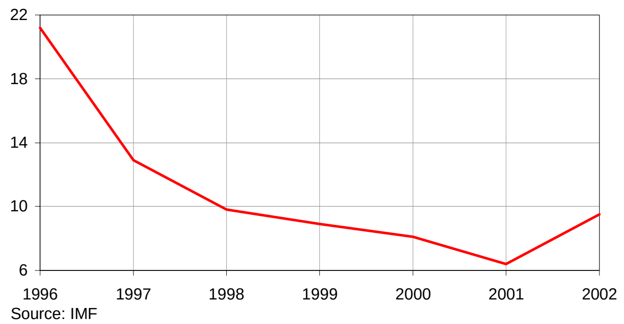
Regional trade balance
US$ billion



Source: IMF
1/ Forecast.

Despite the reduced dynamism of the international trade sector, Latin America is expected to register an overall trade balance surplus due particularly to the efforts made by a number of countries to penetrate the markets of new trading partners and to devaluation of their local currencies. According to IMF projections, the positive balance will come to US$9.9 billion, as a result of positive growth in exports of goods and cutbacks in imports. One consequence of this movement will be a reduction in the current account deficit. Export and import operations carried out by Mexico – the largest importer and exporter in Latin America – expanded in the month of July by respective rates of 8.7% and 7.9%, compared to July 2001 and closed with totals of US$14 billion and US$14.6 billion in the period.

Inflation
Annual change
%



Source: IMF

Following adoption of more flexible exchange systems, coupled with the inflation targeting mechanism, national macroeconomic policies have achieved enhanced efficiency in several countries since the latter half of the 1990s. On the other hand, internal and external difficulties did not trigger generalized price growth, as occurred in 2001 when the average rate of inflation at the consumer level moved to 6.1% in the region. For 2002, this figure is expected to increase as a result of rising prices in Argentina, Uruguay and Venezuela. The other countries of Latin America have been able to hold inflation to very moderate levels in recent years.

The crisis of corporate governance in the United States, coupled with the uncertainties that have marked Latin American economies and particularly those of the Southern Cone nations since the second quarter of the current year, has resurrected the movement that came to be known as flight to quality, one of the major characteristics of 2001. In several countries of the region, domestic political tensions converged with uncertainties regarding economic fundamentals and generated an increased perception of risk on the part of the international financial market.

The adverse international situation was further aggravated by investor concerns in the face of the Argentine imbroglio and wariness of a possible ripple effect into other countries of the region. This is precisely what happened in Paraguay and Uruguay. Brazil was also affected by the Argentine predicament and came under increasing pressures, particularly as uncertainties regarding future economic policy were heightened by increased global aversion to risk. It was precisely in light of the deteriorating internal and external economic factors that Uruguay, Paraguay and Brazil formalized new Stand-by Agreements with the IMF.

In the case of Uruguay, a deepening banking crisis resulted in a sharp downward slide in the volume of deposits from U$13.6 billion at the start of the year to U$8 billion at the end of July. Deposits by nonresidents plunged by 60% while those of residents fell by 35%, compared to the beginning of the year. The cutback in the volume of banking system deposits generated a loss of international reserves, which closed July at just U$655 million, as against U$1.47 billion at the end of June and U$3.1 billion at the end of 2001. In this scenario, the government turned to the IMF and other multilateral agencies and managed to obtain a total of U$3.9 billion. Of this total, U$2.8 originated in the IMF, U$0.3 billion in the World Bank (IBRD) and U$0.8 billion in the Interamerican Development Bank (IDB).

Paraguay was seriously jolted by the decline in trade operations with its Southern Common Market (Mercosul) partners and managed to obtain approval for a US$200 million Stand-by agreement with the IMF. With respect to Argentina's negotiations with the IMF, the government sent the outline of a letter of intent to the Fund in August, containing projections of macroeconomic variables for 2002 and a presentation of the government's guidelines for restructuring the banking sector. However, over the short-term, there are still some serious hurdles to the signing of a final document. One positive sign occurred in early September, when the IMF granted a one year postponement of payment of an Argentine debt of US$2.78 billion owed to that organization.

4.5 – Petroleum

At its ordinary June 26 meeting in Vienna, the Organization of Petroleum Exporting Countries (Opec) carried out a review of the oil market in general, as well as the supply and demand outlook for the second half of 2002. It was noted that the cutbacks adopted in 2001 and 2002, coupled with measures taken by several nonmember countries in the first half of the current year, had managed to reestablish a state of relative market balance. However, it was also noted that the relative tension in current market prices is basically a result of today's political situation.

With these factors in mind and taking due account of the doubts that have arisen with respect to world economic recovery, moderate demand growth and the rather comfortable level of existent world stocks, Opec decided to maintain the agreed output levels at 21.7 million barrels per day (mbd) up to the end of September.

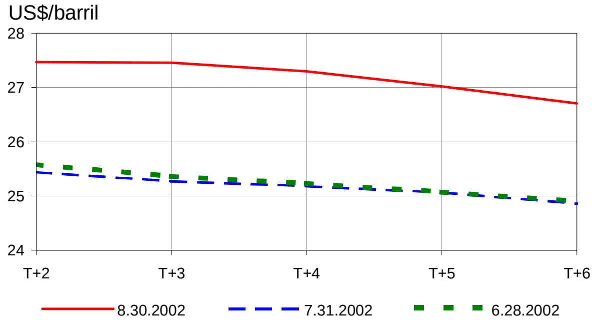
In the second quarter of 2002, according to International Energy Agency (IEA) figures, overall petroleum demand came to 75.41 mbd, compared to 76.65 mbd in the first quarter. This decline was mostly due to lesser demand in the countries belonging to the Organization of Economic Cooperation and Development (OECD). In the specific case of the United States, growth in petroleum demand seems to be gaining momentum. Preliminary figures suggest recovery in May and June, though the second quarter as a whole was marked by stability.

IEA figures state that overall demand in the third quarter of the year is estimated at 76.28 mbd, moving to 78.18 mbd in the fourth quarter. Both of these results reflect growth, principally as a result of greater demand in the OECD member countries.

Preliminary estimates indicate average July production of 76,5 mbd, corresponding to an increase of 780 thousand barrels per day in relation to the June level. To some extent, this increase was provoked by expanded Opec output.

The spot market price of Brent type petroleum at the end of the period increased from US$25.45/barrel in June to US$25.57/barrel in July and US$27.01/barrel in August. The decline in total United States oil stocks in recent months and the threat of war with Iraq have generated upward pressure on prices which has been somewhat offset by increased output in the Opec nations.

Crude oil - future (brent)



Source: Bloomberg

In the futures market, the price of Brent type petroleum tended downward for subsequent delivery periods negotiated on the same date. For contracts negotiated at the end of August, price levels were higher than in previous months.

4.6 – Conclusion

The drop in the pace of world economic growth is a given fact. The upswing in United States economic activity, obviously a key element in defining the trajectory of the world economy, was insufficient to reverse the downward slide in the world's major economies. Consequently, it is now recognized that world trade growth will be relatively limited due to the ongoing Japanese recession and its impacts on other Asian nations, though these countries have managed to achieve higher growth figures than Japan, and to a rather listless pace of expansion in Europe.

The worsening of the external difficulties that have long plagued the emerging economies, particularly those of Latin America, including the so-called contagion effect, has converged with a sharp loss of world economic dynamism and plunging volumes of financing flows to these nations. In the latter case, this combination of risks and uncertainties has generated a disproportionate heightening of risk perceptions and this is clearly reflected in the levels of country risk which, in turn, further restrict capital flows.

In the globalized financial market, national economies are marked by a high degree of interdependence, principally in the case of the emerging countries. Consequently, overcoming the current crisis will depend on the capacity of the world economy to find a renewed source of dynamism. In Latin American countries, economic reforms must be implemented in order to create an environment of competitive stability capable of stimulating investments and exports and reducing the high level of external vulnerability that is characteristic of most of these nations.

In a context of growing uncertainties, a new conflict in the Middle East could radically alter the current world economic scenario and trigger a new oil price spiral. Viewed in this light, petroleum market volatility is expected to worsen in coming months with highly negative impacts on the international economy through to the end of the year.

5 – Foreign sector

The balance of payments reflects important adjustments that have occurred in the external sector of the Brazilian economy. The sharp drop in the current transactions deficit is a consequence of the ongoing process of import substitution, the impact of depreciation of the real on the nation's external accounts with clearly favorable repercussions on both the competitiveness of the country's foreign sales and access to new markets and, furthermore, of the slowdown in the pace of economic activity.

Topping off this adjustment process, the Program of Financial Assistance (PAF) to the country was further reinforced with a new agreement with the IMF. This is considered a factor of fundamental importance until such time as private capital flows return to normal.

With these factors in place, the conditions required for achieving balance of payments equilibrium in both 2002 and 2003 coupled with a comfortable international reserve position have been assured.

5.1 – Trade in goods

Trade balance - FOB

US$ million

Period		Exports	Imports	Balance	Trade flow
Jan-Aug	2002	37 026	31 648	5 378	68 674
Jan-Aug	2001	39 619	38 955	664	78 574
% change		-6.5	-18.8		-12.6

Source: MDIC/Secex

Note: In 2001, 169 working days; in 2002, 168.

The balance of trade surplus accumulated up to August of this year totaled US$5.4 billion, the best result since 1994. What is most important perhaps is that this surplus was attained in the framework of a highly negative international trade situation. In September, up to the 25th of the month, the surplus came to US$2 billion. Foreign sales up to August totaled US$37 billion, while imports added up to US$31.6 billion. These figures mirrored reductions of 6.5% and 18.8%, respectively, generating a trade flow that was 12.6% less than in the same period of 2001.

Based on data purged of seasonal factors, the movable six month median trade balance surplus also mirrors the excellent trade balance performance, remaining above the mark of US$400 million since December 2001. This was the best result since the period prior to January 1995.

Exports to Argentina and other countries - FOB

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

US$ million

Itemization	Argentina	Other	Total
Total	-2 324	- 269	-2 593
Manufactured products[1/]	-1 994	201	-1 793

Source: MDIC/Secex

1/ Includes manufactured product reexports.

The performance of foreign sales of manufactured goods was the factor responsible for the 6.8% drop in average daily exports in the January-August 2002 period, when compared to the same period of 2001. To a great extent, this result was a consequence of the downturn in the Argentine economy. In this context, analysis shows that out of a total reduction of US$2.6 billion in overall foreign sales from January to July 2002, compared to the same period of 2001, US$2.3 billion were due to cutbacks in exports to Argentina. Of this total, US$2 billion referred to manufactured goods.

Exports by aggregate factor - FOB

Daily average - January-August

US$ million

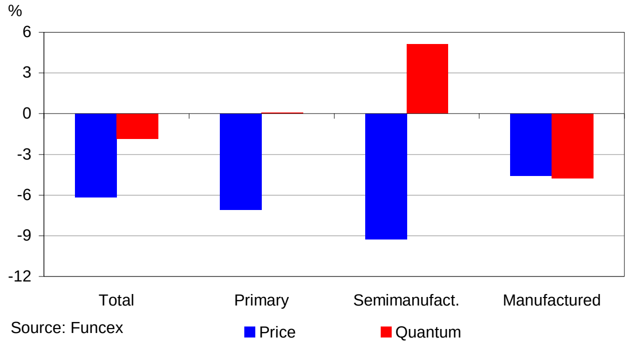
Itemization	Accumulated		
	2001	2002	% change
Total	234.4	220.4	- 6.0
Primary products	62.2	59.8	- 3.9
Industrial products	164.2	154.4	- 6.0
Semimanufatured goods	32.2	31.2	- 2.9
Manufactured goods	132.1	123.1	- 6.8
Special operations	8.0	6.3	- 21.7

Source: MDIC/Secex

Note: In 2001, 169 working days; in 2002, 168.

The decline in the exported volume of manufactured products from January to July 2002 came to 4.8%, compared to the same period of 2001. This result justifies the 1.9% reduction in the volume of total foreign sales, since the drop in sales of basic products and semimanufactured goods in the period was exclusively a consequence of lower prices. The price reduction in the three categories of goods evinced the process of world economic deterioration, as well as possible partial transfer of larger exporter earnings generated by depreciation of the real to the prices of exported goods expressed in dollars.

Exports - price and quantum index - Jan-Jul/2002
Change over the same period in 2001



Source: Funcex

Among manufactured goods, the sharpest highs in value terms in the period from January to August 2002 occurred under transmission and reception equipment (7.1%), automobile engines (15.8%) and refined sugar (28.2%), when compared to the same period of the preceding year. The most significant reductions were registered under exports of aircraft (26.8%), automobiles (10.9%), footwear (11.4%), auto parts (6.3%) and fuel oils (41.5%). In general, the revenue increases were due to volume growth, since prices remained low. Exceptions to this rule occurred under sales of transmission and reception equipment and aircraft, with price growth in the range of 7.2%.

In terms of the daily average in the January-August 2002 period, revenues on basic products dropped by 3.9%, compared to the corresponding period of the previous year. Analysis shows that this result was caused by a generalized decline in world economic activity and a rise in protectionist measures among the developed countries. For the first seven months of the current year, the volume index points to stagnation in the quantity of exported basic goods, when viewed against the same period of 2001. Particular note should be taken of petroleum sales, as the volume of exports increased by 79.5% up to July.

With respect to manufactured goods, in the period from January to July the index of exported volume increased by 5.1% while the price index dropped by 9.3%.

Among the products that registered accumulated revenue increases up to the month of August, the most important were iron or steel semimanufactured goods with 21.1%, leather and hides with 2.5% and unrefined aluminum with 7.8%. Sales of cellulose and raw sugar dropped by 21.7% and 34.2%, respectively.

Imports registered an accumulated total of US$31.6 billion up to August, reflecting a reduction of 18.3% in the daily average for the period, compared to the same period of the previous year. Foreign

Imports by end-use category - FOB
Daily average - January-August

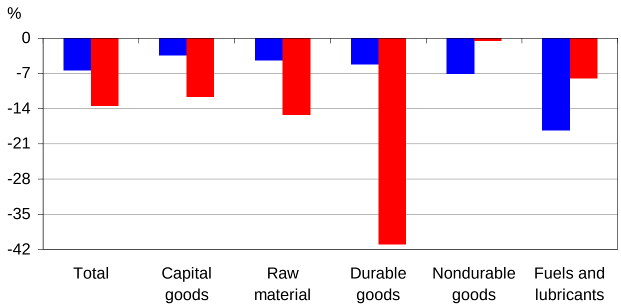
US$ million

Itemization	Accumulated 2001	2002	% change
Total	230.5	188.4	- 18.3
Capital goods	60.4	49.1	- 18.7
Raw materials	115.9	93.1	- 19.6
Naphtha	6.6	2.2	- 65.9
Consumer goods	29.6	23.5	- 20.5
Durable	15.2	9.9	- 34.5
Passenger vehicles	6.3	3.1	- 51.8
Nondurable	14.4	13.6	- 5.8
Fuels	24.6	22.6	- 8.2
Crude petroleum oil	12.3	11.5	- 6.0

Source: MDIC/Secex

Note: In 2001, 169 working days; in 2002, 168.

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



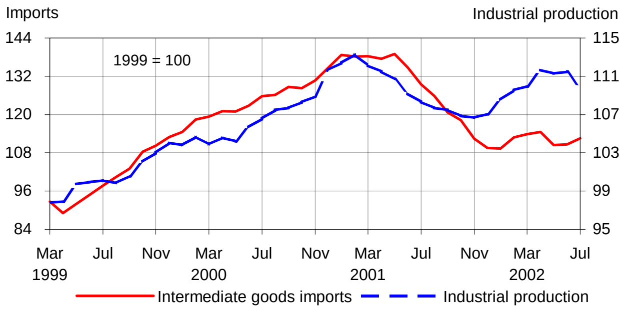
Source: Funcex

purchases of capital goods and raw materials and intermediate products turned in similar reductions of 18.7% and 19.6%, in that order, while those involving durable consumer goods fell by 34.5%, mostly as a result of the 51.8% reduction in automobile acquisitions.

In the three use categories – capital, intermediate and consumer goods, price indices in the January to July period registered less accentuated reductions with respective declines of 3.5%, 4.4% and 5.2%, while volume indices fell by approximately 11.7%, 15.2% and 41.1%. Consumer durables and fuels and lubricants registered slightly different performances, with greater reductions under prices than under volumes.

In the case of capital goods and raw materials and intermediate goods, the falloff in imported volume is, to some extent, a consequence of the statistical effect of a higher basis of comparison, since imports under these headings remained high in the early months of 2001. On the other hand, there are signs of a possible ongoing process of import substitution in such sectors as chemicals, which received investments targeted to expanding production facilities, and in those industries that have increased the national component index of their output.

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



Source: IBGE and Funcex

The differences that exist between indicators of industrial production and those involving imports of raw materials and intermediate products also point in the direction of a possible process of import substitution that has picked up speed as depreciation of the real has intensified and the decline in international prices has lessened.

The fact that the volume of nondurable consumer goods was maintained despite sharper depreciation of the real in 2002 is, to some extent, explained by purchases of medicines. In the period from January to July 2002, outlays on imports of medicines accounted for 34.1% of spending on nondurable goods, reflecting growth of 4.3% over this heading in the same period of 2001. This performance resulted from growth of 19.1% in volume and a 12.5% price decline.

The drop in fuel and lubricant prices, in turn, was mainly due to a higher reference base in the first half of 2001. Following the events of September of that year, expectations of world economic growth were reversed and oil prices moved into a downward curve up to December when they closed in the range of US$18.50/barrel. At that point, a gradual process of recovery began in the direction of previous price levels.

With the exception of Mercosul trading partners, trade exchanges with the major blocs and countries improved in the period from January to August 2002, when compared to the same 2001 period.

The sharpest growth in the bilateral balance occurred in trade with the United States. In this case, the US$611 million surplus accumulated up to August 2001 climbed to US$2.7 billion in the same period of the current year. The factors underlying this growth were a reduction of 20.8% under imports and growth of 2.2% under foreign sales. The import cutback was most intense under such components as airplane engines and turbines, integrated circuits and micro electronic equipment and such items as measurement and verification apparatuses and instruments and computers. In the opposite direction, Brazilian purchases of engines, power generators and electric transformers increased by 134%.

The trade deficit with Asian countries turned in a sharp reduction from US$1.7 billion to US$318 billion, resulting from an increase of 6.7% under exports and a reduction of 16.4% under imports. Among the major factors that contributed to this performance, mention should be made of reductions of 27.1% and 36.2% in imports from Japan and South Korea, respectively, and growth of 25.6% in Brazilian exports to the latter of these two nations. The surplus in trade with China fell by US$209 million, reflecting a cutback of 7.4% in foreign sales and an increase of 12.6% in imports.

Exports and imports by geographic area - FOB
January-August

US$ million

Itemization	Exports			Imports			Balance	
	2001	2002	% change	2001	2002	% change	2001	2002
Total	39 619	37 026	-6.5	38 955	31 648	-18.8	664	5 378
Laia	8 470	6 244	-26.3	7 151	5 598	-21.7	1 319	646
Mercosur	4 690	2 076	-55.7	4 981	3 827	-23.2	- 291	-1 750
Argentina	3 748	1 424	-62.0	4 449	3 259	-26.7	- 701	-1 835
Other	942	652	-30.8	532	568	6.7	410	84
Mexico	1 155	1 447	25.3	503	395	-21.5	652	1 052
Other	2 625	2 721	3.6	1 667	1 377	-17.4	958	1 344
USA 1/	9 708	9 922	2.2	9 097	7 208	-20.8	611	2 714
EU	10 426	9 322	-10.6	10 356	8 936	-13.7	70	386
E. Europe 2/	1 059	1 067	0.7	702	521	-25.8	357	546
Asia	4 669	4 982	6.7	6 341	5 300	-16.4	-1 672	- 318
Japan	1 367	1 347	-1.4	2 224	1 621	-27.1	- 858	- 274
South Korea	405	508	25.6	1 194	762	-36.2	- 790	- 254
China	1 340	1 241	-7.4	862	971	12.6	478	269
Other	1 559	1 886	21.0	2 061	1 945	-5.6	- 502	- 59
Sundry	5 286	5 489	3.8	5 308	4 086	-23.0	- 22	1 403

Source: MDIC/Secex

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

Trade operations with the European Union slipped by 10.6% under exports and 13.7% under imports, generating an increase of US$316 million in the surplus. As far as imports are concerned, reductions were registered under automotive industry components, particularly those originating in Germany, France and Italy.

The surplus in operations with the member countries of the Latin American Integration Association (Laia) dropped by US$673 million, as a result of a 26.3% reduction under foreign sales and a 21.7% cutback under imports. Basically, this performance was brought about by an increase of US$1.5 billion in the deficit with Mercosul trading partners which, in turn, was almost entirely a consequence of a 62% downturn in exports to Argentina. This reduction was particularly strong under the headings of automotive industry goods, iron ore and raw materials for the chemical industry. In the opposite sense, exports to Mexico increased by 25.3% and were especially strong under products for the automotive industry, due to the automotive sector agreement with that country, as well as mobile cell phones and iron or steel semimanufactured products.

5.2 – Services and income

In the first eight months of 2002, the current transactions deficit declined by 41.8%, compared to the same period of the previous year. The underlying reasons for this performance were strong growth in the trade balance surplus and cutbacks in outlays on services and net income remittances.

Net outlays on services added up to US$3.4 billion, reflecting a decline of 38.2% in the period. Net spending on transportation came to US$1.3 billion, for a reduction of 38.7% caused by the

Current account

US$ billion

Itemization	2001 Jan-Aug	2001 Year	2002 Jan-Aug	2002 Sep-Dec	2002 Year 1/	2003 Year 1/
Current account	-16.5	-23.2	-8.5	-5.5	-14.0	-12.8
Trade balance	0.7	2.6	5.4	3.6	9.0	12.0
Exports	39.6	58.2	37.0	19.6	56.6	62.0
Imports	39.0	55.6	31.6	16.0	47.6	50.0
Services	-5.5	-7.7	-3.4	-2.7	-6.1	-6.7
Transportation	-2.1	-3.0	-1.3	-0.7	-2.0	-2.2
International travel	-1.2	-1.5	-0.6	-0.3	-0.9	-1.2
Computer and information	-0.7	-1.1	-0.8	-0.4	-1.2	-1.3
Operational leasing	-1.4	-1.9	-1.1	-0.9	-2.0	-2.8
Other	-0.1	-0.4	0.4	-0.4	0.0	0.8
Income	-12.7	-19.7	-11.9	-7.2	-19.1	-19.7
Interest	-9.7	-14.9	-8.5	-5.6	-14.1	-14.7
Profits and dividends	-3.1	-5.0	-3.4	-1.7	-5.1	-5.0
Compensation of employees	0.1	0.1	0.1	0.0	0.1	-
Current transfers	1.1	1.6	1.4	0.8	2.2	1.7

1/ Forecast.

strong downturn in the international trade in goods and expenditures on international airline tickets. Net spending on international travel continued on the downward curve highlighted in the previous report and closed at a level of US$629 million, for a reduction of 45.7% in the period. Payments of equipment rentals resulted in net outflows of US$1.1 billion between January and August, compared to US$1.4 billion in the same period of the previous year, while net spending on computer and information services added up to US$768 million, for growth of US$44 million. Other services accumulated net inflows of US$357 million.

Net income remittances abroad totaled US$11.9 billion or 6.7% less than in the first eight months of 2001. Net payments of interest came to US$8.5 billion, corresponding to a drop of US$1.2 billion, partly offset by an increase of US$278 million in net remittances of profits and dividends, which totaled US$3.4 billion.

Growth in the trade surplus and reductions in net spending on services were greater than the decrease in direct foreign investments. As a result, the country was able to finance the current account with considerable leeway.

The current transactions account reflects the ongoing process of import substitution, exchange depreciation, with direct impacts on the competitiveness of Brazilian exports and access to new markets, and the decelerating pace of economic activity. Thus, the current transactions deficit for 2002 is expected to close at nearly US$14 billion, US$9.2 billion less than in the preceding year.

Projections of the current transactions deficit for 2003 are lower than for 2002 due to expectations of 9.5% growth in exports and 5% under imports.

5.3 – Financial account

The financial account registered net inflows of US$10.5 billion in the period from January to August. In this case, the items that deserve specific mention are net inflows of US$5.6 billion in IMF loans and US$11.4 billion in direct foreign investment.

Financial account

US$ billion

Itemization	2001		2002			2003
	Jan-Aug	Year	Jan-Aug	Sep-Dec	Year[1/]	Year[1/]
Financial account	18.3	28.0	10.5	4.3	14.8	-0.9
Direct investments	15.9	24.7	9.5	3.4	12.9	14.5
Abroad	2.1	2.3	-2.0	-0.1	-2.1	-1.5
In Brazil	13.8	22.5	11.4	3.6	15.0	16.0
Equity capital	11.1	18.8	12.6	3.6	16.2	16.0
Intercompany loans	2.7	3.7	-1.2	-	-1.2	-
Portfolio investments	3.7	0.1	-1.9	-1.6	-3.5	1.0
Assets	-0.7	-0.8	-0.3	-0.1	-0.4	-
Liabilities	4.4	0.9	-1.6	-1.5	-3.1	1.0
Derivatives	-0.3	-0.5	-0.3	0.2	-0.1	-
Other investments	-1.0	3.6	3.3	2.2	5.5	-16.5
Assets	-6.5	-6.6	-2.7	-3.0	-5.7	-3.6
Liabilities	5.5	10.2	5.9	5.3	11.2	-12.9

1/ Forecast.

Foreign portfolio investments closed with net outflows of US$1.6 billion. In the January-April period, net inflows of foreign capital for purposes of stock investments came to US$2.2 billion, while resources targeted to bonds added up to US$3.7 billion. The highlights here were placements of Bonds of the Republic in the amount of US$3.9 billion, for a net inflow of US$3.8 billion. In the following period from May to August, this situation reversed course, as net outflows closed at US$5.4 billion. Funding based on notes and commercial papers, which are private funding operations, remained below the volume of amortizations since the start of the year. Average rolling of the debt in the period from January to August came to 41.4%.

BP medium and long-term financing sources

Selected items

US$ billion

Itemization	2001		2002			2003
	Jan-Aug	Year	Jan-Aug	Sep-Dec	Year[1/]	Year[1/]
Medium and long-term funds	16.6	19.9	7.3	1.7	9.0	13.0
Bonds	7.0	7.5	4.1	-	4.1	4.0
Notes and commercial papers	5.5	7.4	1.8	0.9	2.7	5.0
Direct loans	4.1	5.0	1.5	0.8	2.2	4.0
Short-term loans[2/]	-0.5	-1.9	-0.2	-0.3	-0.5	1.0
Roll-over rates[3/]						
Bonds	155%	118%	245%	0%	165%	105%
Notes and commercial papers	90%	81%	41%	48%	42%	100%
Direct loans	192%	138%	61%	52%	56%	100%

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

Funding operations based on foreign resources targeted to portfolio investments are expected to recover by the end of this year, particularly those involving issues of private papers. In the period from January to July, the rates at which these papers were rolled diminished steadily and closed July at 15%. In the month of Augustit reached a level of 34%. For the September-December period, expectations point to gradual recovery so that it will be possible to keep an average of 48% in the rolling of these papers. In pursuing this objective, several external policy measures are being applied, including the new PAF to the country signed with the IMF and contacts with foreign creditors so that they will stabilize their positions.

The behavior noted under funding operations based on private papers was similar to that of direct loans, which registered an average rolling rate of 61% from January to August. Expectations are that this level will remain stable from September onward.

Access to external credits is expected to continue improving in 2003. According to forecasts, rolling of private papers will reach at least 100%, and for direct loans in average terms for the year.

Uses and sources

US$ billion

Itemization	2001		2002			2003
	Jan-Aug	Year	Jan-Aug	Sep-Dec	Year[1/]	Year[1/]
Uses	-39.9	-58.4	-28.5	-15.3	-43.8	-40.8
Current account	-16.5	-23.2	-8.5	-5.5	-14.0	-12.8
Amortizations ML-term[2/]	-23.4	-35.2	-20.0	-9.8	-29.8	-28.0
Securities	-12.8	-19.0	-7.9	-2.8	-10.7	-9.8
Paid	-10.7	-15.5	-6.2	-2.7	-8.9	-9.8
Nationalization debt	-3.1	-3.1	-	-	-	-
Refinanced	-2.2	-2.2	-	-	-	-
FDI conversions	-0.1	-1.4	-1.7	-	-1.7	-
Suppliers' credits	-1.9	-2.8	-1.6	-1.0	-2.6	-3.3
Direct loans[3/]	-8.6	-13.3	-10.4	-6.1	-16.5	-14.9
Sources	39.9	58.4	28.5	15.3	43.8	40.8
Capital account	0.2	0.0	0.3	0.1	0.4	-
FDI	13.8	22.5	11.4	3.6	15.0	16.0
Domestic securities[4/]	2.2	2.2	1.2	0.2	1.4	1.8
ML-term disbursements[5/]	27.6	34.6	14.3	5.2	19.5	24.4
Securities	14.7	17.0	5.9	0.9	6.8	9.0
Supliers' credits	2.3	3.3	0.9	1.0	1.9	2.6
Direct loans	10.5	14.3	7.5	3.3	10.8	12.9
Brazilian assets abroad	-4.7	-4.6	-4.4	-3.0	-7.4	-4.6
Loans to Bacen	1.9	6.6	5.6	5.8	11.4	-11.1
Other[6/]	2.2	0.3	0.9	2.3	3.2	0.5
Reserve assets	-3.3	-3.3	-0.8	1.1	0.3	13.7

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

Short-term loans, which include trade credit lines through banks, also declined over the course of the year. Up to June, net funding operations totaled US$1.8 billion. In July and August, however, this position reversed and the period closed with net payments of US$2 billion. Expectations for this type of operation point to stabilization in the final months of the year and growth in 2003, keeping pace with the stregthening of the trade balance.

IMF loans were an important source of funding for the financing of the 2002 balance of payments. Up to August, gross disbursements accumulated US$10 billion, with entry of US$3 billion in the framework of the new agreement on September 11. Direct foreign investments were an important source of financing and should surpass the value of the current transactions deficit projected for 2002.

Market borrowing requirements or, in other words, balance of payments requirements – excluding net Central Government remittances that impact the international reserve position – are forecast at US$6.2 billion in the September-December period. Aside from the current transactions deficit, the most important demands are concentrated under net payments of long-term loans, with the consequent

Net external liabilities

The International Investment Position (IIP), which aggregates external assets and liabilities, is equivalent to the nation's net external liabilities. Compilation and presentation are modeled after the 5th edition of the IMF Balance of Payments Manual and its components are the same as the balance of payments financial accounts: direct investment, portfolio investment, derivatives and other investments.

The position for March 2002 registered US$271.8 billion, 54.5% of GDP, with US$109.1 billion under assets and US$380.9 billion under liabilities.

Brazilian assets abroad include international reserves and other foreign exchange assets subject to Banco Central do Brasil management. They also encompass information provided to Banco Central through the survey known as Brazilian Capital Abroad (CBE)[1]. This survey was carried out from January to May of this year and requires residents with assets abroad in amounts of more than R$200 thousand on December 31, 2001 to declare those amounts.

International investment position
Assets

US$ million

Itemization	2001	2001 March
International investment position (A-B)	**-264 481**	**-271 845**
Assets (A)	**108 145**	**109 090**
Brazilian direct investment abroad	50 746	51 273
Equity capital 1/	43 641	44 198
Intercompany loans	7 104	7 075
Portfolio investment	6 402	6 554
Equity securities	3 001	3 207
Debt securities	3 401	3 347
Bonds and notes	1 816	1 761
Of which collateral (principal)	1 239	1 177
Money-market instruments	1 585	1 585
Financial derivatives	42	30
Other investment	15 089	14 513
Trade credits	155	155
Loans	697	732
Currency and deposits	9 442	8 843
Other assets	4 795	4 783
Of which collateral (interests) and membership in international financial organizatio	1 383	1 374
Reserve assets	35 866	36 721

1/ Includes reinvested earnings.

1/ See http://www.bcb.gov.br/mPag.asp?perfil=1&cod=958&codP=956&idioma=P.

Data referring to March 2000, except for the international reserves were compiled from balances which were calculated by the CBE for the month of December 2001, and from the balance of payment flows, during the first quarter of 2002.

It was shown that the most significant modality of Brazilian assets abroad is direct investment, including claims on affiliated enterprises, US$ 51.3 billion, or 47% of the total. Following that comes international reserves (33.7%) and deposits in banks abroad (8.1%). Investment in stocks and fixed income securities accounted for US$6.6 billion, or 6% of assets.

CBE data for December 2001 indicates that the targeting of direct Brazilian assets – excluding US$7.1 billlion in claims on affiliated enterprises – according to type of activity are concentrated in financial intermediation (32.2%), in financial intermediation auxiliary activities (17.3%) and 24.7% in services rendered to companies (controlling companies). On a lesser scale, mention should be made of investment in commerce, petroleum production and building.

Direct investments abroad - Equity capital

Distribution by sector*

US$ million

Itemization	Total
Total	43 641
Financial intermediation	14 048
Services rendered mainly to corporations	10 778
Financial intermediation assistance acivities.	7 536
Commerce	1 724
Petroleum extraction and related services	1 556
Construction	1 229
Others	6 771

* Preliminary data - 12.31.2001.

With respect to the nation’s external liabilities, the most important item is the external debt (US$209.9 billion, 55% of the total), composed of fixed income securities negotiated abroad (bonds, notes and commercial paper), trade credits and loans. Based on the Foreign Capital Census[2], the next item is the direct foreign investment stock, US$121.9 billion, corresponding to 33% of the total. The remaining liabilities are concentrated under foreign investment in the stock of Brazilian companies traded in the country or abroad (DR’s) and in fixed income securities negotiated in the country and acquired through inflows under Resolution 2,689.

2/ See http://www.bcb.gov.br/mPag.asp?perfil=1&cod=957&codP=769&idioma=P.

International investment position
Liabilities

US$ million

Itemization	2001	2001 March
Liabilities (B)	**372 626**	**380 935**
Direct investment in reporting economy	121 948	126 014
Equity capital[1/]	105 815	109 829
Intercompany loans	16 133	16 185
Portfolio investment	152 306	157 206
Equity securities	37 407	41 712
In the reporting country	13 883	14 931
Abroad	23 524	26 781
Debt securities	114 899	115 495
Bonds and notes	114 899	115 495
In the reporting country	1 710	1 720
Abroad	113 189	113 775
Long-term	111 989	112 142
Short-term	1 200	1 633
Financial derivatives	45	67
Other investment	98 327	97 647
Trade credits	6 025	5 698
Long-term	5 398	5 103
Short-term	628	595
Loans	90 720	91 304
Monetary authority	9 130	8 926
Use of Fund credit & loans from the Fund	8 346	8 203
Other long-term	784	723
Short-term	0	0
Other sectors	81 590	82 378
Long-term	55 759	55 194
International entities	22 440	22 430
Government agencies	12 418	12 368
Buyers	8 362	8 173
Direct loans	12 539	12 222
Short-term	25 831	27 184
Currency and deposits	1 582	1 621
Monetary authority	129	145
Banks	1 453	1 476
Other liabilities	0	0

1/ Includes reinvested earnings.

Statement of international reserves

US$ billion

Itemization	2001	2002			2003
	Year	Jan-Aug	Sep-Dec	Year[3/]	Year[3/]
Reserves position in previous period	33.0	35.9	37.6	35.9	36.6
Net Banco Central interventions	-7.2	-4.5	-4.9	-9.3	-
Spot	-7.2	-2.9	-3.3	-6.2	-
Repurchase lines	0.0	-1.2	-	-1.2	-
Export lines	0.0	-0.4	-1.6	-2.0	-
Debt servicing (net)	-7.1	-5.1	-2.4	-7.5	-9.2
Interest	-3.2	-2.5	-1.5	-3.9	-4.5
Credit	1.9	1.1	0.5	1.6	1.4
Debit	-5.1	-3.5	-2.0	-5.5	-5.9
Amortization	-3.9	-2.6	-0.9	-3.6	-4.7
Disbursements	7.8	5.0	0.4	5.4	6.7
Multilateral organizations	1.2	1.1	0.4	1.5	2.7
Sovereign bonds	6.7	3.9	-	3.9	4.0
Exceptional financing (IMF)	6.8	5.6	5.8	11.4	-11.1
Disbursement	6.8	10.0	6.0	16.0	-
Amortization	0.0	-4.4	-0.2	-4.6	-11.1
Others[1/]	2.6	0.7	-	0.7	-
Change in assets	2.9	1.8	-1.1	0.7	-13.7
Gross reserves position	35.9	37.6	36.6	36.6	22.9
Net reserves position - agreement with IMF[2/]	27.8	21.1	14.2	14.2	11.8

1/ Includes pre-payment to Poland in November 2001. Includes payments/receipts in the framework of the Reciprocal Credit Agreement (CCR), fluctuations in prices of securities, exchange parities and price of gold, discounts and premiums, duty fees and release of collaterals.
2/ In order to comply with the performance criterion, in the framework of the International Monetary Fund Agreement, the calculation parameters for the net adjusted reserves - as defined in the Technical Memorandum of Understanding (TMU) of the third review of the Stand-By Agreement - should be observed. In this case, the net adjusted reserves denominated in USD take into account the parities set on dates established by the TMU to figure out the assets denominated in currencies unlike the USD, including the SDR. The same methodology is applied in the case of the gold price. Also, pursuant the TMU, the outstanding debt with the IMF should be excluded from the reserve assets (international liquidity concept), as well as the deposits in banks domiciled abroad, though headquartered in the country, and the securities issued by residents that surpass altogether US$1,023 million.The exceeding value as of August 2002 is equal to US$2,348 million.
3/ Forecast.

reductions in external indebtedness, and formation of Brazilian assets abroad. Net inflows of direct foreign investment are expected to cover almost the entirety the current transactions deficit. Thus, market requirements, known as the financial gap, will be covered by Banco Central operations implemented through exchange market interventions (US$4.9 billion) and by growth in the positions of private resident banks (US$1.3 billion).

The projection for 2003 is a decline in the current transactions deficit, making it possible for resources originating in direct foreign investments, together with stock investments, to finance all other market payments. In this case, there will be no need for Banco Central interventions.

In 2003, international reserves are seen as the major source of balance of payments financing, due to amortization of US$11.1 billion with the IMF. The projection for 2003 does not take account of the possibility of an additional withdrawal of IMF resources in the framework of the new agreement with that institution, which placed US$24 billion at the disposal of the country for the coming year. The forecast reduction for gross reserves is projected at US$13.7 billion due not only to payments to the IMF but also to payments of interest and principal of debts contracted by the National Treasury. Therefore, there is no forecast of sales of reserves to the market in 2003.

5.4 – Conclusion

Balance of payments - Market

US$ billion

Itemization	2001	2002 Jan-Aug	2002 Sep-Dec	2002 Year	2003
Current account	-20.0	-6.0	-4.0	-10.1	-8.2
Capital (net)	16.7	0.1	-2.1	-2.1	8.2
Foreign direct investment	22.5	11.4	3.6	15.0	16.0
Portfolio investment	2.2	1.2	0.2	1.4	1.8
Medium and long term loans	-3.2	-4.2	-2.8	-7.1	-2.9
Trade credits - short, medium and long term	1.5	1.2	0.0	1.2	-1.6
Banks	-3.6	-2.4	-1.2	-3.6	-0.9
Other	5.1	3.6	1.3	4.9	-0.8
Brazilian investment abroad	-3.2	-5.9	-4.3	-10.2	-4.6
Of which: operations with foreign institutions	-3.9	-4.2	-4.3	-8.5	-3.6
Other	-3.1	-3.6	1.1	-2.5	-0.5
Financial gap	-3.4	-6.0	-6.2	-12.1	-
Banco Central net interventions	7.2	4.5	4.9	9.3	-
Bank deposits	-3.9	1.5	1.3	2.8	-

Growing balance of trade surpluses have clearly benefited the current transactions result. Despite reductions in exports, mostly as a result of the Argentine crisis and a lower pace of international economic activity, imports dropped even more sharply. This was basically a response to depreciation of the real, which has generated a process of import substitution and deceleration in the level of activity.

The same factors that affected imports of goods impacted service imports and further attenuated the current transactions deficit.

Though lower than in the previous year, inflows of direct foreign investment are still a major source of balance of payment financing and have been sufficient to cover the current transactions account. Other sources of financing, including issues of papers and short and long-term loans, have dropped to very low levels and have been replaced temporarily by normalization loans contracted with the IMF.

Projections for 2003 show that balance of payments borrowing requirements can be provided with no new withdrawals from the IMF nor Banco Central exchange market interventions.

6 – Inflation Outlook

This chapter of the *Inflation Report* presents the Monetary Policy Committee (Copom) assessment of Brazilian economic performance since the last *Report*, in June 2002, as well as the outlook for inflation through 2003. The projections are based on the assumption that the basic interest rate will hold steady during the period under analysis at 18.00% a year, the rate set by Copom in its last meeting, on September 17-18, and that the exchange rate will remain at the same level as on the eve of that meeting. An alternative forecast is also presented, taking into account market expectations for the basic interest rate and for the exchange rate paths on September 16. One should notice that these procedures are strictly technical. Hence, these assumptions should not be taken as forecasts of the future interest rate path.

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

6.1. – Determinants of inflation

A momentary gap between production and sales has been observed, with the latter showing more dynamism. The industrial production is expected to close the year almost stable, which would ensure a GDP growth of about 1.4% in 2002, particularly as a result of the performance of the agricultural sector and of the mineral extraction industry. In the second quarter of 2002, the GDP grew by 0.61% in relation to the previous quarter (seasonally adjusted) and by 0.99% in relation to the same period last year. As compared to the first semester of 2001, GDP grew by 0.14% in the first semester of 2002. The industrial production, as measured by the IBGE, purged of seasonal adjustments, remained stable in July. Nevertheless, a growth of 2.5% can be observed if one compares July 2002 to July 2001, as a result of the electricity rationing scheme.

On the other hand, sales in the retail sector are beginning to improve, but orders have not increased for manufacturers yet. CNI data point to a growth of 4.46% in real industrial sales in June compared to May and of 1.61% in July compared to June (data without seasonal adjustments), indicating a possible outflow of stocks, which are above the desired levels. The Consumer Intention Rate (IIC), as measured by Fecomercio of São Paulo, rose by 9.61% in September with the level of 100.4, the best one in the year so far. The consumer credit should be reestablished in the next few months as a result of a drop in the default rate, largely caused by the release of FGTS (Warranty Fund for Severance Pay) resources.

One reason for the expansion in sales is the release of FGTS funds, which, only for the third quarter of this year, is estimated to be over 5 billion reais. The postponement of orders for Christmas, as in last year, can push prices up a little in December. This delay in orders in the current environment of uncertainty, added to the recent depreciation of the exchange rate, can enhance the arm-wrestling between manufacturers and traders for profit margins in the two sectors. Overall, however, consumption is expected to grow only moderately. Notwithstanding the positive effects brought about by the release of FGTS funds and by improved expectations, the slow growth of the salary mass and of formal jobs are likely to be the main determinants of the consumption.

In the next few months, investment spending will be limited by credit restrictions and by the entrepreneurs' state of confidence. The Industrial Entrepreneurs' Confidence Rate dropped significantly in the third quarter of the year in relation to the second quarter, although it rose a little as compared to the same period in the previous year.

No growth in aggregate demand as a result of government spending is expected either. The maintainance of fiscal balance requires a primary surplus above the level of 3.75% of GDP in the coming years.

In the foreign sector, the adjustment in current accounts continues to surprise positively. The trade balance registered a surplus of US$ 7.4 billion in the 12-month period ending in August. The current account deficit has been dropping continually since August 2001, hitting the mark of US$ 8.5 billion in the first eight months of the year. This deficit has been fully financed by net inflows of direct foreign investments, which totaled US$ 11.4 billion until August. The projections for 2002 indicate a current account deficit of US$ 14 billion, which should be fully financed by net inflows of direct foreign investments of US$ 15 billion. There will be a greater adjustment in the current account in the next year, when the deficit is expected to drop even further. However, there was a drop in international liquidity that affected even foreign lines. As a result, the real depreciated by 16% since the last *Report*.

An important factor to be highlighted is the change observed in the composition of direct investments between January and July, half of which was caused by debt conversion into capital, mainly between the headquarters of corporations and their subsidiaries. This fact means a lesser need for additional financing this year and smaller expenditures on amortization and interest. On the other hand, this change in the composition of investments may increase the remittance of profits abroad. Since profits depend on the performance of the economy, the debt conversion into capital should increase the correlation between GDP and capital flows.

The positive result of the trade balance was brought about by the real exchange rate adjustment. In addition, the drop in imports was partly caused by incentives to import substitution and by the slow growth of the economy. The trade balance is expected to close the year with a surplus of US$ 9 billion and the projections for 2003 point to US$ 12 billion.

Regarding aggregate supply, neither capacity utilization nor the situation of the labor market are pushing up corporate costs. The average use of the installed capacity (data provided by the Getúlio Vargas Foundation - FGV) was 79.6% in July, higher than in April (79.1%) but still lower than the 81.7% average registered in 2001. Moreover, as opposed to last year, the production will not be limited by the electricity-rationing scheme, which was lifted in February.

The real average income of employed personnel in the second quarter of 2002 was above the one registered in the previous quarter, but below the figures registered in the same period in 2001 (data provided by IBGE - without seasonal adjustments). The open unemployment rate as measured by the IBGE dropped to 7.5% in June from 7.7% in May and remained stable in July. Manufacturing in São Paulo laid off 15,000 employees in August, but this fact may have resulted from structural changes in the regional location of industrial jobs.

As elements pushing costs up, special mention should be made of the evolution observed in the prices of managed items, particularly of gasoline, and also of the exchange rate depreciation. The expectation of a possible war in Iraq has pushed oil prices up in the international market, where the price of the Brent barrel hit an average mark of US$ 28 in the first 18 days of September as compared to the average US$ 23.1 in the first semester of the year. The recent adverse conjuncture, characterized by higher uncertainty, had a negative impact on the price of assets in both foreign and domestic currency. Between the Copom meetings of June and September, the real depreciated by about 16% and the risk as measured by the Embi+ rose from 1350 basis points in June to 1730 b.p. in July, reaching a level of over 1960 b.p. in August. On the eve of the last Copom meeting, Brazil risk hit the mark of 1778 basis points. On the other hand, there was an increase in the prices of treasury bonds and there has recently been a positive evolution in the funds industry.

Since the Copom meeting in August, the impact of the exchange rate variation has been reassessed. According to the models used by the Central Bank, the behavior of the inflation of market prices in the year up to August is consistent with the exchange rate depreciation observed in the period. However, given the magnitude of the exchange rate depreciation observed throughout the year, the exchange rate pass-though may increase. In particular, the possibility of a higher pass-through is increased in an environment of recovering growth. However, in this scenario of recovered economic activity and improved expectations, an exchange rate appreciation can be reasonably expected. Nevertheless, Copom has deemed it was necessary to add to the next year's inflation forecast an exchange rate pass-through that was repressed this year.

In addition to the impact of a repressed pass-through on the inflation of market prices in 2003, the exchange rate depreciation will also have a bearing on next year inflation through the adjustment of managed prices.

In sum, after the current pressure on market and managed prices derived from the exchange rate depreciation, from the inflationary inertia, and from the effects of the period between harvests is over, one should expect, in the medium run, market price inflation to resume its downward path and to become more consistent with the targets.

6.2 – Baseline scenario: assumptions and associated risks

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

The baseline scenario for the Copom forecasts for the next 15 months presupposes, on the one hand, that the economic policy in 2003 will remain committed to fiscal responsability and to inflation targeting and, on the other hand, that the transition to the new federal administration will not be subject to exaggerated and/or protracted turbulence.

The main sources of uncertainty as to the prospects for the inflation rate until the end of 2003 are mainly related to the behavior of exchange rate and of domestic assets, to the evolution of the world economy, and to the possibility of a war in Iraq and its impact on the prices of oil by-products.

The inflation of prices administered by contract and monitored prices as a factor of uncertainty is no longer as relevant for the inflation in 2002 as indicated in previous *Reports*, since most price adjustments (7.6% of the anticipated 9.3%) have already taken place in the first eight months of this year.

In addition to the possibility of a war in Iraq and its likely repercussions on the international market of oil by-products, there was a downward review of growth prospects for the industrialized economies as a result of the possibility of a military confrontation and of the higher degree of uncertainty caused, among other factors, by accounting frauds and by lower profits. There are no signs of recovery in the Mercosur economies in the short term either.

The volatility of the exchange rate and of the other markets continues to be the main focus of uncertainty for inflation forecasts, particularly for 2003. The exchange rate depreciation has led to an upward review of the projected figures, in addition to increasing uncertainties in relation to the persistence of this depreciation and to the pass-through to market prices. As explained in section 6.1, according to the forecast models, the impact of the recent exchange rate depreciation on market price inflation should be observed still in 2002. Nevertheless the Copom believes that an additional pass-through may be felt in 2003, even if the exchange rate remains at the level observed on the eve of the Committee meeting (R$ 3.20).

The projection for the spread between the six-month rate and the Selic rate, according to the specification of the VAR model with error correction presented in the *Inflation Report* of June, begins at 510 basis points in the third quarter of 2002 and slopes downward thereafter until the end of 2003.

The expectations for the IPCA inflation in 2002 and 2003, as collected by the Investor Relations Group (Gerin) of the Central Bank of Brazil, rose from 5.5% and 4.0% to 6.6% and 5.2%, respectively, between the Copom meetings of June and September.

In relation to the *Report* of June, the inflation forecasted for prices administered by contract and monitored prices in 2002, which have a weight of 31.5% in the IPCA in August, rose 1.2 percentage points to 9.3%. This increase is due to an upward review of projections for oil by-products, particularly for gasoline, to a higher adjustment of electricity and fixed telephone rates, and to the exchange rate depreciation registered in the period**.** For 2003, the inflation forecasted for managed prices hit the mark of 7.9%, which is 1.8 p.p. higher than the one indicated in the previous *Report*. This increase is attributed to the exchange rate depreciation registered since the *Report* of June and to new expectations about the IGP-M, which is used as a basis for projecting certain managed prices, particularly those linked to transportation.

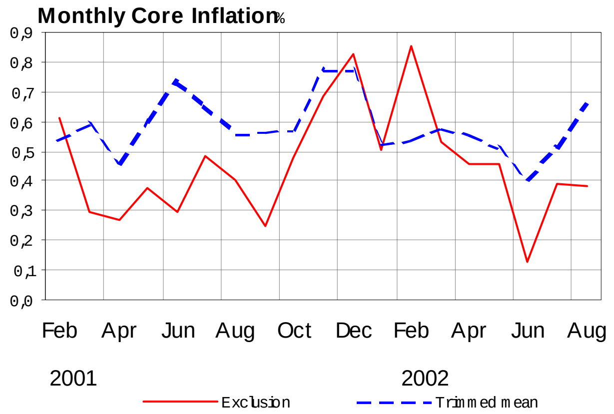
For the prices of oil by-products, the methodology of full pass-through of the international price used in the last *Report* has been temporarily suspended, and no decision has been made so far as to what methodology will be used in the medium run. In this new scenario, the price of gasoline to the consumer is expected to increase by 3.3% in 2002 as a whole. For cooking gas, the projections point to price increases of approximately 25.1% in 2002, 34% of which were registered in the period between January and August. In the last *Report* a price adjustment of 28% for the year as a whole had been forecasted. This lower projection is due to a 12% decrease in refinery prices in August, the impact of which on the IPCA should still be reflected in this index in September.

The September projections for electricity rates point to an increase of 3.8% in the remainder of 2002. Up till August, residential electricity rates rose by 16.2%. In the last *Report*, electricity rates were projected to rise by 19.4% in 2002 as a whole. This 1.2 p.p. upward review was particularly determined by the exchange rate depreciation. For 2003, a 20.7% price adjustment has been projected, which is significantly higher than the 12.3% projected in the last *Report*. This upward review was also determined by the exchange rate depreciation observed in the period.

As in the *Report* of June, no factors that could restrict the growth of the aggregate supply have been identified. For agricultural products, it was maintained the underlying assumption adopted in the last *Reports* that their prices will evolve according to the inflation of market prices up to the end of 2002 and in 2003 .

The baseline scenario suggests a constant path for the exchange rate until the end of 2002 and also in 2003. This is a standard procedure, which has been used since the Inflation Report of September 2001. There is still a residual depreciation for the fourth quarter of 2002, due to the difference of the exchange rate in the eve of the Copom meeting and the average rate during the third quarter.

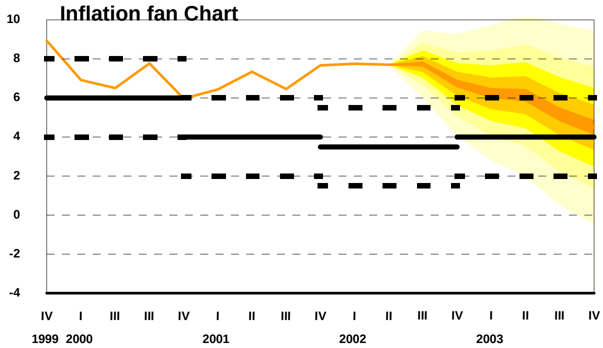
Regarding the fiscal policy, it is assumed that the target of 3.75% set for the primary surplus of the consolidated public sector will be achieved.



The core inflation of the IPCA, as calculated by the symmetric trimmed-mean method, rose from 0.40% in June to 0.51% in July and 0.65% in August. In the last 12 months, a variation of 7.17% was registered in this core inflation. As for the core inflation of the IPC-BR, as calculated by the symmetric trimmed-mean method, it hit the mark of 0.41% in June, 0.40% in July, and 0.65% in August. Accumulated in 12 months, the core index increased by 6.69%. The core inflation calculated by the exclusion of administered prices - considering a wide set of items weighing 31.5% in the IPCA in August - and of household food prices had a variation of 0.38% in August, which is practically equal to the one registered in July (0.39%). In June, the core inflation calculated with the exclusion of these items was not higher than 0.13%. The variation accumulated in the last 12 months was 6.10%.

6.3 – Inflation forecast

Forecasted 12-month IPCA-inflation with Selic interest rate constant at 18% p.a.



(accumulated inflation in 12 months)

Based on the assumptions and associated risks considered by Copom and on all the information available, the IPCA variation in twelve months was projected assuming that the basic interest rate will remain constant at the level of 18.00% a year, as defined at the meeting held on 17-18 September 2002, and that the exchange rate will remain constant at the level observed on the eve of the Copom meeting (R$ 3.20). The inflation projection using the market-expected interest rate path will be presented as well.

12-month IPCA inflation with 18% p.a. fixed interest rate

Year Q	Confidence Intervals 50%	30%	10%				Central Projection
2002:3	7,0	7,3	7,6	7,9	8,1	8,4	7,7
2002:4	5,6	6,1	6,5	6,9	7,3	7,8	6,7
2003:1	4,8	5,4	6,0	6,5	7,1	7,7	6,2
2003:2	4,4	5,2	5,8	6,5	7,1	7,8	6,1
2003:3	3,3	4,1	4,8	5,5	6,2	7,1	5,2
2003:4	2,5	3,3	4,1	4,9	5,7	6,5	4,5

Note : The values correspond to the ones shown in inflation fan chart, with Selic interest rate constant at 18% p.a. inflation accumulated in 12 months.

The central path expected for the inflation accumulated in 12 months declines steadily from 7.7% at the end of the third quarter of 2002 to 6.7% at the end of the year and to 4.5% in 2003. One should notice that the probabilities of deviations are symmetrically distributed around the median, reflecting Copom's judgment on the balance of risks associated with the projection. The inflation accumulated in 12 months drops strongly in each quarter, except from the first to the second quarter of 2003. These drops mean that high inflation rates are being replaced by figures that are more consistent with the targets set for the inflation and reflect, to a large extent, the continuous depreciation of the domestic currency observed in 2002, which is not expected in the next year.

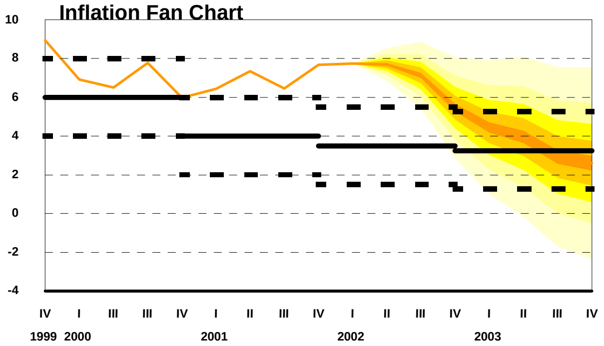
Prices administered by contract and monitored prices are the ones causing the highest inflationary pressure. These prices are projected to rise by about 9.3% in 2002 and to account for 2.9 percentage points in the IPCA variation. Of the 9.3% rise forecasted for the year as a whole, a rise of 7.6% was registered until August. For market prices, which account for about 70% of the IPCA, a 5.6% growth is expected, with a contribution of 3.8 percentage points. In the last quarter of 2002, the monthly average anticipated for the inflation of market prices is 0.36% a month, which is below the average of 0.49% projected up to September. A relatively high inflation of market prices has been projected for the last quarter of the year as a result of the lingering effects of the exchange rate depreciation registered since the second quarter and of the inertia associated with the inflation of 2.40% in the third quarter of the year.

For the IPCA as a whole, an inflation rate of 4.5% has been projected for 2003. This lower inflation as compared to 2002 can be mainly explained by the absence of exchange rate depreciation (*see Box "Determinants of the Fall in the Projected Inflation between 2002 and 2003"*).

For 2003, a 7.9% inflation rate is estimated for prices administered by contract and monitored prices, with a contribution of 2.5 p.p. to the IPCA. For market prices, a lower figure is estimated: 2.9%, with a contribution of 2.0 p.p. to the IPCA. The monthly average inflation of market prices should therefore be close to 0.25% in 2003, with higher figures anticipated for the first quarter of the year, which incorporates about 0.4 p.p. of the repressed exchange rate pass-through. The inflation of market prices should drop after the first quarter of 2003 as a result of the assumption of no exchange rate depreciation over the period and to the lower inertia inherited from the previous quarter.

It is estimated that that the contribution of the primary effect of the shock to prices administered by contract and monitored prices to the IPCA - the value exceeding the inflation target after the impact of the exchange rate pass-through and of inertia on prices administered by contract and monitored prices is eliminated - will amount to approximately 0 p.p. in 2002 and to 1 p.p. in 2003. Therefore, there was a drop of about 0.5 p.p. in the shock projected for 2002 since the *Report* of June. This drop means that the inflation of managed prices has not been following the same pace of the exchange rate variation. This result was expected to a certain extent, considering that many managed prices are readjusted only once a year. For those prices that were readjusted in 2002, the impact of the exchange rate depreciation will only be felt when they are adjusted again in 2003. It is also estimated that the impact through inertia of the inflation above the target set for 2002 on the IPCA will amount to 0.3 p.p. in 2003.

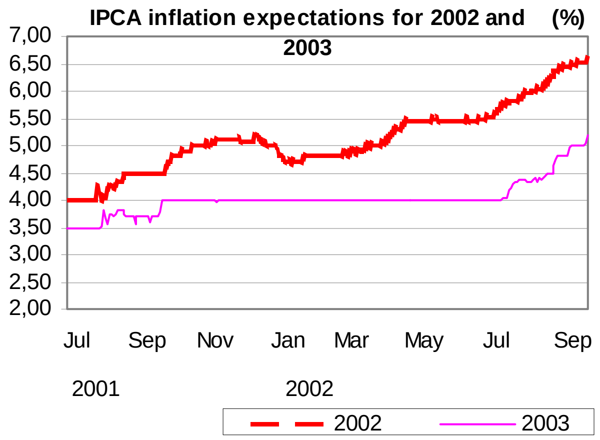
Forecasted 12-month IPCA-inflation with interest rate constant at 18% p.a. (March Report)



(Accumulated inflation in 12 months)

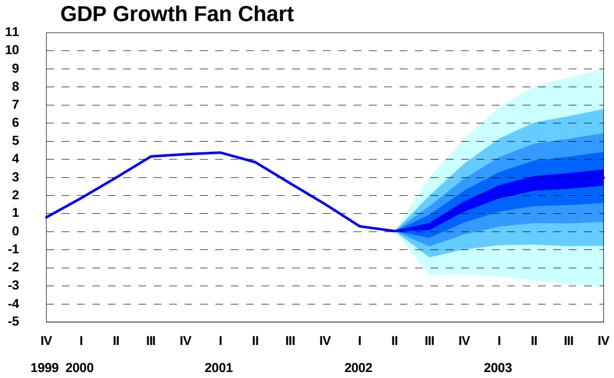
Comparing the current projection with that of the June *Report*, a change in the expected path can be observed. Even though it is not possible to compare them directly, as projections are based on different assumptions in terms of scenario and interest rate, it is worthwhile to make a few comments. The central projection for 2002 rose from 5.5% to 6.7% and the one for 2003 rose from 2.6% to 4.5%.

For 2002, the main causes of the higher projection were the impact of the exchange rate depreciation on market prices, which accounts for about two-thirds of the increase, and the inflation of prices administered by contract and monitored prices, the projected variation of which rose from 8.1% to 9.3%. For 2003, market prices contributed 1.3 p.p. and managed prices contributed 0.6 p.p. to the higher inflation projection. The higher inflation of market prices projected for 2003 is due to the inertial effects of the inflation in 2002, to the incorporation of a repressed exchange rate pass-through, and to the upward review of the expected inflation itself. Regarding managed prices, the higher projection is attributed to both the direct and indirect effects of the exchange rate depreciation, where the indirect effects reffer to the impact of exchange rate depreciation on the General Price Indices.



The graph on the side illustrates the evolution for the expectations for the inflation rate in 2002 and 2003 according to information gathered by the Investor Relations Group (Gerin) of the Central Bank of Brazil. As shown in the graph, the projections for the two years rose by more than 1 p.p. since the *Report* of June. The most important factor to explain this increase is the exchange rate variation that has been registered since then. In addition, the higher expectations for 2003 may have been influenced by the increase of 0.75 p.p. in the inflation target (*see Box "Setting the Target for 2004 and Reviewing the Target for 2003"*). In fact, in the weeks after the announcement of the new target for the inflation in 2003, the inflation rate was reviewed upwards after a long period during which it remained constant at 4%. However, the increase in the projection for 2003 was similar to the one observed for 2002, when no new target was announced.

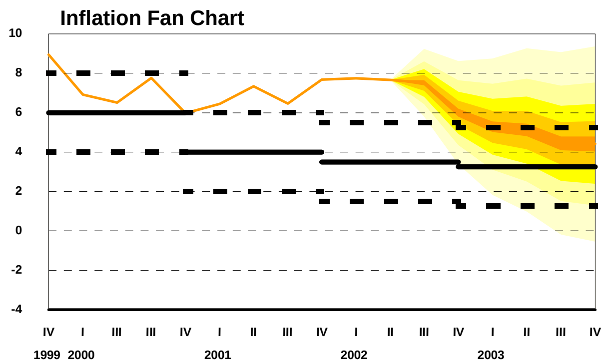
GDP growth with 18% p.a. constant interest rate



(GDP variation , 12 months over previous 12 months)

As in previous Reports, this issue also presents the fan chart for output growth. It is constructed based on the same underlying assumptions used in the baseline scenario of Copom. It should be stressed that the forecasting errors associated with GDP growth projections are considerably larger than in the case of inflation projections. This happens because GDP growth projections involve the path of two non-observable components, namely, potential output and output gap, and because the calculation of the output is, by definition, more complex and less precise than that of the inflation. The central projection for output growth in 2002 is approximately 1.4%, assuming that the basic interest rate will remain constant at 18% a year. Therefore, there was a drop of about 0.6 p.p. in the projection of GDP growth in 2002 since June. This decline is particularly associated with the effects of a higher uncertainty that prevailed over the period.

Forecasted IPCA-inflation with market interest rate expectation. [1]



(Accumulated inflation in 12 months)

1 Source : Gerin - 18/09/2002

The inflation fan chart taking into account the market-expected path for the basic interest rate and the exchange rate on September 16 is also presented. As in the previous *Reports*, the median of market expectations captured by Gerin surveys until that date was directly used. The market-expected interest rate path slopes downward from the current level to 17.50% p.a. in the last quarter of 2002 and to 15.00% in 2003. Based on this path and on the VAR model, the path for the six-month swap rate through the forecast horizon was estimated. Besides the interest rate assumption, this fan chart assumes the real at R$ 2.93/1.00 US$ in the last quarter of 2002 and at R$ 3.00/ 1.00 US$ in late 2003. The inflation estimated on the basis of these assumptions amounts to 6.0% in 2002 and to 4.4% in 2003. The remaining assumptions are the same as those spelled out in the baseline scenario. One should notice that since the market-expected exchange rate is lower than the one used in the baseline scenario, which was the

IPCA-inflation with market expectations for interest rate and exchange rate expectation [1]

	Confidence Intervals						
	50%						
		30%					
			10%				Central
Year Q							Projection
2002:3	6,8	7,1	7,4	7,6	7,9	8,2	7,52
2002:4	4,9	5,4	5,8	6,2	6,6	7,1	6,00
2003:1	3,9	4,5	5,0	5,6	6,1	6,7	5,29
2003:2	3,4	4,1	4,8	5,4	6,1	6,8	5,12
2003:3	2,5	3,4	4,1	4,8	5,5	6,3	4,4
2003:4	2,4	3,3	4,0	4,8	5,6	6,4	4,4

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

1 Source: Gerin - 18/09/2002

actual rate on the eve of the Copom meeting, the inflation projected for 2002 and 2003 based on the figures expected by the market for the exchange rate and interest rates is lower than the one projected under the baseline scenario.

Determinants of the Fall in the Projected Inflation between 2002 and 2003

The projections for the inflation in 2003 are lower than those for 2002. In the *Report* of June of this year, the lower inflation projected for 2003 was justified by the absence of exchange rate depreciation next year; by the smaller inflation for managed prices; and by a high real interest rate, with its consequent impact on the output gap. Similar explanations were provided in the *Minutes* of the Copom meeting in August.

It should be highlighted that inflation forecasts crucially depend on the underlying assumptions that are adopted. For example, using the assumptions related to the exchange rate (1 US$ = R$ 2.36) and to the inflation of managed prices (adjustment of 5.6% in 2002) made in the *Report* of December 2001, the inflation projected for 2002 would drop from the present level of 6.7% to 4.5%. Similarly, the inflation for 2003 may deviate from the 4.5% projected in this *Report* depending on the behavior of the exchange rate and of the inflation of managed prices. However, there are no grounds for us to believe that deviations between the actual figures and those anticipated in this *Report* would tend to push inflation up or down in the next year.

This note intends to evaluate the importance of the determinants of inflation in bringing down the inflation projected for next year. Before presenting the results, it is important to clarify that in an inflation targeting regime where the Central Bank enjoys credibility, the inflationary process should present small auto-correlation. Therefore, when a series of shocks hit the economy for a certain period, as has been the case since 2001, one can expect inflation to rise temporarily, without significantly pressuring inflation in the following periods.

Usually, the inflation of market prices can be specified by a Phillips curve of the following type:

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

That is, the inflation of market prices (p^l) depends on the headline inflation (p) with a lag; of the inflation expected in the following period ($E_t p_{t+1}$); of the contemporary variation in reais of the price of tradable goods, defined by the sum of the logarithms of exchange rate (*e*) and the level of international prices (p^f); of the output gap (*h*), with a lag; and of a cost-push shock (e^p).

The headline inflation is then obtained by the weighted sum of market and administered price inflation. For managed items, price adjustment projections are based on specific rules and depend on existing contracts, on the importance of the exchange rate pass-through in the price formation process, among other factors.

The terms on the right side of the equation shown above indicate the direct contribution of each factor to the inflation rate. For example, the contribution of inertia is given by $\alpha_1\pi_{t-1}$ and the contribution of the expected inflation is given by $\alpha_2 E_t\pi_{t+1}$. The chart below shows the direct contribution of each factor to the inflation rate in 2002 and 2003, as well as the difference between the two years.

	2002	2003	Difference
Headline Inflation	6.7	4.5	-2.2
Administered Prices	2.9	2.5	-0.4
Market Prices	3.8	1.0	-1.8
Determinants of Market Price Inflation			
Inertia	1.8	1.4	-0.4
Expected Inflation	2.2	1.7	-0.6
Exchange rate pass-through[1]	1.5	0.4	-1.1
Output gap	-2.0	-1.4	0.6
Residual	0.3	0.0	-0.3

1 – Besides the direct contribution, includes also the indirect effects, via inertia.

As shown in the table, the exchange rate pass-through and the inflation inertia are the main determinants of the drop in the inflation rate between 2002 and 2003. The contribution of 1.1 p.p. associated with the exchange rate pass-through is based on the underlying assumption that the exchange rate will remain at the same level as on the eve of the Copom meeting. Therefore, the only impacts projected for the variation in tradable goods prices expressed in reais in 2003 will be those associated to the pass-through that was repressed in the previous year and to the foreign inflation.

The behavior of the expected inflation contributes to a drop of 0.6 p.p. in the inflation rate in 2003. This result is attributed to the credibility of the inflation target regime: despite that the projected inflation in 2002 is 6.7%, the rate expected for 2003 is not significantly different from the target. That is, there is the perception that the high inflation in 2002 was basically caused by shocks and that the Central Bank has been conducting the monetary policy in such a way as to prevent these shocks from leading to an inflationary spiral. Therefore, since no shocks are anticipated for 2003, the expectation that the inflation rate will drop to levels close to the target is an important factor for bringing inflation down next year.

Inflation inertia directly contributes with 0.4 p.p. to the drop in the inflation rate between 2002 and 2003. To a large extent, this contribution is attributed to the fact that the inflation projected for the fourth quarter of 2002 (1.2%) is much lower than the one registered in the fourth quarter of 2001 (2.2%).

The output gap is expected to push the inflation down both in 2002 (-2.0 p.p.) and in 2003 (-1.4 p.p.). However, since the downward pressure is higher in 2002, the output gap will contribute directly to push inflation up in 2003 as compared to 2002.

Other factors contributing to a lower inflation in 2003 are the lower projections for the adjustments of managed prices and the residuals. The latter refer to projection errors and shocks. For 2002, a shock was characterized to capture the lingering effects of the electricity crisis, which led to an increase in the prices of the electricity consumed by factories. In 2003, there will be no shocks other than those already incorporated in the adjustment of managed prices and in the repressed exchange rate pass-through. Moreover, since there are no figures observed for 2003, but only projections, it is not possible to talk about projection errors. Therefore, the contribution of residuals to the inflation in the next year is null.

Setting the Target for 2004 and Reviewing the Target for 2003

The National Monetary Council determined, through Resolution 2,972 of June 27, 2002, that the inflation target for 2003 should be changed from 3.25% to 4%, with a tolerance interval of minus or plus 2.5 p.p. and set the inflation target for 2004 at 3.75% with the same tolerance interval.

In July 1999, six months after the floating exchange rate regime was adopted, the Brazilian inflation target system was implemented. The purpose was to find a new nominal anchor, a role that would be played by the inflation target itself.

In an inflation targeting regime, the commitment to price stability is the main objective of the monetary policy. In order to achieve this objective, the Monetary Authority announces medium-term goals for the inflation rate and acts according to inflation forecasts. Credibility is a crucial requirement in a regime of this kind. However, uncertainties are inherent in any inflation forecast process, given the uncertainties underlying the parameters of the model and the impossibility to foresee all exogenous shocks that affect the economy.

According to Mishkin and Schmidt-Hebbel (2001)[1], an inflation target regime should be structured in such a way as to preserve credibility in face of shocks. There are four ways to do this. The first one is to adopt some measure of core inflation in order to reduce the volatility of the price index. The second one is to make way for the use of escape clauses. The third way to lessen the effects of shocks is to expand the evaluation time horizon of the target regime. The fourth way is to adopt wider tolerance intervals that allows a better absorption of inflation rate fluctuations by the economy.

Given the intensity and comprehensiveness of the set of shocks that have been affecting the Brazilian economy and of their impact on the inflation, adopting a smoother path for the targets became a better option. This adjustment was necessary because the monetary policy should be conducted in such a way as to gradually bring inflation back to the target, avoiding an excessive volatility in the activity level.

[1] Mishkin, F.e Schimdt-Hebbel, K.(2001), *One Decade of Inflation Targeting in the World: What Do We Know and What Do We Need to Know?* NBER Working Paper 8397.

Countries	Ranges (for 2002)	Volatility of the Exchange Rate (local currency/US$) (*)	Volatility of the Inflation Rate (accumulated over 12 months) (**)(***)
Brazil	1.5-5.5%	0.36	6.73
Iceland	1-4.5%	0.12	4.02
Thailand	0-3.5%	0.25	2.00
South Africa	3-6%	0.45	0.61
New Zealand	0-3%	0.16	0.70
Canada	1-3%	0.10	0.41
Chile	2-4%	0.22	1.26
Czech Republic	2.75-4.75%	0.14	3.16
Switzerland	<2.0%	0.11	1.94
Australia	2-3%	0.15	1.50
Israel	2-3%	0.19	1.33
England	2.50%	0.08	0.38

Source: Bloomberg and Central Banks
(*) variation coefficient
(**) series used to validate the inflation target regime
(***) standard deviation
Horizon: February 1990 – April 2002
Exceptions for the Calculation of the Inflation Rate Volatility: England – 02/91-03/02; Israel – 02/01-03/02; Chile – 02/97-04/02; Czech Republic – 01/95-12/01; Brazil – 06/95-05/02; Canada – 06/96-07/02; Thailand – 91-01; New Zealand – 03/94-04/02; Australia – 03/90-06/02.
Exceptions for the Calculation of the Exchange Rate Volatility: Israel –11/91-03/02; Czech Republic – 07/93-04/02; Iceland – 12/92-04/02; Brazil – 06/95-05/02.

The optimum size of the tolerance interval can be determined according to the volatility of economic variables that affect the price levels, such as the exchange rate. As shown in the table, the volatility of shocks in Brazil has been higher than in other economies that adopt the same monetary regime. The volatility of exchange rate was measured by the variation coefficient observed during the period of the inflation target regime. Brazil presents the second highest score, only after South Africa. Also, Brazil presents the highest volatility of inflation, as measured by the standard deviation of 12-month inflation. The higher volatility of the inflation rate in Brazil can be attributed to the more pronounced effect that shocks have on the country because of its specific features as an emerging economy under restructuring.

It should be highlighted that countries such as Israel and New Zealand reviewed the optimum size of their ranges and expanded the intervals they use as a target in order to adjust the path of inflation targets to the conditions prevailing in their economies.

Annex

Minutes of the 72nd Meeting of Banco Central do Brasil Monetary Policy Committee (Copom)

Date: June 18th and 19th, 2002
Place: Central Bank's Headquarters 8th floor Meeting room (on June 18th) and 20th floor (on June 19th) - Brasília - DF

Called to Order: 3:43 PM on June 18th and 11:18 AM on June 19th
Adjourned: 7:33 PM on June 18th and 1:35 PM on June 19th

In attendance:
Members of the Board
Armínio Fraga Neto **- Governor**
Beny Parnes
Edison Bernardes dos Santos
Ilan Goldfajn
Luiz Fernando Figueiredo
Sérgio Darcy da Silva Alves
Tereza Cristina Grossi Togni

Department Heads (all present on June 18th)
Altamir Lopes – Economic Department (DEPEC)
Daso Maranhão Coimbra - International Reserve Operations Department (DEPIN)
Gustavo Alberto Bussinger - Research Department (DEPEP)
José Antônio Marciano - Department of Banking Operations and Payment System (DEBAN)
Sérgio Goldenstein - Open Market Operations Department (DEMAB)

Other participants (all present on June 18th)
Antônio Carlos Monteiro - Executive Secretary
José Pedro Ramos Fachada Martins da Silva - Advisor to the Board
Alexandre Pundek Rocha - Advisor to the Board
João Borges - Press Secretary (ASIMP)
Fabia Aparecida de Carvalho - Investor Relations Group

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

Economic Activity

The economic activity continues to show gradual expansion, albeit at a slower pace than at the beginning of the year. The initial perception of stronger growth was partly due to a statistical seasonality effect, created by Easter holidays falling earlier this year, in March.~~n~~ The latter has a strengthening effect on the seasonally adjusted results in April. In fact, there are signs of economic slowdown, evident from, among other factors, the recent outcomes of both consumer and entrepreneur expectation surveys.

The economic recovery was confirmed by the growth of 1.3% in Gross Domestic Product (GDP) in the first quarter of 2002, compared to the previous quarter, according to seasonally adjusted indexes released by the Brazilian Institute of Geography and Statistics (IBGE). Compared to the same quarter of 2001, GDP declined by 0.73%, mostly due to the sequence of shocks that occurred between the two periods rather than by an adverse result in the quarter in reference. In addition to the favorable performance of the agricultural and livestock sectors, the output of the services sector continued to increase, particularly due to the good results of the communications sub-sector, which still reflected the investment cycle initiated after the privatization of the telecommunication companies.

In April, industrial production increased by 4.1%, seasonally adjusted data, with an increase of 7.1% in the production of capital goods, 7.2% in consumer goods and 2.4% in intermediary goods. These good results, as previously mentioned, were influenced by the Easter Holiday falling in March this year. This fact is not offset in the seasonal adjustment process, and thus atypically increased the results in April and similarly reduced them in May.

The Continuous Survey of Agricultural Production, carried out by the IBGE in April, forecasted that in the primary sector, the total grain production in 2002 should reach 99.3 million tons, an expansion of 0.8% in relation to the 2001 harvest. It should be highlighted that the increase in the production of beans and rice, which are products of great importance to the basic consumer basket, caused reductions in their prices. The latter had a favorable influence on inflation in the first months of 2002. In addition, the growth in the harvested crop of soybeans and the higher production of oranges should contribute positively to the trade balance. On the other hand, the reduction in the harvested crop of corn may lead to an increase in the cost of livestock production and require imports to supply the domestic demand.

Regarding demand indicators, retail commerce has shown a roller coast pattern of monthly ups and downs throughout the year. This fact is partly explained by the seasonality effect of Easter coming in

March and reflecting in April too. However, the latter trend reveals a loss of dynamism in the process of recovery of the sector – initiated in the second semester of 2001, attributed to the still low growth in income and credit. On the other hand, Mother's day and the proximity of the World Cup contributed to sales in May, according to the preliminary data from the São Paulo State's Federation of Commerce (Fecomércio), which shows a 3.2% growth in the monthly sales (seasonally adjusted data).

The volume of credit operations further revealed more moderate expansion. The total balance of those operations in the domestic financial system reached R$ 343.4 billion in May, with increases of 1.3% in the month and 2.7% in the quarter ending in May. The operations with freely allocated resources totaled R$ 201.8 billion, increasing by 1.2% in the month, particularly due to a 1.6% growth in the stock of credit granted to private individuals. Noteworthy are the increases of 2.1% in personal credit in the month and 1.4% in the financing of automobiles in the month, 9.4% accumulated in the year.

The stock of credit operations for corporations increased 0.9% in the month. With the 6.7% exchange rate depreciation in May, this expansion was concentrated in the credit lines linked to foreign resources, which grew by 4.4% in the month. On the other hand, the stock of credit lines granted with domestic resources declined by 0.8%, indicating that companies may be liquidating debts and postponing their banking credit requirements.

The average prefixed interest rate charged on credit operations increased by 0.4% p.p. in May. This trend was a result of the increase of the interest rates in the futures market, which raised the average cost of funding. The banking spread declined by 0.3%p.p. in the month. The default rate in operations with freely allocated resources increased by 0.2% to reach 8.9%. The percentage of operations with private individuals in arrears grew by 0.1 p.p., reaching 15.2%, whilst the same figure related to companies remained stable at 4.9%.

The credit conditions and the high default rate have affected consumer expectations. The Index of Consumer Intentions (IIC), released by Fecomércio declined by 12.3% in June, reflecting sharp drops both in the current and future consumer intentions. Furthermore, the index was influenced by concerns regarding unemployment and by the unease related to the development of the country's political scenario and the international environment.

Investment, which is another demand component, is showing a partial recovery from the deceleration observed in the last months of 2001. The shift in results is a consequence of the evolution of the production of both capital goods and basic materials for the civil construction industry, as confirmed by recently released indicators for April, bearing in mind the influence of the seasonality effect in this case too. In the month, there were increases of 2.2% in the production of civil construction materials, 6.2% in the production of machinery and equipment and 6.2% in the *quantum* of imported capital goods, seasonally adjusted data. Another indicator of business investment decisions is the financing granted by the National Bank of Economic and Social Development (BNDES), which increased by 29% in the first five months of 2002 compared to the same period of 2001. The BNDES financing requires a 40% to 50% complement from the investor.

Regarding the evolution of investment flows, it should be highlighted that despite the recovery trend observed in the last few months, the absorption of capital goods declined by 4.9% in the first quarter, in comparison to the same period of 2001. This was a result of the combination of the 0.3% growth of domestic production, an 18% decline in imports of capital goods, and to the 12.5% fall in the exports of capital goods.

In the labor market, the increase in the formal employment index is worth noting. There was a 0.4% increase in April, in the seasonally adjusted series, reflecting the creation of 175 thousand job positions, according to the Ministry of Labor and Employment. However, the IBGE’s Monthly Employment Survey registered an increase in the unemployment rate to 7.6%, from 7.1% in March, mainly as a result of the 7.5% increase in the number of unemployed, since the number of employed workers declined by 0.2%. The decline in the number of active workers was mainly due to the slowdown of the civil construction industry and of commerce, whilst the manufacturing industry showed a 2.3% increase. Data released by the National Confederation of Industries (CNI) indicated a similar trend, apart from revealing an increase in the real payroll.

As for the external transactions of the Brazilian economy, the current account deficit declined to US$ 7 billion during the January-May 2002 period, compared to US$ 11.2 billion deficit registered in the same period of 2001. The current account deficit in the January to May 2002 period was totally financed by the net inflow of foreign direct investment, which reached US$ 8.1 billion.

The better current account result reflected the reduction of the deficit in the services and income accounts and, principally the reversal of the trade balance, which reached a US$ 1,933 million surplus in the first five months of 2002, in comparison to a deficit of US$ 353 million in the same period of 2001. The shift in the trade balance result was due to the 21.4% fall in imports, as the contraction of important markets for Brazilian products led to a 12.2% decline in exports. Moreover, soybean exports have been delayed this year, in spite of the growth in the production, as the sector is well capitalized and waits the right moment to trade an important part of the current harvest. Regarding the decline in imports, in addition to the impacts of the substitution of purchases abroad by domestic producers, the decline in exports of manufactured goods, which have a high coefficient of utilization of imported raw materials and components, all had a noteworthy influence too.

In summary, activity related to production is still growing, but shows some signs of deceleration. From the demand viewpoint, the positive effects of the increasing agricultural revenue and the beginning of the payment of the installments related to the agreement on the losses of the Time in Service Guarantee Fund (FGTS) are being, nevertheless offset by the deterioration of consumer expectations.

External Environment

In the United States, the scenario of recovery of economic activity is still unclear. The GDP growth in the first quarter was revised to 5.6% from 5.8%. The result was highly influenced by isolated factors, such as the increase in defense expenditures and private investments, mainly in inventories, whilst final demand evolved more slowly than in the previous quarter. The industrial production expanded by 0.1% in May, compared to the forecast of 0.3%, showing signs of deceleration. The level of utilization of the installed capacity remained stable at 75.5%. Industry and commerce inventories declined by 0.2% in April, despite the upward trend of the last months. There was a marginal improvement in the labor market, with a reduction in the unemployment rate to 5.8% in May from 6% in April and stability in the number of employees and hours worked, in addition to the retraction in the real average income.

The retail commerce sales (excluding food services) declined by 0.9% in May, according to seasonally adjusted data, albeit being 1.9% above the sales of May 2001. In the same month, the producer’s price index (PPI) once again registered negative variation (0.4%), with the highest fall of the last six months. The core index, which excludes food and energy price variations, remained unchanged. The consumer prices continued to be stable in May, resulting in an annual variation of 1.2%, while the core index of consumer prices increased by 0.16% in the month, maintaining the 2.5% annual variation. The entrepreneur and consumer expectations remained on an upward trend, according to the indications of surveys by the *Institute for Supply Management* and the *Conference Board.*

In Japan, the statistics revealed some positive signs of economic recovery. First estimates indicated that GDP grew by 1.4% in the first quarter of 2002, in comparison with the previous quarter, and 5.7% on an annual basis, geared by the performance of the external sector. Exports totaled US$ 32.9 billion in April, increasing by 3.8% over the same month of 2001, while the imports declined by 9.2% over the same period, reaching US$ 26.9 billion. The growth in the exports of automobiles and electronic goods should be highlighted. Industrial production increased by 0.2% in April, whilst inventories declined for the third consecutive month, and factory orders increased by 11.3%, indicating a recovery in commercial investments. The unemployment rate reached 5.2% in March, after remaining stable at 5.3% in the first two months of the year.

In the Euro Area, after a long period of stagnation, the economy starts showing signs of moderate expansion. GDP grew by 0.2% in the first quarter of 2002, favored by export growth, despite the recent exchange rate appreciation. Domestic demand remained sluggish, with retail sales increasing only 0.3% in March, after rising by 0.5% in February. In May, the expectations of the entrepreneurial sector remained favorable in France and in Italy, improving in Germany, after an localized retraction in

April. Consumer confidence is improving in France and in Germany and is stable in Italy. The inflation of consumer prices declined to 0.1% in May, and to 2% on an annual basis, favored by the drop in food prices, by the appreciation of the euro and even by the favorable statistical effect derived from the fact that May 2001 registered the highest rise of consumer prices in the year.

In Argentina, the fall in the level of economic activity, the liquidity crisis, and the exchange rate market volatility persist. Industrial production shrank by 16.5% in April compared to the same month of 2001. The inflation showed signs of deceleration in May, but the price variation ytd is 25.9% in the consumer index and 80.4% in the wholesale index. The trade balance maintained a surplus in the first four months, with a fall of 65% in imports, due to the reduction in the quantum, and a drop of 5% in exports, reflecting depressed prices. The overall public sector deficit reached P$3.3 billion in the first four months of the year, exceeding the annual budgetary target of P$3 billion.

Prices

The main price indices showed a divergent path in May. The Consumer Price Index – Extended (IPCA) decreased to 0.21% in May from 0.8% in April, while the General Price Index – Domestic Supply (IGP-DI) increased to 1.12% in May from 0.7% in the previous month. The recent evolution of the price indices can be largely attributed to the behavior of food prices – with distinct trends in the wholesale and retail commerce - and to monitored prices, especially fuel prices.

In the IPCA, food prices fell in April (0.71%) and May (0.59%), benefiting from reductions in the prices of items with relevant weight in the basic consumer basket, such as rice, beans, meat and, recently, *in natura* products. This behavior is explained by the seasonality in the period, by favorable agricultural harvests and by favorable climatic conditions, characterizing a favorable supply shock. The group of products with prices administered by contracts and monitored was the main reason, for the second consecutive month, for the rise in the IPCA in May, reflecting mainly the readjustments of electricity tariffs and the wages of housekeepers.

In the past months, except for food prices, the free market prices continued to show relative stability in their monthly variation (0.48% in March, 0.52% in April and 0.46% in May). Among the main groups responsible for these variations are pharmaceuticals in March, privately owned vehicles and clothing in April, and electro electronics and services of maintenance and repair in May.

Regarding the IGP-DI results, it is worth highlighting the evolution of the wholesale prices, which have a weighting of 60% in the general index. In this segment, it is worth mentioning the recovery, after consecutive falls since the beginning of February, in agricultural prices, which rose by 0.85% in May compared to a decline of 0.71% in April and to a reduction of 0.6% in the agricultural prices in the IGP-M of May. The main factors that explained the behavior of Agricultural Wholesale Price Index

(IPA) were the prices of the soy (influenced by the variation of the exchange rate), corn (this product has a supply constraint this year, its price had already increased in the previous months), and meat in general (whose prices are now presenting a less intense decline). The wholesale prices of industrial products continued on an upward trend observed since the beginning of April. This trend reflected, in part, the depreciation of the exchange rate in the period, especially affecting the metallurgical and mechanics segments, in addition to paper and cardboard, chemical and food products. The civil construction workers' wage readjustment scheduled in their labor agreement in three out of the eleven surveyed capitals increased the variation of the National Index of Civil Construction (INCC) by 2.5%, impacting with 0.25 p.p. in the monthly variation of the IGP-DI. The variation of the Consumer Price Index (IPC) registered deceleration, reaching 0.28% compared to 0.71% in April, mainly due to the lower rises observed in transport and housing.

In June, the prices administered by contracts and monitored should remain as the main source of inflationary pressure, as a result of the recent readjustments in the prices of bottled gas, urban transport tariff in Rio de Janeiro and Salvador, and fixed telephone tariffs. The contribution of the food group should be smaller, as a result of the behavior of wholesale agricultural prices. However, these movements constitute supply pressures, thus with temporary effects on the trajectory of the indices. Trend inflation Indices (core inflation indices in twelve months or free market prices excluding food) show favorable prospects.

Money market and open market operations

The last Copom decision did not cause significant shifts in the yield curve. From the beginning of June onwards, however, a significant increase was observed in the slope of the yield curve due to the deterioration in the risk perception on the part of the economic agents. The spread between the 1-year interest rate and the Over-Selic target increased to 833 bps on June 18th, from 188 bps on May 21st. The 1-month interest rate spread increased to 38 bps from -23 bps.

In the period between May 22nd and June 18th, the National Treasury and Banco Central carried out six auctions to rollover R$ 10.0 billion in NBCE and NTN-D maturing. For the first rollover of R$ 3.7 billion in NBCE redeeming on June 13th, two NTN-D auctions were carried out at a five-month tenure. For the second rollover of R$ 6.3 billion in NTN-D maturing on June 19th, four exchange rate swap auctions were carried out, one at 2-year tenure, representing 45% of the total, and the others at a 6-month tenure.

Meanwhile, the National Treasury carried out three auctions of LTNs. In the first one, 6-month securities maturing in December 2002 were offered. In the second, which had demand for only 68% of the offers, 7-month securities maturing on January of 2003 were offered. Consequently, the National Treasury decided to reduce the tenure of the offers in the last auction of the period to four months. The total financial volume of the operations was R$ 4.3 billion, of which 84% referred to the placements of securities maturing in 2002.

Considering the financial settlements that occurred between May 23rd and June 19th, there was an expansionary monetary impact of R$ 12.5 billion, resulting mainly from the R$ 3.7 billion net redemptions of LTN and the R$ 7.9 billion redemptions of dollar-indexed securities (mainly due to the rollover of NTN-D with exchange rate swaps).

During the 18 working day period between May 23rd and June 19th, Banco Central do Brasil intervened in the open market by withdrawing and providing liquidity at one working day tenure and yields of 18.40% and 18.50% p.a., and average volumes of R$ 6.5 billion and R$ 0.9 billion, respectively. In the same period, Banco Central operated with daily spread auctions to level out the banking liquidity. In all operations in which Banco Central provided liquidity to the market, the yield was 18.60%. In the liquidity withdrawing interventions, the yield fell to 10% from 15%, ending the period at 18.30%. In the 18-day period, the average liquidity withdrawn and provided in the leveling operations, reached R$ 0.7 billion and R$ 0.2 billion, respectively. There were also two selling auctions of LTN with repurchase agreements, totaling R$ 3.4 billion and with an average tenure of 20 working days.

Moreover, in June, Banco Central carried out several operations to exchange federal securities (LFT and dollar-indexed). The operations intended to reduce the duration of those securities in the market, in order to reduce the market's exposure to these assets' price volatility.

In the first auctions to exchange LFT, the securities repurchased were scheduled to mature in 2004, 2005 and 2006, and the ones placed will mature in 2003, totaling R$ 24.3 billion. In the other auctions, the securities offered were scheduled to mature in 2002 and the ones repurchased will mature in 2003. The nature of these operations was due to the rise in the discount of the latter securities. Banco Central accepted, on June 14 and 17, bids to exchange securities maturing in 2004 to 2006, amounting R$ 5.1 billion. The bids for LFT maturing in 2003 reached R$ 14.4 billion, on June 17 and 18.

In the three auctions to exchange dollar-indexed securities, the repurchased securities were scheduled to mature in 2004 and 2005. In the first two, securities maturing in 2003 were sold (totaling R$ 4.0 billion), and, in the last one, Banco Central sold securities maturing in 2002 (amounting to R$ 3.0 billion).

Three auctions to exchange FX swaps were carried out in order to reduce the duration and distortions in the slope of the exchange rate coupon. In the first two, the contracts accepted were scheduled to mature in 2004 and the ones placed will mature in 2003. The notional value of the operations reached USS 1.7 billion. In the third operation, Banco Central assumed a long position in contracts maturing in 2003 and 2007 and a short position in contracts maturing in 2004. The notional value of the operation was USS 1.9 billion.

In May, the domestic federal securitized debt increased by R$ 6.1 billion compared to the previous month. The increase in the share of the exchange rate indexed debt to 30.3% in May from 28.8% in April was mainly due to the depreciation of the Real.

Assessment of Inflation Trends

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

1. May inflation rate, measured by the IPCA, declined in relation to April, reaching 0.21% in May, compared to 0.80% in the previous month;

2. For 2002 as a whole, a 4.5% decline in gasoline prices is forecast due to the fall in January and February. This forecast is higher than the –6.6% forecast in the last Copom meeting. For bottled gas, a 28.0% increase is forecast for 2002 (compared to an increase of around 29% in the last meeting), of which 21.5pp has already occurred from January to May. The increase in the forecasts of these products was partially offset by a smaller than expected readjustment of these products in the May IPCA;

3. The average increase of electricity tariffs in 2002 is estimated at 19.4%, compared to 18.0% forecast in May. For 2003, the forecast for the readjustment of electricity tariffs declined to 12.3% from 13.6% forecast in May;

4. Regarding the set of prices administered by contracts and monitored, with a weighting of 30.8% in the IPCA, the inflation forecast for 2002 is 8.1% compared to 7.6% forecast in the May Copom meeting. The increase in the forecast was basically due to the exchange rate depreciation that occurred between the Copom meetings of May and June. This depreciation was partially offset by the evolution of the international price of petroleum and its by-products. The gasoline price in the United States, which is used by Petrobras as a parameter, has declined. Likewise, the future prices of gasoline and propane gas have declined compared to the Copom meeting of May. The forecast inflation for the prices administered by contracts and monitored is 6.1% for 2003. There was thus an increase of 1.6 p.p. since the May Copom meeting. The increase in the inflation forecast for 2003 is due to the effects of the exchange rate depreciation, to the increase in the future price of petroleum by-products next year, and to the change in the hypothesis of price readjustments for specific items;

5. The inflation forecasts were based on the new specification of the structural models that has the 180-days pre-fixed DI swap as its explanatory variable, replacing both the Selic rate and the slope of the term structure of the interest rate. The forecast of the 6-month spread over the Selic rate is based on a model specification that is based on the new method of estimating by error correction. Maintaining

the Selic rate constant, the 6-month spread forecast starts at 350 b.p. on the third quarter of 2002, presenting a declining trend afterwards to reach 50 b.p. during 2003.

6. The trend of the U.S. Fed Funds rate, based on the maturities of the future contracts, was changed to reflect a 1.75% average rate in the second quarter of 2002, increasing to 2.25% in the first quarter of 2003, and stabilizing at 2.5% from the second quarter of 2003 onwards.

7. The sovereign risk premium, based on the spread over treasury of Brazil's Global 08, is forecast to decline gradually to 700 b.p. in 2003 from the average plateau of 940 b.p. in this quarter. On the eve of the Copom meeting, it reached around 1,500 b.p.

The core inflation of the IPCA, calculated under the symmetric trimmed-mean method, declined to 0.51% in May from 0.56% in April. In the last 12 months, this core figure registered a 7.58% variation. The IPC-BR core inflation, calculated under the symmetric trimmed-mean method, declined to 0.36% in May from 0.46% in April. In the last 12 months, this core figure registered a 7.10% variation. Core inflation calculated by excluding prices administered by contracts and monitored plus household food prices registered a 0.46% variation in May, accumulating 6.39% in 12 months.

The accumulated variation of the IPCA in 12 months was 7.77% in May, below the rate observed in April (7.98%) and close to the rate observed in March (7.75%). The free market prices contributed with 4.05p.p. to inflation and the prices administered by contracts and monitored contributed with 3.72p.p. The inflation expectations surveyed by Banco Central do Brasil's Investor Relations Group (GCI) remained stable for 2002 and 2003, respectively at 5.46% and 4.00%.

Regarding the fiscal policy, the hypothesis assumed is to achieve the primary surplus target of 3.75% for the consolidated public sector. The remaining assumptions established in the previous meeting were maintained.

From the simulation exercises with several specifications of the structural model, it has been concluded that the maintenance of the interest rate at 18.5%p.a. and the exchange rate at the same plateau as on the eve of the Copom meeting will lead to an inflation rate of approximately 5.5% in 2002 and below the target in 2003.

Monetary Policy Guidelines

The indicators of economic activity on the second quarter of 2002 seem to confirm that the economy is recovering from the low level of growth observed last year, albeit at a slower pace. In the first quarter of 2002, seasonally adjusted GDP grew by 1.34% compared to the previous quarter. The strong seasonally adjusted growth in the industrial production in April (4.07%), measured by the

IBGE, was partially influenced by the anticipation of the seasonal bank holidays. In line with the growth in industrial production was the increase in the real payroll in April, both in São Paulo, according to FIESP, and throughout Brazil, according to the CNI.

For the month of May, some indicators point to a reduction in industrial production compared to the previous month. The inventory levels in the manufacturing industry of raw materials and intermediate goods declined according to CNI estimates, whilst inventories of final goods increased in the first quarter. The open unemployment rate, measured by the IBGE, interrupted the downward trajectory and started to rise again, reaching 7.6% in April, compared to 7.1% in March. The Consumer Intentions Index, measured by São Paulo's Fecomércio, significantly declined by 12.31% in June (seasonally adjusted). Likewise, the Industrial Entrepreneur Confidence Index fell slightly in the current quarter, albeit rising significantly in the first quarter of the year compared to the two previous quarters. Credit to consumers and corporations should be relatively constant in the following months due to the increase in default rates, constraining expenditures with consumption and investments.

The performance of the external sector continues to be positive. The trade balance showed a positive result of US$ 4.9 billion in the last twelve months up to May. The current account deficit accumulated in 12 months has continuously declined since August 2001, reaching US$ 19.4 billion in April. From January to May 2002, this deficit was fully financed by the net inflows of foreign direct investment, which totaled US$ 22.4 billion accumulated in the last 12 months. For 2002, the deficit is projected to reach US$ 19 billion, and should be almost entirely financed by the US$ 18 billion net inflow of foreign direct investment.

Nonetheless, the recent adverse economic scenario, marked by an increase in the uncertainties regarding the future of the country, has negatively influenced the price of local and foreign assets. Comparing the exchange rates quoted on the days immediately preceding the Copom meetings, the Real has depreciated by 7.5% since the meeting in May, with the country risk measured by the Embi+ rising to a level above 1,300 bps from 930 bps. The volatility in the markets also hit other assets. The one-year exchange rate coupon significantly increased in comparison with that observed at the beginning of the year, the same occurring with the discounts on the long term LFTs.

The IPCA inflation in May was 0.21%, 0.59 p.p. below April inflation. The prices administered by contracts and monitored increased by 0.43%, influenced by the readjustments in the prices of oil by-products. Free market prices increased by 0.11%, benefiting from the seasonal behavior of food prices. The variation of the free market prices has declined since February 2002, reaching 0.64%. Excluding the impact of *in natura* food prices, free market prices increased by 0.17% in May.

For the months of June and July, a higher increase is expected in free market prices compared to those registered in May. The reversal in the decline of agricultural prices is already impacting on wholesale prices, with the agricultural IPA increasing by 0.85% in May. Moreover, the recent exchange rate depreciation should exert pressures on free market prices in the following months. Nonetheless, this impact may be limited. Firstly, as a result of slower economic growth, the capacity of firms to pass through the cost increases associated with the exchange rate variation is limited. Furthermore, during the first four months of the year, for the establishment of prices, in all likelihood, a more depreciated exchange rate than effectively occurred was being used as a parameter. Likewise, the economic agents may also be establishing prices based on an exchange rate that is more appreciated than is effectively occurring.

Prices administered by contracts and monitored should also exert pressures on inflation in June and July. Petrobras announced a 9.2% readjustment in the refinery prices of bottled gas, effective from June 1st. In that period, there will also be a concentration of readjustments in the prices of electricity and fixed-line telephones.

The impact of the exchange rate variation on prices administered by contracts and monitored is more direct than on free market prices. In the case of prices of oil by-products, the domestic prices closely follow international prices converted into Reais, though the percentage readjustment to consumers would be lower due to the existence of other cost elements and the disproportion between taxes and prices. In the case of electricity and fixed-line telephones, the contracts signed with the concessionaires usually embed readjustments based on the exchange rate variation and/or on the IGP variation, which is influenced by the exchange rate.

The shock of prices administered by contracts and monitored is defined as the value that exceeds the inflation target, after deducting the impact of the exchange rate pass through and the inertia on these prices. As the exchange rate depreciated, the impact of its pass through on the prices administered by contracts and monitored increased. However, the projection for the inflation of prices administered by contracts and monitored was lower than that predicted by the pass through coefficient, mainly due to the drop of international prices of oil by-products. Thus, the primary effect of the shock of prices administered by contracts and monitored declined to around 0.5 p.p. On the other hand, the forecast for the impact of 2001 inertia on 2002 inflation increased to 0.9 p.p. from 0.7 p.p. due to the incorporation of the chain effect through 2002, as detailed in the Technical Note n. 22 (“Methodology for calculating the inflation inertia and the effects of the shock to administered prices”). The inflation target for 2002 adjusted for the impact of the primary effects of the shocks of prices administered by contracts and for part of the impact of the 2001 inertia on the 2002 inflation is between 4.5% and 5%.

The inflation expectations surveyed by the Banco Central do Brasil’s Investor Relations Group (GCI) are still indicating a decline in inflation for the near future. For 2002 and 2003, the expectations are converging to a figure below 5.5% and around 4.0%, respectively.

Copom has worked with a basic scenario for the following 18 months that assumes both the maintenance of an economic policy in 2003 that is committed to fiscal stability and the inflation target regime and a transition to the future government without exaggerated and/or prolonged moments of turbulence.

In this basic scenario, the inflation of free market prices should maintain its downward trend and the inflation measured by IPCA should be in accordance with the targets established by the government. According to the models used by the Central Bank, the projection of the variation of IPCA for 2002 increased since the May meeting and is around 5.5%. The revision was due exclusively to the exchange rate depreciation in the period. The projection for the IPCA in 2003 is below the established target of 3.25%.

In this scenario, the Copom understands that it would be advisable to reduce the interest rate due to the following factors: (i) in the current monetary conditions, the projection of inflation for 2003 is significantly below the target, (ii) the inflation expectations show confidence prevailing to a downward trend for inflation in the following 18 months, and (iii) despite the projection for inflation in 2002 being slightly over the center of the target adjusted by the impact of the shocks of prices administered by contracts and monitored and in part due to the impact of the inflationary inertia of 2001 on 2002 inflation (resulting in an interval between 4.5% and 5.0%), this difference reflects the recent increase of the market's volatility, especially in relation to the exchange rate, which tends to be a temporary factor.

However, one should evaluate the risk of the non-materialization of this basic scenario. As uncertainty in relation to the future of the country's economy and the recent adverse conjuncture, characterized by the steep depreciation of asset prices and of the exchange rate persist, the risk of an increase in the projections for inflation in 2002 and 2003 also exists. Especially, the perception of a temporary exchange rate variation and the magnitude of its pass through to prices could be brought into question, in spite of the factors that could restrain the exchange rate pass through described above.

Weighing up all the options, Copom considered that, although the prospects for inflation are favorable in the baseline scenario, the increase of the uncertainties regarding the economic scenario place doubts on the materialization of this scenario and recommends the maintenance of the present interest rate. However, as the financial market normalizes, with the stabilization of asset prices and of the exchange rate at levels that reflect more adequately the economic fundamentals, the prospect of declining inflation in the following 18 months will become more likely, and may in turn permit a reduction in the interest rate. As a result, taking into account that the recent instability does not reflect the current fundamentals of the Brazilian economy and thus can be considered as temporary, the Copom assessed that the situation recommends signaling of a possible reduction in the interest rate before the meeting in July.

In the light of these facts, the Copom decided, unanimously, to maintain the target for the Selic interest rate at 18.5% p.a., and signal a downward trend.

At the close of the meeting, it was announced that the Committee would meet again on July 16th, at 3:00pm, for technical presentations and, on the following day, at 11:00am, in order to discuss monetary policy guidelines, as scheduled in the Calendar of Copom's Ordinary Meetings, published in the BCB Communiqué n. 8911, of Oct 3, 2001, and in the BCB Communiqué n. 9586, of June 6, 2002.

Minutes of the 73rd Meeting of Banco Central do Brasil Monetary Policy Committee (Copom)

Date: July 16th and 17th, 2002
Place: Central Bank's Headquarters 8th floor Meeting room (on July 16th) and 20th floor (on July 17th) -Brasília - DF

Called to Order: 3:35 PM on July 16th and 11:28 AM on July 17th
Adjourned: 7:52 PM on July 16th and 2:21 PM on July 17th
In attendance:
Members of the Board
Armínio Fraga Neto **- Governor**
Beny Parnes
Carlos Eduardo de Freitas
Ilan Goldfajn
Luiz Fernando Figueiredo
Sérgio Darcy da Silva Alves
Tereza Cristina Grossi Togni

Department Heads (all present on June 18th)
Altamir Lopes – Economic Department (DEPEC)
Daso Maranhão Coimbra - International Reserve Operations Department (DEPIN)
José Antônio Marciano - Department of Banking Operations and Payment System (DEBAN)
Paulo Springer de Freitas - Research Department (DEPEP)
Sérgio Goldenstein - Open Market Operations Department (DEMAB)

Other participants (all present on June 18th)
Antônio Carlos Monteiro - Executive Secretary
José Pedro Ramos Fachada Martins da Silva - Advisor to the Board
Alexandre Pundek Rocha - Advisor to the Board
João Borges - Press Secretary (ASIMP)
Tarsila Segalla Afanasieff - Investor Relations Group

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

Economic Activity

The economic activity has been showing deceleration in the last few months, as a consequence of the recent instability and its impact on the aggregated demand. Some indicators show that the favorable results of industry and commerce, observed in previous months, were associated with circumstantial facts such as the statistical effect of the Easter holidays in March, and events like the Mother's Day and the World Cup. Recent information indicates relative economic stability, due to the modest growth of payroll and of credit demand. Further circumstantial factors, such as the payment of the balances of Time in Service Guarantee Fund (FGTS), in a context of financial uncertainty, may marginally affect the evolution of the activity level indicators in the following months.

Industrial production fell by 5.1% in May (seasonally adjusted data), due to the 6.4% reduction in the manufacturing industry, compensated in part by the 2.8% growth in the mining industry. The contraction of production of manufacture in the month was predictable - as the result was partly due to the statistical effect compared with the steep growth registered in April - albeit the decline was sharper than expected. All the categories of use showed decline, especially the durable consumer goods (-12.9%) and capital goods (-9.7%). Regarding the performance of the industrial sectors surveyed, one can observe that most sectors registered declines (16 out of the 22), especially electrical material and communications (-8.9%), mechanical (-8.8%), transport material (-7.6%), food products (-5.7%) and metallurgical (-4.6%). Indicators related to the production of corrugated paper and machinery for agricultural activities registered another fall in industrial production in June, however far less steeper than the one observed in May.

The Continuous Survey of Agricultural Production, carried out by IBGE in May, continued to indicate an increase in the total grain production between 2001 and 2002, however lower than the one registered last month. Total grain production would reach 98.8 million tons in 2002, representing 0.3% increase in relation to 2001. Besides grain production, other important farming products should show higher production levels, such as sugar cane (4.5%), oranges (10.2%) and coffee (12.4%).

In the last months, demand indicators have been showing an unstable behavior with no defined trend. The real turnover of the retail commerce in São Paulo's Metropolitan Region decreased by 2.1% in June (seasonally adjusted data), maintaining the pattern of ups and downs throughout the year, according to data from the São Paulo State's Federation of Commerce (Fecomércio). The analysis by segments shows that the automobile commerce and the non-durable goods sales maintained a favorable performance during the month, growing 1.3% and 0.9%, respectively. The environment of economic instability apparent in June contributed to the negative performance of the remaining segments.

According to the São Paulo Trade Association (ACSP), the enquiries to the Credit Protection Service (SPC) and to the Usecheque expanded 1.5% in June, in relation to May (seasonally adjusted series). However, according to the same institution, the default rate rose to 8.3% in June from 7% in May (seasonally adjusted data).

The Index of Consumer Intentions (IIC), released by Fecomércio, registered steep recovery (12.8%), according to seasonally adjusted data, after two consecutive months of decline. The fact that Brazil won the World Cup together with the payment of the balances of the FGTS reflected positively on consumer expectations in July. Both actual and future intentions registered growth in their indexes.

The demand for credit remains retracted, influenced by the economic instability observed in the last few months, while the financial institutions continue to be selective with their lending policies. Nevertheless, in June, there was an expansion of 2.4% in bank credit stock - that reached R$ 351.8 billion - basically due to the accounting effect of the exchange rate depreciation over the portfolios funded by external resources and the incentive to operations using the Advance on Export Contracts (ACC).

Among the operations with freely allocated resources, responsible for 59% of the total balance, the stock of credit to companies increased 4.2% in June, totaling R$ 130.5 billion. This expansion was concentrated, for the second consecutive month, in modalities contracted with foreign resources, which increased by 8.5% in the month. Noteworthy are the expansions of 8.7% in the balance of loans with external funding and 8.2% of the ACC operations. The stock of credit contracted by private individuals remained practically stable at R$ 76.5 billion, with a variation of 0.1% in the month.

The banking spread of prefixed credit operations reached 37.1 pp, the smallest value in the last 12 months, mainly due to the increase in the medium and long term funding cost and to the stability of lending rates. This stability resulted from a 0.7 pp decline of credit to companies, especially short-term operations, in relation to May, while the credit to private individuals increased 0.4 pp, as several credit lines to individuals increased, especially credit to finance automobile purchases. The credit operations default with freely allocated resources declined by 0.4 pp, reaching 8.5%. The default levels on credit operations with freely allocated resources declined by 0.4 p.p., reaching 8.5%. This performance is a result of debt renegotiation, mainly related to personal credit lines, lent by large financial institutions.

In the labor market, the average rate of unemployment, measured by IBGE, remained almost stable in May, 7.7% compared to 7.6% in April. However, both the employed workers, according to IBGE, and the formal employment, according to the Ministry of Labor and Employment, maintained an upward trend in May. The seasonally adjusted series of formal employment showed an increase of 0.2% in May, while the number of employed workers, according to the Monthly Employment Survey carried out by IBGE, increased 0.5% in the same period.

Regarding the external transactions of the Brazilian economy, the trade balance accumulated a US$ 2.6 billion surplus in the first semester, in comparison to the US$ 72 million deficit registered in the same period of 2001. This result was caused by a 22.6% reduction in imports, mainly of raw materials and capital goods, motivated by the gradual and continuous import substitution, by the drop of exports of manufactured goods, by the slower pace of industrial production and by the reshaping of investment projects. Exports dropped by 13.4% in the first semester as a result of the decline in exports to Argentina. In the first two weeks of July, the trade surplus reached US$ 764 million, due to the sharp increase in exports of basic and semi-manufactured goods. Daily average of exports, which were showing successive drops in the previous months, registered a 28.5% growth in the first fifteen days of July, in comparison to the same period in 2001, while the imports registered a decline of 3.3%. The result of July is in part a consequence of the normalization of shipments after the delays of May and June, due to the strike of the customs authorities.

The improvement in the trade balance has contributed to the reduction in the current account deficit that is taking place simultaneously with the reduction of the resources available to finance the balance of payments, mainly the issuance of securities abroad and long term foreign loans. In June, the current account deficit reached US$ 1.3 billion, in comparison to the US$ 2.1 billion in the same month of 2001, totally financed by the US$ 1.6 billion inflow of foreign direct investment.

In summary, the second quarter was a period of downturn in economic activity from the recovery initiated at the end of 2001, especially towards the end of the period due to deteriorating expectations. The deterioration of the environment of uncertainties due to the elections in October and unfavorable events in the international scenario have influenced the decisions of the economic agents who have postponed expenditure on consumption and investment.

External Environment

The uncertainty in capital markets, caused by the accounting frauds, is causing an increase of risk aversion by investors and reducing international liquidity. This fact has asymmetrically impacted on emerging market countries, especially those with largest balance of payments borrowing requirement. This scenario worsened by the lack of recovery in economic activity of developed countries and to the decline in international trade.

In the United States, the scenario of a possible economic recovery continues to be undefined. In the last revision, real GDP grew 6.1% p.a. in the first trimester of 2002. In May, personal consumption expenditures remained stable for the third consecutive month. The sales of industry and commerce declined 0.4% in May, with inventories showing a variation of 0.2%. The inventory-to-sales ratio reached 1.36, slightly superior to the previous level. Retail sales increased by 1.1% in June, above market expectations. In spite of the 0.14% growth, in June, producer price index declined by 2.04% in the year. The core index registered 0.2% in the month, accumulating 0.27% in the year. The entrepreneurs confidence indicators, surveyed by the *Institute for Supply Management*, stayed positive, however, showing some variations - PMI-manufacture ratio rose to 56.2% in June from 55.7% in May, while BAI-Services ratio declined to 57.2% from 60.1%, in the same period. The latest forecasts of the index of consumer confidence have shown retraction. The index measured by the Conference Board fell to 106.4 in June, while that measured by the University of Michigan declined to 86.5 in July, the lowest level since November 2001. The trade quantum continued retracting in April and the trade deficit registered slight growth, due to the reduction in exports. In the first quarter, the current account deficit increased and the net financial flow declined.

The expectations regarding the behavior of the Japanese economy improved with more optimism over the prospects of the future recovery in the levels of economic activity. Retail sales have not reacted yet, with the growth rate staying stable at 0.1%, over the 12 months, up to April. However, factory orders increased by 2.5%, in May, compared to April, increasing for the third time in the year. Industrial production, in May, expanded by 4.1%, reflecting gains of electrical machinery and of the transport equipment sectors. The confidence index Tankan that expresses the expectations of the larger entrepreneurs, reached -18 points in the second trimester, in comparison to -38 points in the previous period, the first positive variation since the second quarter of 2000. The trade balance reverted its downward trend, in spite of the appreciation of the yen. The performance of trade balance in May was mainly due to the decline in imports. Exports totaled US$ 36.6 billion in May, a 6.9% increase in relation to May 2001, while imports fell 8.2%, in the same period, reaching US$ 29.3 billion.

In the Euro Area, the domestic demand remained depressed, with a 0.1% growth in retail sales, in 12 the months up to April. The rate of unemployment remained stable at 8.3%. Regarding inflation, the annual variation of the Consumer Price Index - Harmonized declined to 2% in May, from 2.4% in April. In addition, the producer price index registered a higher deflation of 0.9%, in comparison to the deflation of 0.7% in April. The evolution of the main confidence indicators shows a reversion in the recovery trend of the expectations of entrepreneurs and consumers. In spite of the euro appreciation, the trade balance accumulated in 12 months continues to grow, although export sales are growing at a slower rate.

In Argentina, the economic activity continues to slowdown, although some demand indicators have increased in May, in relation to April, such as supermarket sales (4.7%), shopping center sales (7.1%)

and civil construction (2.5%). Industrial production in May declined by 13.5% in relation to May 2001 and increased by 0.9% in relation to the previous month. Preliminary data shows that 23% of the Economically Active Population is unemployed and 22% are sub-employed. The recession and the demand contraction have been responsible for the restraints on prices, resulting in the decline in inflation in the last two months. The trade balance registered a US$ 6.6 billion surplus in the first five months of the year, in comparison to a US$ 1.1 billion surplus in the same period of last year. The result reflects contractions of 6% in exports and 64% in imports.

Prices

The main price indices registered increases of inflation in June compared to May, reflecting the rise in food prices, the impact of exchange rate depreciation, mainly in the wholesale prices, and the readjustments of the administered and monitored prices in the period. The IPCA increased by 0.42% in comparison to 0.21% in May, and the IGP-DI increased by 1.74%, in comparison to 1.11% in May.

Amongst the items that most pressured the IPCA in June, noteworthy are the increase in bottled gas (9.02%), urban bus fares (2.44%) and clothing (1.39%) - due to the launch of the Autumn/Winter collection. It is important to stress that the free prices maintained relative stability in the month varying 0.12% in June and 0.11% in May, contributing to the maintenance of the IPCA close to the threshold of the market expectations interval, in June.

Regarding the IGP-DI results, the evolution of the wholesale prices, mainly the agricultural prices should be highlighted. The Agricultural Wholesale Price Index showed a 4.57% rise, reinforcing the recovery of prices initiated in May, when the index showed a 0.85% variation. It is worth mentioning that the agricultural prices reflect, to a large extent, the recent behavior of the exchange rate – much of the impacts observed in the month came from items whose prices were highly influenced by the exchange rate, such as soy, wheat and soy bean oil. The wholesale industrial prices registered rises of 1.74% in June, compared to 1.42% in May, reflecting, among others, the exchange rate depreciation. The Consumer Price index (IPC) did not follow, to the same extent, the increase in the wholesale prices, reaching 0.55% in June, compared to 0.28% in May.

For July, a larger impact of administered by contracts and monitored prices is expected on the inflation indices, due to the concentration of readjustments of public services tariffs in the period, namely, electricity (in São Paulo and Curitiba) and fixed-line telephone (in the whole country), and the readjustments of fuel prices at the beginning of the month. This factor should increase the rates of consumer price indices in July, when the highest inflation of the year may be registered. However, free prices should go on showing favorable behavior, going slightly above the level registered in June, due to the recovery of food prices.

It is worth highlighting that from August onwards the administered by contracts and monitored prices tend to show expressively smaller variations, since the main readjustments expected for the year have already occurred. Moreover, the effects of exchange rate depreciation over the prices – although meaningful for the wholesale prices – mainly due to the absence of items of services and by the presence of commodities in their composition - tend to be significantly smaller compared to the consumer prices indices, mainly due to the limited growth of the activity level.

Money Market and Open Market Operations

The deterioration in the risk perception and the movement of some market participants that unwound contracted positions in the interest rate future market, contributed to the interest rate yield curve reaching the highest level of slope within the period, and the spread between the 1-year rate and Selic rate target reaching 1280 b.p., on June 21st. After that, there was a gradual reduction of interest rate practiced in the interest rate futures market. On July 16th, the spread between the 1-year rate and the Selic target rate reached 878 b.p, compared to 833 b.p. on June 18th.

In the period between June 19th and July 16th, the Banco Central do Brasil (BCB) carried out three auctions to rollover the NBCEs. Exchange rate swap auctions were carried out in two stages in order to rollover R$ 5.5 billion maturing on July 11th. In the first, the value corresponded to R$ 2.8 billion, and contracts were offered with maturity in 2005, 2007 and 2008; in the second rollover, amounting to R$ 2.7 billion, contracts were placed for redemption in 2 and 7 months. Regarding the R$ 2.9 billion rollover of NBCE maturing on July 18th, only the equivalent of R$ 1.2 billion in Fx swap contracts were auctioned, with maturity in 2, 7 and 17 months. The partial rollover was due to the weak demand observed.

At the same time, the National Treasury auctioned on three occasions, LTN and LFT maturing in September 2002, limiting the total offer to 500 thousand securities per auction. The financial volume was R$ 1.6 billion, of which R$ 1,2 billion in LTN.

Considering the financial settlements between June 20th and July 16th, there was an expansionary monetary impact of R$ 14.2 billion, resulting mainly from the net redemptions of LTN and dollar-indexed securities.

During the 19 working day period between June 20th and July 16th, the BCB intervened in the open market by withdrawing and providing liquidity at one working day tenure and yields of 18.40% and 18.50% p.a., and average volumes of R$ 10.5 billion and R$ 2.1 billion, respectively. The BCB also carried out an auction of LTN with a repurchase agreement totaling R$ 0.6 billion with tenure of 29 working days.

Moreover, Banco Central carried out three operations to exchange LFT. The operations intended to reduce the duration of the securities in the market in order to reduce the market's exposure to the volatility of these assets' price. R$ 3.0 billion in LFT was exchanged maturing in 2003 for LFT maturing in 2002.

The BCB carried out two auctions of exchange Fx swap aiming at reducing distortions in the slope of the Fx coupon and at reducing the average tenure. In the first, the BCB assumed short position in contracts maturing in July 2003, amounting to US$ 1.1 billion and assumed a long position in contracts maturing in January 2003 and January 2005, to the sum of US$ 0,8 billion e US$ 0,3 billion, respectively. In the second, assumed long position in contracts maturing in October 2002, amounting to US$ 1.5 billion and a short position maturing in April and July 2003, of US$ 0.5 and US$ 1.0 billion, respectively.

The BCB and the National Treasury carried out on July 12th a joint operation to exchange NBCE by LFT with Fx swap. The selling auction of LFT by National Treasury amounted to R$ 9.9 billion, a sum equivalent to the NBCE purchased by the BCB. The operation intended to generate less volatility to the quotas of investment funds that were the holders of securities and Fx swaps (due to the asymmetric evolution of the Fx coupom slopes of the two instruments) and the decline in the volume of the collateral maintained in the BM&F.

In June, the domestic federal securitized debt increased by R$ 14.4 billion (2.3%). The increase in the share of the exchange rate indexed debt by R$ 23.4 billion was due to the depreciation of the Real of 12.8% occurred in June.

Assessment of inflation trends

The identified shocks and their impact were reassessed in the light of newly available information. The scenario considered in the simulation considers the followings assumptions:

1. The inflation rate in June, measured by the IPCA, reached 0.42%, in comparison to 0.21% observed in May;

2. For 2002 as a whole, a reduction of 2% is forecast for gasoline prices due to the fall in January and February, a lower reduction than the projected in the last Copom meeting (-4.5%). For bottled gas, a 42% increase is forecasted for 2002, of which 32% has already occurred from January to June. In the Copom meeting of June 2002 an increase close to 28% was projected, characterizing a substantial increase in the forecasts.

3. Regarding electricity tariffs, an increase of 19.2% for 2002 is projected, compared to a 19.4% forecast in June. For 2003, the forecast for the readjustment of electricity tariffs increased to 14.4% in July from 12.3% in June, due to exchange rate depreciation and the expected increase of inflation for 2003;

4. Regarding the set of prices administered by contracts and monitored, with a weighting of 30.8% in the IPCA, the inflation forecast for 2002 is 8.9%, compared to 8.1% forecasted in the Copom meeting of June. The increase in the forecast was basically due to the exchange rate depreciation that occurred between the Copom meetings of June and July. For 2003, the inflation forecast for the prices administered by contracts and monitored is 6.6%. There was thus an increase of 0.5 p.p. since the Copom Meeting of June. The increase in the inflation forecast for 2003 is also due to the effects of the exchange rate depreciation, besides the increase of expected inflation for 2003, which is used in forecasts of some specific items as water and sewage tax, electricity and fixed-line telephones.

5. The projection of the 6-months spread over the Selic rate, applying a specification based on a error correction estimation model and maintaining constant the Selic rate at 18.5%p.a., starts from 460 b.p. at the third quarter of 2002, declining to –80 b.p. in the last quarter of 2003;

6. The path of the U.S. Fed Funds rate, based on the futures contracts maturities, was revised to reflect a 1.75% rate at the third and fourth quarters of 2002, increasing to 1.8% in the first quarter of 2003 and remaining unchanged at 2.0% after the second quarter of 2003;

7. The sovereign risk premium, based on the spread over treasury of Brazil's Global 08, is forecasted to decline gradually to 700 b.p. in 2003 from the average plateau of 1.800 b.p. in this quarter;

The core inflation of the IPCA, calculated under the symmetric trimmed-mean method, declined to 0.40% in June from 0.51% in May. In the last 12 months, this core registered a 7.23% variation. In its turn, the IPC-BR core inflation, calculated under the symmetric trimmed-mean method, increased to 0.41% in June from 0.36% in May. In the last 12 months, this core registered a 6.94% variation. Core inflation calculated by excluding the prices administered by contracts and monitored plus household food prices registered a 0.13% variation in June, accumulating 6.22% in the 12 months.

The accumulated variation of the IPCA in 12 months registered 7.66% in June, below the rate observed in May (7.77%) and in April (7.98%). The free market prices contributed with 4.02p.p. to inflation and the prices administered by contracts and monitored with 3.65 p.p.. The inflation expectations surveyed by the BCB's Investor Relations Group (Gerin) for 2002 and 2003, increased to 5.8% and 4.2% respectively.

Regarding the fiscal policy, the hypothesis assumed is to achieve the primary surplus of 3.75% for the consolidated public sector. All the others assumptions considered in the previous meeting were maintained.

From the simulation exercises with several specifications of the structural model, it has been concluded that the maintenance of the interest rate at 18.5% p.a. and the exchange rate at the same plateau as on the eve of the Copom meeting indicates an inflation rate slightly over 5.5% in 2002 and well below the target in 2003.

Monetary Policy Guidelines

The economic activity has lost dynamism in the last few months, reflecting the recent instability and its impact on aggregate demand. Most of the data related to industry showed decrease in May in comparison to April, in the seasonally adjusted series. According to the IBGE, production declined by 5.1% and, in accordance to the CNI, there was a decline in employment (0.1%), in hours worked in production (4.1%), in the payroll (0.6%) and in the utilization of installed capacity (1.2%). Preliminary indicators, such as the reduction of shipments of corrugated paper and in the production of agricultural machinery, indicate a new decline of industrial production in June. There is also a prospect of fall in the Industrial Entrepreneur Confidence Index.

In spite of the negative results of the industrial sector, there are factors that have softened the deceleration of the activity level. Agricultural production in 2002 should be higher than in 2001, with some items growing more than 10%, like soy, wheat, coffee and oranges. Besides, demand has been sustained by the increase of agricultural income, the liberation of balances of the Time in Service Guarantee Fund (FGTS) and the social programs expenditures. The Consumer Intentions Index increased by almost 10 p.p. between June and July, although this figure only partially offsets the 12 p.p. fall registered between May and June.

The interest rates set by the market showed a considerable increase in the last two months, constraining the activity level. The 6-month fixed interest rate swap increased to 23.0% from 18.5% between the meetings of May and July, and the 12-month fixed interest rate swap reached 26.4% from 20.2%. It is understood that the aggregate demand is not a factor of inflationary pressure in the economy.

The foreign sector has registered positive results in the last twelve months. The trade balance shows a US$ 5.3 billion surplus in the twelve months up to June, which represents an increase of approximately US$ 0.4 billion since May. The current account deficit, in the twelve months result, has continuously declined since August 2001 and reached US$ 18.2 billion in June. This deficit was entirely financed by the net inflows of foreign direct investment, which reached US$ 22.2 billion in the twelve months up to June.

However, the adverse situation observed since mid-April, characterized by an increase of the uncertainty in relation to the future of the country and, aggravated, in the last month, by the increase of the risk perception in relation to the world economy, has negatively influenced the asset prices denominated in foreign and local currencies. The risk measured by the Embi+ reached 1572 b.p. and the thirty-day volatility of the exchange rate increased by 20.3%, despite the fall to 12.8% of the five-day volatility. The volatility of the markets also affected other assets. The one-year FX coupon reached 16.6%.

The inflation measured by the IPCA was 0.42% in June, above the 0.21% registered in May, due to the behavior of administered by contracts and monitored prices, which increased 1,09% in June. The inflation of these prices was pressured mainly by the readjustments of bottled gas (9.02% in June and

32.4% year-to-date) and urban bus fares in Salvador and Rio de Janeiro (10.0% and 9.09%, respectively). The prices administered by contracts and monitored should also impact significantly on inflation in July. In this respect it is worth highlighting the readjustments of 6.75% and 6.2% for gasoline and bottled gas in the refineries, the 8.07% average increase in the tariffs of fixed-line telephones and the 14.24% and 10.96% increase in electricity tariffs in São Paulo and Curitiba.

Recent data confirm the declining inflation of free market prices in the economy. After reaching a 0.64% variation in February, the inflation of free market prices declined to 0.45%, 0.24%, 0.11% and 0.12% in the following months. It should be emphasized that, unlike in May, inflation in June was not benefited by the harvest season. When household food items are excluded from the free market prices, corresponding to core inflation measured with the exclusion of administered by contracts and monitored prices and of household food items, inflation declines to 0.13% in June, from 0.46% in May. The variation of the core inflation measured by the symmetric trimmed-mean method also decreased, reaching 0.40% in June from 0.51% in May.

The shock of administered by contracts and monitored prices declined to a figure close to 0.35 p.p., as the projection for the inflation of administered by contracts and monitored prices was smaller than that forecasted by the pass-through coefficient, as occurred in June. The projection for the 2002 inflation is above the center of the target adjusted by the impact of the shock of administered by contracts and monitored prices and by the impact of part of the inflationary inertia of 2001 in 2002, resulting in the 4.0%-4.5% interval for the adjusted target. However, the difference between the projection for 2002 and this interval reflects the recent depreciation of the exchange rate, which tends to be temporary (at least partially) and, due to its magnitude, recommends a more gradual correction of its inflationary effects.

The inflation expectations surveyed by the Investor Relations Group (Gerin) of the BCB increased since the Copom’s meeting of June. For 2002, the expectations changed to 5,8% from around 5,5%, probably due to the depreciation of the exchange rate observed in the period. For 2003, the inflation expectations were revised in 0.2 p.p., rising to 4.2% from 4.0%.

The inflation caused by free market prices may rise in the coming months due to the pass-through of the exchange rate depreciation to prices. However, this impact may be limited, as firms may have difficulties to pass-through the increase in costs linked to the exchange rate variation, due to the slower pace of economic growth.

The exchange rate depreciation and the increases in the several risk premiums in the markets are due to the uncertainties in relation to the international scenario and the future macroeconomic policy in Brazil. This combination of the increase in risk aversion by enterprises and global banks and the perception of fragility in Brazil requires a response that is beyond monetary policy.

The Copom has worked with a basic scenario for the next 18 months that assumes the maintenance of an economic policy in 2003 committed to the fiscal and monetary responsibility and to the fulfillment of contractual obligations. These policies are not related to ideologies or political parties, and represent an essential condition to ensure economic security, growth and development. It is therefore reasonable that one awaits their maintenance in the next administration, which has been indicated by the main Presidential candidates. This commitment may make possible, if necessary, stronger financial support from the international community.

In this basic scenario, the decreasing trend of the inflation of free market prices observed in this year should continue through the following eighteen-month period. For 2003, the basic scenario forecasts inflation significantly below than the new target of 4%. In addition, the change of the target for 2003 and the definition of 3.75% as the target for 2004 offer more leeway to accommodate fortuitous upward revisions of the projections, if alternative scenarios are confirmed. Consequently, the members of the Copom agreed that there is room for a loosening of the monetary policy.

However, there was no consensus about the adequate timing for the returning to the process of reducing the basic interest rate. Five members considered that the forecast of inflation for 2003 significantly below the target and the confidence in the maintenance, in the future, of a responsible macroeconomic framework, recommend immediate reduction of the current basic interest rate. Two members of the Copom considered, however, that, as the turbulence in the financial market causes uncertainties on the inflation projections, recommend the loosening of the monetary policy when the situation in the financial market stabilizes, voting for the maintenance of the interest rate with a downward bias.

In the light of these facts, the Copom decided, by a majority of 5 to 2, to reduce the target for the Selic interest rate to 18.0% p.a.

At the close of the meeting, it was announced that the Committee would meet again on August 20th, 2002, at 3:00 pm, for technical presentations and, on the following day, at 11:00 am, in order to discuss the monetary policy guidelines, as set in the Communiqué no. 8911, of Oct.3.2001, and in Communiqué 9586, of Jun.6.2002.

Minutes of the 74th Meeting of Banco Central do Brasil Monetary Policy Committee (Copom)

Date: August 20 and 21, 2002
Place: Central Bank's Headquarters 8th floor Meeting room (on August 20) and 20th floor (on August 21) - Brasília - DF

Called to Order: 5:10 PM on August 20 and 11:47 AM on August 21
Adjourned: 7:51 PM on August 20 and 2:29 PM on August 21

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

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

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

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

Economic Activity

Recently released indicators confirmed the loss of dynamism of economic activity - signaled after May - due to the adverse conditions in the financial markets and as a result of uncertainties created by the Presidential elections campaign. Such factors reflected significantly on consumer and business expectations, with impact on expenses, mainly those related to goods of relatively higher value. In spite of that, the FGTS (Time in Service Guarantee Fund) disbursements and significant improvement of the agricultural income this year, amongst others, supported the level of consumption, mainly of non-durable or durable goods of low value.

Preliminary figures released by São Paulo State's Federation of Commerce (Fecomércio-SP) showed a 3.5% increase in real turnover of retail commerce, seasonally adjusted data, in the metropolitan region of São Paulo in July. This performance is due particularly to the increase in sales of goods with lower unitary value. Sales of non-durable consumer goods increased by 3.4%, of semi-durable 3.3%, and of durable goods 3.2%, boosted by optical, film, photo and sound items. The sales of vehicles in general showed a decline of 9.6% in the month. The increasing trend of retail commerce had been shown by the indicators of São Paulo Trade Association (ACSP), regarding consultations of its Credit Protection Service (SPC) and the Usecheque with 3.5% and 3.2% variations respectively, compared to June, seasonally adjusted series.

Besides the payment of the remaining balance of the FGTS and the increase in agricultural sector income, the recent expansion of commerce turnover could be associated to factors such as increasing promotions and special sales in the period.

Another possible effect of the previously mentioned factors was the reduction of defaults to 7.2% in July from 8.3% in June, according to ACSP, mainly due to an increase of 23.4% of canceled registers (reinstatement). Also, in the financial market, the default data was favorable in July, when the percentage of returned checks due to insufficient funds showed a decline in relation to the total of cleared checks, reaching 4.7% as compared to 5% in June.

The volume of credit supplied remained stable in July. In addition to tighter selectivity imposed by financial institutions, demand remains constrained due to the uncertain economic scenario, together with higher interest rates, which reflected on the movement of the futures market.

The outstanding credit operations provided by the financial system registered an increase of 2.2% in the month, totaling R$359.5 billion, of which R$213.1 billion referred to operations contracted by freely established rates, representing an increase of 1.7%. This outcome was related, for the third successive month, to resources with external funding, which registered a monthly nominal growth of 5.3%, basically due to exchange rate variation of 20.5% in the period.

Credit contracted by private individuals with freely allocated resources totaled R$75.9 billion, in July, showing a decline of 0.8%. The daily average of new credits declined 4.7%, influenced by the payment of debts and commitments with the use of the FGTS reimbursements and of tax returns from the Internal Revenue (IR). In the period, the reduction in demand for personal credit and for borrowings for acquisition of vehicles should be highlighted.

The credit market had stagnated in part because of worsening of expectations in the last few months. The Index of Consumer Intentions (IIC) released by Fecomércio-SP, declined 5.5% in August, recording the second worst level of the year. Above all, the result was due to perceived deterioration of current economic environment, influenced mainly by the volatility in foreign exchange market. It should be noted that the August survey was carried out before the announcement of Brazil's new agreement with the International Monetary Fund (IMF).

The National Confederation of Industries', (CNI) and Getulio Vargas Foundation's (FGV) business surveys also registered the deterioration of expectations. The Confidence Index of the Industry Entrepreneur (ICEI), composed by the results of the CNI Industrial Survey, declined to 48.5 points in July, from 58.9 points in April, showing the same level as July 2001, at the peak of uncertainty due to the energy crisis. But, the perceptions of entrepreneurs, like those of consumers, regarding future expectations are less pessimistic than in respect to the current economic conditions. Another point to be noted in relation to those surveys was the fact that the entrepreneurs were referring to the general economic situation, and not to their own companies, as the main factor responsible for the recent behavior of the expectations.

In the last few months, the activity in industry clearly illustrated the deteriorating expectations. The industrial production that, in May, showed a 5.2% decline from the previous month, registered a variation of 0.8% in June, according to IBGE seasonally adjusted data. The results confirmed that the decline of production to a lower level was already becoming apparent in the previous month, reaching the same production level of July 2001, when the economy was facing the effects of the electricity rationing. It should be noted that the categories of durable consumer goods and capital goods were significantly affected in the 3rd bimester - May/June -, when the average levels of production were, respectively, 6.6% and 3.6% lower than the averages registered in the first four months of the year.

In fact, the general investment indicators are showing deceleration, influenced especially by lack of dynamism in the civil construction industry. Imports of capital goods declined significantly in May and June, but partially due to the customs strike. The domestic production of machinery and equipment showed a decline of 1.1% in the semester, but the hike in non-serial machinery for industry, transport equipment, and agricultural machinery and its related equipment should be mentioned. Regarding financing through the Brazilian Development Bank (BNDES), the resources directed to the sectors of infrastructure and agriculture merit note.

The loss of economic dynamism in the last few months reflected on the labor market. Although the average of open unemployment rate measured by IBGE had declined to 7.5% in June, from 7.7%, in May, the Economically Active Population (PEA) declined for the first time this year, indicating that the perception of those who were looking for job that opportunities had diminished. The decline in the unemployment rate was due to the decline of 0.2% in the number of employed workers and of 3% in the number of unemployed workers. It must be pointed out that the average rate of unemployment reached 7.3% in the first semester, with prominence to the increase of 22% in the number of people looking for jobs and of 2.4% in the level of employed workers, in relation to the same period in the previous year. In the area of formal employment, according to the Ministry of Labor and Employment, there was a growth of 3%, compared to the first semester of 2001.

Regarding the external sector, the trade balance registered a surplus of US$1.2 billion in July, with US$6.2 billion of exports and US$5 billion of imports. Thus, the accumulated surplus in the year reached US$3.8 billion and the accumulated surplus of twelve months to July 2002, reached US$6.4 billion. The trade balance surplus of twelve-month to July 2002 was the best result for equivalent periods since 1995.

In August, considering twelve business days, the trade balance accumulated a surplus of US$831 million, with daily average exports of US$256 million, against US$217 million average for the whole year. The daily average of imports in August, of US$187 million, is almost the same level as observed for the whole year average. The increase of exports of commodities and semi-manufactured goods in July should be noted, and, the fact that even after incorporating the rise in the prices of some products such as soy beans, crude oil, crude soy oil and cellulose, a significant increase of exported quantities of the main products of theses categories was maintained.

In summary, the economic activity registered, by the end of the first semester and beginning of the second, a relatively low productivity plateau, due to the deterioration of expectations as a result of the unfavorable external environment and due to the increase of uncertainties related to the elections period. However, there are factors that contributed to suggest favorable prospects for the evolution of economic activity, such as the performance of retail trade – supported, amongst other factors, by the FGTS disbursements and by the agricultural income - and the improved, even if partial, expectation, as a result of the new IMF agreement.

External Environment

Despite the recent improvements, global financial markets remained volatile and averse to risk, reflecting uncertainty as a result of corporate results, due to accounting frauds and bankruptcies of large conglomerates, mainly in the United States. As a result, the financing conditions for emerging market countries have worsened, especially for Turkey and for those in Latin America. Expectations concerning a possible attack on Iraq have contributed to the uneasiness in the oil market, and prices returned to the level of US$30 per barrel. This scenario was aggravated by the further delay in the recovery of advanced countries, increasing protectionism and the decline in international trade.

In the United States, macroeconomic indicators continued to show contradictory signals, predominating indication of deceleration in the pace of economic recovery. There were signs that the contagion of recent financial instability to the real economy was still underway. In its last meeting, the Federal Reserve kept the basic rate at 1.75% p.y., and the downward bias signals concern with the fragility of the economic recovery. The slower economic growth in the second quarter has contributed to keeping inflation under control. The business confidence indicators continued positive, although having presented a strong reversal in July. Consumer confidence indices also worsened in the last surveys, reflecting recent falls in the stock markets and higher unemployment rates.

Pessimistic expectations regarding the performance of the Japanese economy have been gradually easing, as a result of the external trade performance. The Asian countries growth has stimulated Japanese exports, particularly of final goods. Despite the appreciation of the yen, reduction in imports has also contributed to the growth of the trade balance. Domestically, however, demand continued stagnant, since lower income constrains sustainable growth, and factory orders declined again in June, after showing expansion in the previous three months. Industrial production kept an upward trend in the 12-month accumulated figures, but at a declining rate.

In the Euro Area, economic growth has shown itself to be weaker than projected. Domestic demand continued its slow recovery and industrial production remained stagnant. Despite the Euro appreciation, the trade balance accumulated over the 12 months up to May continued to expand, with higher imports and exports, especially sales to Great Britain and Asia. CPI annual variation reached 1.9% in July, slightly higher than in the previous month, but below the ceiling of 2% established by the European Central Bank. The main confidence indices point to declining expectations of both businesses and consumers.

In Argentina, despite the slow pace of economic activity, some demand indicators, such as supermarket sales and shopping center sales, increased in the third quarter. Industrial production, in June, declined 1.4% compared to May and by 17.4% compared to June 2001. Figures for May indicated that 21.5% of the Economically Active Population was unemployed. The recession and the contraction of demand have been the cause of restrained prices, leading to declining inflation rates in the last three months. Administered prices were not revised since the floating of the peso at the beginning of the year. The trade balance registered a US$8.1 billion surplus in the first half of 2002, reflecting mainly the reduction of imports.

Prices

The inflation rate measured by the main price indices accelerated in July, due to a mix of factors such as the concentration of readjustments in monitored prices in the period, the beginning of off-season period of agriculture and the effects of the recent exchange rate depreciation especially on wholesale prices.

The Consumer Price Index - Extended (IPCA) inflation was 1.19% in July, accumulating a 4.17% variation in the year and a 7.51% variation in 12 months. Similar to 2000 and 2001, July is likely to register the highest monthly variation in the year, mainly reflecting the readjustments in the public services tariffs. The monitored prices increased 2.52% and contributed individually with 0.78 of a percentage point to the general index variation. In addition to the readjustments in the fixed telephone tariffs approved on June 26, the IPCA reflected an average increase of 10.54% in electricity tariffs in São Paulo and Curitiba. Added to these factors, there were increases in the prices of oil-by products at the refineries (6.2% in bottled gas and 6.75% in gasoline), partially offset by the drop of 6.42% in the prices of hydrated alcohol. Furthermore, the effect of the rise in the minimum wage in April on the cost of housekeeper services is reflected in the IPCA mainly in July, for methodological reasons.

The food prices showed the second highest increase in July, with a 1.05% rise (a 0.23 percentage point contribution), compared to a 0.08% rise in June. In addition to the continued recovery in agricultural prices since the end of harvest time, the recent exchange rate depreciation caused an increase in the prices of French rolls and soy oil, which were the items that most increased in the month. The IPCA was also under pressure of prices of clothing that have significantly impacted the index since April, accumulating a rise of 4.7% in the last four months. It should be registered that the monthly inflation would have reached a significantly lower level if there had been no increases in monitored prices. The free prices, though they have increased in relation to May and June, varied 0.59% in the period.

In July, the General Price Index - Domestic Supply (IGP-DI) rose by 2.05%, reaching a 6.21% variation in the year and a 10.17% variation in the last 12 months. The Wholesale Price Index (IPA-DI) increased 2.82%, due to the 4.39% rise in the agricultural prices and 2.23% rise in the industrial prices, reflecting the beginning of the off-season period of agriculture and the evolution of the exchange rate. Amongst the industrial products, the evolution of the prices of refined soy oil, fertilizers and rice was notable. Amongst the agricultural prices, out soy, cattle, wheat, beans, eggs, fresh milk, cocoa, tobacco and corn should be highlighted. The Consumer Price Index (IPC-DI) rose by 1.03%, which was the highest monthly increase in the year. The IPC-DI was under pressure basically from the same factors mentioned for the IPCA.

In August, the IPCA variation may retract, due to the declining contribution of the monitored prices, mainly because of less impact as a result of the readjustments in fixed telephone tariffs and fuel.

Nevertheless, this group may still increase, due to the rises in water and sewage tariffs in São Paulo and in airline fares, in addition to the residual effects of the readjustments in electricity tariffs in July and the absorption of the increase of the minimum wage on the housekeepers' wages. The food prices will continue to be pressured, due mainly to rises in the prices of items with relevant weight in the index, like milk and its by-products, beef and poultry, that have increased at wholesale level. The group of other items that make up the free prices may fall in relation to July, mainly influenced by the prices of clothing. These prices may reflect the typical sales season.

One aspect to be noted in the trend of the IPCA until December is that the main impact of the monitored prices forecasted for the year – communications (telephones), electricity and urban transport - has already occurred. There remains to be implemented some readjustments in electricity tariffs in some capitals, but these readjustments would have a relatively small effect. Thus, considering no new increases in fuel prices in the coming months, the monthly variations, till the end of the year, would basically result from the evolution of the free prices.

Monetary Market and Open Market Operations

The perception of scarce foreign capital due to the reduction of the external credit lines and to the deterioration of the country's risk have resulted in a steepening of the slope of the yield curve. The spread between the 1-year interest rate and the Over-Selic target reached 1.234 bps on July 29 from 878 bps on July 16. After the announcement of the agreement with the IMF, the slope reverted somewhat and, on August 20, the spread narrowed to 765 bps.

Between July 17 and August 20 the BCB carried out two partial rollovers of the BCB's Notes - E Series (NBCE), by offering exchange rate swaps with varied maturities. For the rollover of R$1,9 billion in NBCEs, due on July 25, the reference value of the swap contract reached R$1,1 billion. For the rollover of the R$7.6 billion NBCE maturing on August 15 the equivalent of R$4,7 billion exchange rate swaps were placed. The BCB also offered exchange rate swaps against the R$2,3 billion National Treasury Note – D Series (NTN-D), maturing on August 7, but these were not placed due to low demand. It should be pointed out that in this period only 50% of the exchange rate indexed debt was rolled over as a result of the weak demand for exchange rate hedging.

The National Treasury carried out five National Treasury Bills (LTN) and National Treasury Financial Bills (LFT) auctions, limiting the total offer to 500 thousand securities for each one. In the first two, securities maturing in September were auctioned, and, in the others, the maturity was October 2002. The total financial volume was R$2.6 billion, of which R$2.1 billion were in LTN.

In order to reduce financial market exposure to the LFT's price volatility, the BCB purchased bills maturing in 2003 on four occasions amounting to R$10.0 billion, and another R$3.0 billion, maturing in 2004. Those purchases were linked to the sale of securities with repurchase agreements in November and December 2004. Besides that, the BCB redeemed R$0.8 billion of LFT, due in 2002, and carried two exchange operations by placing LFT maturing in 2003 and repurchasing securities in the amount of R$2.46 billion maturing in 2004, R$2.28 billion maturing in 2005 and R$9.66 billion maturing in 2006.

Throughout the 24 working day period between July 18 and August 20, BCB intervened in the open market by withdrawing and providing liquidity at one and three working day tenure and yields of 17.9% and 18.0% p.a., and average daily volumes of R$20.7 billion and R$3.3 billion, respectively. There were also selling operations of five long term securities with repurchase agreement, with a total financial value of R$13.3 billion and an average tenure of 78 working days — four of these operations (R$13.0 billion) were simultaneously placed with the purchase of LFT by the BCB, as mentioned above.

As regards the financial settlements between July 18 and August 20, the monetary impact was expansionary by R$35.1 billion, resulting mainly from the R$13.0 billion redemptions of LTN and the R$17.0 billion net redemptions of exchange rate indexed securities and R$3.9 billion of LTN.

In the process of reducing the volatility of investment funds composed by exchange rates indexed securities and DI x USD swaps, four exchange operations of NBCE and NTN-D by LFT and exchange rate swaps of equivalent tenure were carried out reaching R$19.2 billion.

In July, the domestic federal securitized debt increased by R$20.7 billion (+3,2%). The exchange rate indexed securities grew by R$33.1 billion, due to the 20.5% appreciation of the USD in the period.

Assessment of inflation trends

The identified shocks and their impact were assessed according to newly available information. The scenario considered in the simulations covers the following hypotheses:

1. For the year 2002, still as a result of the price drop in January and February, a reduction of 0.8% is forecast for the price of gasoline, albeit at a higher value than the previous one forecast in the last Copom meeting (-2,0%). For bottled gas, an increase of 25% is projected for 2002, a significantly lower increase than the 42% projected in the last meeting. This change is due in part to the 12% decline in the bottled gas price at refineries in August.

2. For the electricity tariffs, an increase of 20.1% for 2002 is projected, in comparison to the 19.2% projected in July. The forecast for the readjustment of electricity tariffs for 2003 increased substantially, to 20.7% in August from 14.4% in July, mainly due to the exchange rate depreciation.

3. Regarding the set of prices administered by contracts and monitored, with a weighting of 31.05% in the IPCA, the inflation forecast for 2002 fell 0.1 p.p. in relation to the previous Copom meeting. For 2002 as a whole, a readjustment of 8.8% is projected for the prices administered by contracts and monitored. The reduction in the projection is due to the expected decline of the consumer price of bottled gas in August and September. The fall in the total of the prices administered by contracts and monitored is not larger due to the effects of exchange rate depreciation. For 2003, the inflation forecast for the prices administered by contracts and monitored is 7.6%. In July, the same forecast was 6.6%. The increase in the projection for 2003 is mainly due to the revision of the readjustments projected for electricity.

4. The projection of the 6-months spread over the Selic rate, applying a model specification based on an error correction forecasting method and maintaining constant the Selic rate at 18.0% p.a., starts from approximately 600 b.p. in the third quarter of 2002 and declines to -70 b.p. in the last quarter of 2003.

The monthly inflation rate, measured by IPCA, reached 1.19% in July, in comparison to 0.42% registered in June. The core inflation of the IPCA, calculated by the symmetric trimmed-mean method, increased to 0.51% in July from 0.40% in June. In the last twelve months, this core varied 7.08%. In turn, the core inflation of the Consumer Price Index- Brazil (IPC-BR), calculated by the symmetric trimmed-mean method, fell to 0.40% in July from 0.41% in June. In the last twelve months, this core registered a 6.62% variation. The core inflation calculated by excluding the prices administered by contracts and monitored and household food prices registered a variation of 0.39% in July, accumulating a variation of 6.12% in twelve months.

The variation accumulated by the IPCA in twelve months registered 7.51% in July, below the observed in June (7.66%) and in May (7.77%). Free market prices contributed to inflation with 4.11 p.p. and the prices administered by contracts and monitored with 3.40 p.p.

The inflation expectations surveyed by BCB’s Investor Relations Group (Gerin) for 2002 increased to 6.4% in August from 5.8% in July. For 2003, the expectations increased to 4.6% in August from 4.2% in July.

Regarding the fiscal policy, the hypothesis considered is to achieve the primary surplus of 3.75% for the consolidated public sector. The other assumptions considered in the previous meeting were maintained.

From the simulation exercises with several specifications of the structural model, it has been concluded that the maintenance of the interest rate at 18.0% p.a. and the exchange rate at the level observed on the eve of the Copom meeting indicates an inflation rate over 6.0% in 2002 and below the target of 4.0% in 2003.

Monetary Policy Guidelines

The economic activity continues to show loss of dynamism, already identified in the last few months, due to the recent volatility of the financial markets and to its impact on aggregate demand. In fact, comparing the seasonally adjusted data of June to those of May, one perceives that industry does not show signs of recovery. According to the CNI, there was a decline in employment (0.07%), in the real payroll (0.25%) and in the utilization of installed capacity (0.36%).

There are factors that have softened the pace of deceleration of the level of activity. Firstly, agricultural production in 2002 should exceed 2001. Secondly, one may perceive an improvement in the commercial sector: the real turnover of the retail commerce in São Paulo rose approximately 3.5% in July, mainly in non-durable consumption goods. In this segment, demand has been sustained by the increase of agricultural income, the liberation of balances of the Time in Service Guarantee Fund (FGTS) and the social programs expenditures, in spite of the 5.49% decline of the Consumer Intentions Index between July and August.

The improvement in commerce may not influence industry due to increase in inventories of finished products in the last months. According to data released by the CNI, the indicator of finished products inventory rose to 53.1 in August from 50.4 in July, compared to the desirable value of 50 for the inventories level.

The current account of the balance of payments had registered substantial improvement in the last twelve months. The trade balance showed a US$ 1.2 billion surplus in July. Its surplus totaled US$ 6.4 billion in the twelve months to July, which represented an increase of approximately US$ 1.1 billion in relation to the value registered in June. The current account deficit has continuously declined since August 2001 and reached US$ 16.7 billion in the twelve months to July. This deficit was more than entirely financed by the net inflows of foreign direct investment, which totaled approximately US$ 20.6 billion in the twelve months to July. However, the ongoing adjustment in the current account was not sufficient to neutralize the international liquidity shortage that had recently occurred, affecting even the funding of foreign trade. The contraction of external financing was reflected in the pressures on the exchange rate, which had intensified in July.

The inflation expectations surveyed by the Investor Relations Group (Gerin) of the BCB rose since the Copom's meeting of July. For 2002, the expectations increased by 0.6 p.p., reaching 6.4% from 5.8%, probably due to the exchange rate depreciation observed in the period. For 2003, the inflation expectations were revised by 0.4% p.p., rising to 4.6% from 4.2%.

The inflation measured by the IPCA was 1.19% in July, above the 0.42% registered in June, due to the behavior of administered by contracts or monitored prices, which increased by 2.52%, and to the behavior of free market prices, whose inflation was 0.47 p.p. higher than in the previous month. The inflation of administered or monitored prices was mainly influenced by the readjustments of bottled gas (4.42% in July and 38.3% year-to-date), of gasoline (2.87% in July and -0.2% year-to-date) and of fixed-line telephone tariffs (10.54%) and electricity (4.26%). The administered or monitored prices would lead to weaker inflationary pressures in August and September, mainly because of the 9.9% price reduction expected for bottled gas.

The inflation of the free market prices in July was mainly due to the pass-through of the exchange rate depreciation. After showing a 0.64% variation in February and decreasing significantly in the following months, the free prices inflation reached 0.59% in July. When household food items of the free market prices were excluded, which corresponds to the core inflation measured with the exclusion of the administered prices and of household food items, the inflation increases to 0.39% in July, from 0.13% in June. The variation of the core inflation measured by the symmetric trimmed-mean method also increased, reaching 0.51% in July, from 0.40% in June.

The higher variations of the free market and administered prices in July were already expected, thus they did not cause upward revisions in the inflation projection for 2002. However, there was an increase in the inflation projection for 2002 and 2003 due to the exchange rate depreciation that has occurred since the Copom's July meeting. For 2002, inflation above 6.0% is expected and, for 2003, the projected inflation is still below the 4.0% target.

The lower inflation in 2003, in comparison to 2002, may be explained by a set of factors. Firstly, the existing idle capacity in the economy tends to reduce the inflation of non-tradable goods prices. Secondly, administered and monitored prices are forecasted to increase by 7.6% in the coming year that is equivalent to a 1.2% decline in relation to the increase of 2002. Finally, in the basic scenario one assumes the maintenance of the exchange rate in 2003 at the level observed on the eve of the Copom's meeting, and so, the absence of additional depreciation. Furthermore, it is predicted that the larger part of the impact of the recent exchange rate depreciation should still occur in 2002. Due to the magnitude of the depreciation and of the current exchange rate level, the existence of idle capacity in the economy may be insufficient to soften the exchange rate pass-through to prices in the course of this year. Based on the analysis of the behavior of the free prices inflation in the first seven months of the year, one may conclude that up to this moment, there are no signs of a significant accumulation of exchange rate pass-through to prices that would be carried over to 2003.

Despite the projected inflation for 2003 being below the target, the Copom recognizes that there was an increase of uncertainties in relation to the realization of the basic scenario hypotheses until the end of next year. The increase in the risk perception, both in relation to Brazil and to the industrialized countries, has caused higher volatility in the financial markets and foreign capital inflows. In this context, the interventions in the foreign exchange market have been necessary to manage the excessive volatility of the exchange rate in a liquidity short environment, and to avoid perverse dynamics in the foreign exchange market.

The increase of uncertainty in relation to the country's future, aggravated by deterioration in the risk perception regarding the world economy since the Copom's meeting of July, has negatively influenced the asset prices in foreign and local currencies. The risk measured by the Embi+ reached more than 2000 b.p. and the thirty-day volatility of the exchange rate increased to 49.0% from 20.3% between the Copom's meetings of July and August. The exchange rate depreciated 9.4% in the same period.

However, the agreement with the IMF and with its general principles being supported by the main presidential candidates, the reduction of discounts of public securities and the recent evolution of the mutual funds sector, and an improvement in the liquidity conditions of international credit lines for Brazil, provide an adequate environment to revert expectations in the financial market.

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

At the close of the meeting, it was announced that the Committee would meet again on September 17, 2002, at 3:00 pm, for technical presentations and, on the following day, in order to discuss the monetary policy guidelines, as scheduled in the BCB Communiqué n. 8911, of Oct 3, 2001, and in the BCB Communiqué n. 9586, of June 6, 2002.

Acronyms

ac 12m	accumulated in 12 months
ACC	Anticipated Exchange Rate Contracts
BM&F	Mercantile and Futures Exchange
bp	Base Points
CDI	Interbank Futures Contract
CETIP	Center for Financial Custody and Settlement of Private Securities
CNI	National Confederation of Industries
CPMF	Provisory Contribution on Financial Transactions
CSLL	Social Contribution on Net Profit
DI	Interbank Deposit
Fecomércio	Federation of Commerce of the State of São Paulo
FED	Federal Reserve System
FOMC	Federal Open Market Committee
FRA	Forward Rate Agreement
GDP	Gross Domestic Product
IBGE	Brazilian Institute of Geography and Statistics
IF	Financial Institution
IGP-DI	General Price Index – Domestic Supply
IIC	Consumer Intentions Index
IPA	Wholesale Price Index
IPC	Consumer Price Index
IPCA	Consumer Price Index – Extended
IPCH	Consumer Price Index – Harmonized
IPP	Producer Price Index
IR	Income Tax
IRF-M	Market Fixed Income Index
IRRF	Withholding Income Tax
LFT	National Treasury Letters (floating)
LTN	National Treasury Notes (fixed rate)
NAPM	National Association of Purchasing Managers
NBC-E	Central Bank Note - E Series (indexed to the exchange rate variation)
NTN-D	National Treasury Note – D Series (indexed to the exchange rate)
p.a.	per annum
p.m.	per month
PEA	Economically Active Population
pp	percentage point
Selic	Central Bank's Custody and Settlement Center
STN	National Treasury Secretariat
ytd	year-to-date

Economic policy measures

Measure related to the financial system and credit market

Circular 3,127, 6.14.2002 – Raised the compulsory reserve rate on time deposits, exchange acceptance resources, debenture collateral bills, papers issued by the institution itself and liability assumption contracts earmarked to operations carried out abroad from 10% to 15%. Compliance with compulsory reserve requirements is to be based on the earmarking of federal public securities in the Special System of Clearance and Custody (Selic).

Circular 3,128, 6.24.2002 – Altered the obligatory reserve rate on savings deposits held by entities belonging to the Brazilian System of Savings and Loans (SBPE) from 15% to 20%, effective as of the deposit scheduled for July 1, 2002.

Circular 3,129, 6.27.2002 – Altered the criteria for recording and evaluating stocks and securities and derivative financial instruments in accounting. In order to classify securities under the category held in portfolio to maturity – those not marked-to-market – the institution must demonstrate its financial capacity. Previously, this depended on the availability of third party resources referenced in a currency and with terms compatible with the corresponding securities. The Circular in question determined that financial capacity is to be demonstrated on the basis of the institution's cash flow projection, disregarding the possibility of selling such papers. At the same time, for accounting entry and evaluation purposes, utilization of such papers in hedge operations was permitted.

Circular 3,130, 6.27.2002 – Altered the obligatory reserve rate on funding obtained through rural savings deposits from 15% to 20%, effective as of the deposit scheduled for July 1, 2002.

Resolution 2,971, 6.27.2002 – Deals with the targeting of resources obtained through rural savings deposits. The amounts originating in rural savings deposits at Banco do Brasil S.A., Banco da Amazônia S.A. and Banco do Nordeste do Brasil S.A. are to be invested as follows:

a) 20% in obligatory reserves at Banco Central;
b) minimum of 40% in rural credit operations and marketing, processing or industrialization credits involving crop/livestock products or rural inputs, of which 60% are to be allocated to rural credit;
c) the remainder in operations authorized according to the terms of current legislation.

With respect to the percentages itemized in item b, the daily average balance of the investment may not be less than 40% of the daily average balance of the deposits effected, complying with the following schedule:

I – minimum of 50% in the period from 7.1.2001 to 8.31.2002;
II – minimum of 75% in the period from 9.1.2002 to 8.31.2003;
III – 100%, effective as of 9.1.2002.

Resolution 2,972, 6.27.2002 – Defined the following inflation targets:

a) for 2003: 4%, with a tolerance band of plus/minus 2.5%;
b) for 2004: 3.75% with a tolerance band of plus/minus 2.5%.

Resolution 2,973, 6.27.2002 – Set the Long-Term Interest Rate (TJLP) at 10% per year for the third quarter of 2002, considering that the inflation target calculated on a pro rata basis is equivalent to 3.75% per year for the next twelve months, plus a risk premium of 6.25%.

Resolution 2,986, 7.3.2002 – Instituted the Irrigated Agriculture Support Program (Proirriga) for fixed and semifixed investments in implementation, renovation or restructuring of irrigation systems, including associated infrastructure works. The resources are equalized by the National Treasury in operations with the National Bank of Economic and Social Development (BNDES) up to an amount of R$200 million and an individual limit of R$250 thousand, with financial charges set at 8.75% per year.

Resolution 2,987, 7.3.2002 – Instituted the Cooperative Development Program for Aggregating Value to Crop/Livestock Production (Prodecoop), with the objective of enhancing the competitiveness of the agribusiness complex of Brazilian cooperatives through modernization of productive and marketing systems. This Program is supported by funding equalized by the National Treasury in operations with the National Bank of Economic and Social Development (BNDES) up to the amount of R$250 million and a ceiling of R$20 million per cooperative, with financial charges set at 10.75% per year.

Resolution 2,988, 7.3.2002 – Instituted the Program of Support to the Development of Cocoa Production (Procacau) with the objective of increasing the productivity of this crop through cloning and increased planting density. This Program is supported by funding equalized by the National Treasury in operations with the National Bank of Economic and Social Development (BNDES) up to the amount of R$180 million and a ceiling of R$200 thousand per beneficiary, with financial charges set at 8.75% per year.

Resolution 2,990, 7.3.2002 – Extended the period for normalizing installments in arrears, as well as for financial agents to contract new debt lengthening operations to October 31, 2002, in the framework of the Special Asset Restructuring Program (Pesa), under the terms of Law 10,437, dated 4.25.2002, which calls for securitization of these debts by the National Treasury.

Circular 3,134, 7.10.2002 – Redefined the rules on compulsory reserves on demand resources. The major alterations refer to definition of the calculation base, which is specified as the arithmetic average of the Amounts Subject to Reserve (VSR) registered in the calculation period, deducted from R$4 million. The VSR is to be adjusted each day on the basis of the documents processed through the Clearance Center for Checks and Other Securities (Compe) and that generate transfers among the banking reserve accounts of financial institutions, such as cleared checks, credit documents (DOC) and charging instruments. Aside from this, several exemptions to this type of reserve were revoked, such as those related to inflows of social security contributions and federal taxes. The reserve rate remains at 45% of the calculation base.

Resolution 3,000, 7.24.2002 – Altered provisions of the regulations appended to Resolution 2,967, dated 5.31.2002, which deals with investment of the resources of the reserves, provisions and funds referring to insurance companies, capitalization companies and open complementary pension entities, introducing changes in the composition of variable income investments.

Resolution 3,005, 7.30.2002 – Deals with the targeting of amounts obtained through savings deposits by member institutions of the Brazilian System of Savings and Loans. These resources are to be invested as follows:

I – minimum of 65% for real estate financing, of which 80% are to be targeted to operations in the framework of the Housing Finance System (SFH), and the remainder at market rates;

II – 20% is to be deposited as obligatory reserves in Banco Central;

III – the remaining amount is to be allocated into available financial resources or other operations permitted by current legislation.

Credits with the Wage Variation Compensation Fund (FCVS), which had been assigned by financial institutions in the Proer framework, and those currently held by the Federal Savings Bank, will no longer be calculated for purposes of compliance with targeting requirements over the course of the next one hundred months. Furthermore, investment fund quotas in receivables are to be computed in targeting requirements for purposes of stimulating the secondary market for papers earmarked to real estate operations, provided that these funds are constituted by real estate receivables.

Circular 3,139, 7.31.2002 – Deals with federal public security sales options to be issued by Banco Central for monetary policy purposes, based on authorization given in Resolution 3,006, dated 7.30.2002.

It refers to the right of the holder of the sales option to sell the security in question to Banco Central, should that person so desire, at the exercise price and on the date previously stipulated by the Monetary Authority. The operations will be contracted through public offers and exercise of the option will occur only at maturity. However, these options can be negotiated on the secondary market up to the business day prior to the day of exercise of the option.

Circular 3,144, 8.14.2002 – Instituted additional compulsory reserve requirements on deposits obtained by financial institutions. This additional reserve requirement corresponds to the sum total of the following components, deducted from R$30,000,000.00 (thirty million reals): 3% for demand resources, 5% for savings deposits and 3% for time deposits, applied to the arithmetic average of the value subject to reserve, elaborated in the calculation period of one week. Compliance with the additional requirement will be in cash on business days of the second week subsequent to closing of the calculation period, with earnings based on the Special System of Clearance and Custody (Selic) rate. In cases of noncompliance, the institution is subject to a fine on each daily deficiency found to exist, calculated at Selic + 14% per year.

CVM Instruction 375, 8.14.2002 – Permitted financial investment funds, investment funds that operate with investment fund quotas and foreign investment funds to record stocks and securities in the category held to maturity, in the cases specified therein. The papers must have maturity terms limited to 365 days with postset earnings, contracted on the basis of the Special System of Clearance and Custody (Selic) rate or interbank deposit rate (DI). Furthermore, in order to maintain the papers to maturity, the funds must demonstrate financial capacity based on cash flow projections. This represents a more flexible approach to the rules set down in CVM Instruction 365, dated 5.29.2002, considering that these papers are no longer marked-to-market and will henceforward be evaluated daily according to the interest curve of the paper in question.

Provisional Measure 59, 8.15.2002 – Authorized the Federal Government to grant financing to National Bank of Economic and Social Development (BNDES) with the objective of meeting the needs of electricity generation programs. Furthermore, allocation of Worker Support Fund (FAT) resources in the amount of R$2 billion into special interest bearing deposit accounts was authorized for purposes of granting financing targeted to stimulating foreign trade operations.

Resolution 3,017, 8.28.2002 – Permitted mortgage companies to transform themselves into other national financial system member institutions, including multiple banks. It is stressed that the condition that Housing Finance System (SFH) norms do not apply to these institutions was maintained.

Resolution 3,018, 8.28.2002 – Defined the conditions to be followed in renegotiation of rural credit operations formalized under the terms of the Special Agrarian Reform Credit Program (Procera), in those cases in which the borrowers are up-to-date on their liabilities or normalize them by 10.31.2002.

Fiscal policy measures

Constitutional Amendment 37, 6.12.2002 – Extended application of the Provisional Contribution on Financial Transactions (CPMF) to 12.31.2004. The CPMF rate will be 0.38% (thirty eight one hundredths) in the 2002 and 2003 fiscal years and 0.08% (eight one hundredths) in the 2004 fiscal year. The proceeds of this contribution will be distributed as follows:

a) 0.20% (twenty one hundredths) to the National Health Fund;
b) 0.10% (ten one hundredths) to Social Security System current expenditures;
c) 0.08% (eight one hundredths) to the Fund for Combating and Eradicating Poverty.

In fiscal year 2004, the inflow will be fully channeled to the Fund for Combating and Eradicating Poverty. As of January 1, 2004, resources received by the Federal Government as a result of privatization of joint capital enterprises or public companies directly or indirectly controlled by the Federal Government will also be channeled into the aforementioned Fund, when such operations involve transfer of the respective stock control to a person or entity that is not a component of the public administration or of remaining stock participation after such transfers.

As of the thirtieth day subsequent to the date of publication of this Constitutional Amendment, the CPMF will not be levied on the following entries:

I – deposit accounts opened specifically and used exclusively for operations involving:
  a) clearance and liquidation houses and service providers as cited in the paragraph of article 2 of Law 10,214, dated 3.27.2001;
  b) securitization companies cited in Law 9,514, dated 11.20.1997;
  c) open capital corporations that have the exclusive objective of acquiring credits originating in financial market operations;

II – deposit accounts, related to:
  a) stock purchase and sale operations carried out in stock exchange trading or organized over-the-counter market localities or systems;
  b) contracts referenced to stocks or the various modalities of stock indices, negotiated on stock, commodity and futures exchanges.

Law 10,482, 7.3.2002 – Deals with judicial and extrajudicial deposits of amounts consequent upon litigations or administrative suits in the framework of the states and Federal District, when such deposits are effected in the period from January 1, 2001 to the eve of publication of this Law, including amounts related to arrears subject to judicial execution and their respective accessory amounts. Such deposits may be transferred by the depositing financial institution to the single operating account of each state or of the Federal District, up to the limit of 50% of the deposits existent on the date of publication of this Law.

The states and Federal District will constitute a reserve fund to be maintained at the financial institution that has transferred such resources, and such resources will bear interest equivalent to the Special System of Clearance and Custody (Selic) rate for federal securities. Funding transferred to the states and Federal District in the manner specified in this Law will be used exclusively for judicially mandated payments related to alimony and support-type payments.

Law 10,524, 7.25.2002 – Budget Guidelines Law (LDO) – Defined targets and determined parameters for elaboration of the 2003 Federal Government Budget:

a) the primary Federal Government surplus should correspond to 2.8% of GDP, estimated at R$1,422.1 billion; of this total, 2.25% represents the Central Government (Federal Administration, Central Bank and Social Security and Assistance System) target and 0.55%, the primary result of Federal State Companies. For the Consolidated Public Sector, the primary surplus should come to approximately 3.75% of GDP, with the difference (0.95%) depending on the efforts of state and municipal governments;
b) real GDP growth of 4%;
c) inflation measured by the IGP-DI estimated at 4%;
d) exchange rate estimated at R$2.42/US$;
e) nominal interest rate of 12.84%.

Current legislation and bills now before the National Congress make it possible to forecast a reduction in primary revenues in 2003, as follows:

a) elimination of the additional 1% over and above the Social Contribution on Net Profits (CSLL) rate (dropping from 9% to 8%) is expected to generate an inflow reduction of approximately R$1.1 billion;
b) cancellation of the additional 2.5 p.p. in the maximum rate of the Income Tax – Labor Earnings and the Individual Income Tax (IRPF) will result in a revenue loss of approximately R$1.7 billion.

Provisional Measure 66, 8.29.2002 – Deals with tax system alterations, highlighting the following points:

a) Social Integration Program/Civil Service Asset Formation Program (PIS/Pasep): taxation is no longer cumulative and will henceforward be charged on the amount that each company aggregates to a specific product; in practical terms, the amount of the PIS/Pasep paid in previous stages of production will be credited to the company in a credit and debit system. Since the calculation base will be smaller, the current rate of 0.65% will be raised to 1.65% so that the revenue inflow will remain unchanged. With this measure, those products with more production stages and, therefore, greater aggregate value, such as telecommunications, will pay more taxes. The agribusiness sector will be entitled to a refund of 70% of the PIS on acquisitions of raw materials when the supplier is an individual person;

b) Cofins: by 12.31.2003, the Executive Branch will submit a bill to the National Congress making levying of the Contribution to Social Security Financing (Cofins) non-cumulative;

c) Measures against tax evasion: juridical acts and dealings aimed at reducing the value of a tax, avoid or delay payment, conceal the true nature of the generating fact or of the elements that constitute the tax liability will, for purposes of taxation, be disregarded by the Federal Revenue Secretariat;

d) Renegotiation of debts: the taxpayer debts for which administrative appeals have been submitted to the Federal Revenue Secretariat will be entitled to a reduction in the value of fines in those cases in which the debt is paid-in-full in a single installment by the final business day of September 2002. This measure applies to contributions collected by INSS, duly complying with the regulations issued by that entity. Debts related to contributions to the Pasep by the states, Federal District and municipalities, based on generating facts that occurred up to 4.30.2002, may be paid through the special system of installment payments, based on options formalized up to the final business day of September 2002, according to terms and conditions defined by the Federal Revenue Secretariat;

e) Social Contribution on Net Profits (CSLL): the 9% rate, which was to drop to 8% in January 2003, is maintained for an undetermined period of time;

f) Taxpayer bonus: regarding taxes and contributions managed by the Federal Revenue Secretariat, the fiscal compliance bond is hereby instituted and is applicable to legal entities subject to the taxation system based on real or presumed profits. The bonus corresponds to 1% of the CSLL calculation base and will be granted to taxpayers in full performance over the last five years;

g) Technological innovation: in determining real profits and the CSLL calculation base, legal entities may deduct operating expenditures related to outlays on technological research and development of product technological innovations from net income;

h) Fines: fines for cigarettes with counterfeit stamps or no stamps at all are increased;

i) Incentives to the internationalization of industry: branches of Brazilian companies located in Mercosul will be subject only to payment of local taxes, even when they have exemptions. Previously, when the payment in the other country was smaller than taxation in Brazil, the company was obligated to effect payment of the difference.

Measures related to external sector

Circular 3,127, 6.14.2002 – Altered the compulsory reserve and obligatory reserve rate from 10% to 15% on time deposits, exchange acceptance resources, debenture collateral bills, papers issued by the institution itself and liability assumption contracts earmarked to operations carried out abroad.

Constitutional Amendment 37, 6.12.2002 – Granted a Provisional Contribution on Financial Transactions (CPMF) exemption to entries into foreign investor accounts involving inflows of financial resources to the country and remittances abroad when such resources are used exclusively in stock operations carried out in stock exchange trading or organized over-the-counter market localities or systems and in contracts referenced to stocks or the various modalities of stock indices, negotiated on stock, commodity and futures exchanges.

Decree 4,296, 7.10.2002 – Regulated Constitutional Amendment 37, dated 6.12.2002.

Camex Resolution 14, 6.25.2002 – Altered the List of Convergence of the Informatics and Telecommunications Sector, according to the schedule specified therein.

Secex Circular 25, 7.9.2002 (Brazil-Mexico Trade Agreement) – Distributed a quota of 50,000 vehicles granted by Brasil to the companies cited therein, with the benefit specified in the 7th Additional Protocol to Partial Renegotiation Agreement 9, formalized between Brazil and Mexico and internalized by Decree 3,494, dated 5.29.2000. The quotas corresponds to imports not effected in the second year of validity of the Protocol which was extended to the period between 5.30.2002 and 5.30.2003, under the terms of the Protocol in question.

MDIC Directive 126, 7.10.2002 – Announced the criterion governing distribution among national companies of the exportable volume of 5,000 tons of in natura beef, in the Hilton Quota modality, granted to Brazil by the European Union for the period from 7.1.2002 to 6.30.2003.

Decree 4,311, 7.23.2002 – Promulgated the Convention on Recognition and Execution of Foreign Arbitration Sentences.

Camex Resolution 17, 7.30.2002 (ex-tariff) – Altered the *ad valorem* rates of the Import Tax on Capital Goods, Informatics and Telecommunications Goods and Components of Integrated Systems (SI), as specified therein, to 4% up to 6.30.2004. In the latter case, the tax treatment specified applies only to cases involving import of the totality of the components specified in each system, to be used jointly in the productive activity of the importer. Revokes Appendix B of Ministry of Finance Directive 339, dated 12.18.1997.

Camex Resolution 20, 8.22.2002 (ex-tariff) – Altered the *ad valorem* import tax rates on Informatics and Telecommunications Goods (BK) and Components of Integrated Systems (SI) specified therein to 4% up to 6.30.2004. In the case of the SI, the tax treatment specified applies only to cases involving import of the totality of the components specified in each system, to be used jointly in the productive activity of the importer.

Secex Circular 37, 8.22.2002 (SGP-USA) – Announced that the Trade Act of 2002 was formalized on 8.8.2002. This instrument includes Sections 4101 and 4102 of Division D (Extension of Certain Preferential Trade Treatment), which reauthorizes the Generalized System of Preferences (SGP) of the USA, effective from 10.1.2001 to 12.31.2006.

Provisional Measure 59, 8.15.2002 – Authorized allocation of Worker Support Fund (FAT) resources into special interest bearing deposits at National Bank of Economic and Social Development (BNDES) in the amount of R$2,000,000,000.00 (two billion reals) for purposes of granting financing aimed at stimulating foreign trade operations. The resources will be reimbursed in a single payment in 180 days as of the date of allocation of the funding.

Provisional Measure 61, 8.16.2002 – Deals with Federal Government assumption of civil liabilities to third parties in the case of terrorist attacks or acts of war against the aircraft of Brazilian airline companies.

Decree 4,337, 8.16.2002 – Regulated the provision in Provisional Measure 61, dated 8.16.2002.

Decree 4,343, 8.26.2002 – Deals with implementation of the Sixth Additional Protocol to Economic Complementation Agreement 39, between Brazil and Colombia, Ecuador, Peru and Venezuela (Andean Community member states), dated 6.28.2002.

Provisional Measure 66, 8.29.2002 – Determines that levying of contributions to the Social Integration Program (PIS) and Civil Service Asset Formation Program (Pasep) is non-cumulative, in the cases specified therein; deals with the procedure for disregarding juridical acts or dealings for tax purposes; with one time payment and installment payment of federal tax debts, offsetting of fiscal credits, the declaration of inadequacy for registration of legal entities, customs legislation and takes other measures.

Circular 3,146, 8.30.2002 – Deals with Banco Central do Brasil foreign currency sale auctions tied to the granting of advances on export exchange contracts, effective as of 9.2.2002. Revokes Circular 3,145, dated 8.22.2002.

Circular Letter 3,041, 9.2.2002 – Treats of the individual limits as cited in Circular 3,146, dated 8.30.3003.

Resolution 3,008, 8.2.2002 – Instituted the credit line targeted to financing of the warehousing of the 2001/2002 coffee harvest, based on the use of resources drawn from the Coffee Economy Defense Fund (Funcafé).

Resolution 3,014, 8.28.2002 – Treats of alterations in the operating conditions of the credit line available to exporters for financing the warehousing of the 2001/2002 coffee harvest, based on the use of resources drawn from the Coffee Economy Defense Fund (Funcafé).

Resolution 3,015, 8.28.2002 – Treats of the offer of 2001/2002 coffee harvest option sale contracts through the National Supply Company (Conab).

Appendix

Banco Central do Brasil Management

Members of the Monetary Policy Committee (Copom)

Banco Central do Brasil Management

Board

Armínio Fraga Neto
Governor

Carlos Eduardo de Freitas
Deputy Governor

Beny Parnes
Deputy Governor

Edison Bernardes dos Santos
Deputy Governor

Ilan Goldfajn
Deputy Governor

Luiz Fernando Figueiredo
Deputy Governor

Sérgio Darcy da Silva Alves
Deputy Governor

Tereza Cristina Grossi Togni
Deputy Governor

Members of the Monetary Policy Committee (Copom)

Voting members

Armínio Fraga Neto
Governor

Carlos Eduardo de Freitas
Deputy Governor

Beny Parnes
Deputy Governor

Edison Bernardes dos Santos
Deputy Governor

Ilan Goldfajn
Deputy Governor

Luiz Fernando Figueiredo
Deputy Governor

Sérgio Darcy da Silva Alves
Deputy Governor

Tereza Cristina Grossi Togni
Deputy Governor

Non-voting members

Altamir Lopes
Head of the Department of Economics (Depec)

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

José Antonio Marciano
Head of the Department of Banking Operations and Payments Sistem (Deban)

Marcelo Kfoury Muinhos
Head of the Research Department (Depep)

Sérgio Goldenstein
Head of the Department of Open Market Operations (Demab)

Acronyms

Abimaq	Brazilian Association of Machinery and Equipment Industry
ac.12m.	In accumulated terms for 12 months
ac.a.	In accumulated terms for the year
ACC	Anticipated Exchange Rate Contracts
ACSP	São Paulo Trade Association
ADR	American Depositary Receipts
AIE	Energy International Agency
Aneel	National Electric Energy Agency
Anefac	National Association of Finance, Administration and Accounting Executives
Anfavea	National Association of Automotive Vehicle Manufacturers
ANP	National Petroleum Agency
BAI	Business Activity Index
Banacci	*Grupo Financiero Banamex - Accival*
Banxico	Bank of Mexico
BIS	Bank for International Settlements
BIT	Informatics and Telecommunication Goods
BM&F	Commodities & Futures Exchange
BNDES	National Bank of Economic and Social Development
BNDESpar	BNDES Participações S.A.
BoJ	Bank of Japan
Bovespa	São Paulo Stock Exchange
Cadin	Information File on Outstanding Credits of the Federal Public Sector
Caged	General Reference File of the Employed and Unemployed
Camex	Chamber of Foreign Trade
CBEE	Brazilian Emergency Energy Marketing Company
CBO	Congressional Budget Office
CCR	Reciprocal Payments and Credits Agreement
CDB	Bank Deposit Certificates
CDE	Energy Development Account
CDI	Interbank Deposits Certificate
CDL	Net Domestic Credit
CEF	Federal Savings Bank
Cetes	Treasury Certificates
Cetip	Center of Financial Liquidation and Custody of Securities
CFT-E	Treasury Financial Certificates
CGPC	Council of Complementary Social Security Management

Cide	Contribution on Intervention in the Economic Domain
CIP	Interbank Chamber of Payments
CIR	Currency System
CMN	National Monetary Council
CNI	National Confederation of Industry
Cofins	Contribution to Social Security Financing
Compe	Central Clearance System of Checks and Other Papers
Copom	Monetary Policy Committee
Cosif	Accounting Plan of National Financial System Institutions
CPI	Consumer Price Index
CPMF	Provisional Contribution on Operations or Transmission of Values and Credits and Rigths of a Financial Nature
CSLL	Social Contribution on the Profits of Legal Entities
CSN	National Steel Company
CVM	Securities and Exchange Commission
CVRD	Vale do Rio Doce Company
Demab	Department of Open Market Operations
Depec	Department of Economics
DI	Deposits among financial institutions
Diset	Board of Sectoral Studies
DLSP	Net public sector debt
DOC	Credit documents
DOU	Federal Official Gazette
DRU	Disencunberment of Federal Government Funds
ECB	European Central Bank
EMI	Monthly Industrial Estimator
FBC	Gross Capital Formation
FBCF	Gross Fixed Capital Formation
FECMG	Trade Federation of the State of Minas Gerais
Fecomercio SP	Trade Federation of the State of São Paulo
Fed	Federal Reserve Bank
Fenabrave	National Federation of Automotive Distribution
FGTS	Severance Fund Contribution
FGV	Getulio Vargas Foundation
Fiesp	Federation of Industries of the State of São Paulo
FIF	Financial investment funds
Finame	Special Industrial Financing Agency
FITVM	Investment funds in securities and stocks
FOMC	Federal Open Market Committee
FMI	International Monetary Fund
FMP	Mutual Privatization Funds
FRA	Forward Rate Agreement
Funcafé	Coffee Economy Defense Fund
GCI	Brazil - Investor Relations Group
GDDS	General Data Dissemination System
GDP	Gross Domestic Product
Gerin	Investor Relations Group

HCPI	Harmonized Consumer Price Index
IBGE	Brazilian Institute of Geography and Statistics
Ibovespa	Bovespa Index
ICMS	Tax on the Circulation of Merchandise and Services and the Rendering of Interstate and Intermunicipal Transportation Services and Communications
IED	Direct Foreign Investments
IF	Financial institution
IFO	Institute for Economic Research
Igae	Global Indicator of Economic Activity
IGP-DI	General Price Index - Internal Supply
IGP-M	General Price Index - Market
IHT	Index of Hours Worked by Laborer
IIA	Index of Current Intentions
IIC	Consumer Intentions Index
IIF	Institute of International Finance
IIF	Index of Future Intentions
Imacec	Monthly Economic Activity Indicator
Indec	*Instituto Nacional de Estadísticas y Census*
INE	*Instituto Nacional de Estadísticas*
Inegi	National Institute of Statistics, Geography and Informatics
INPC	National Consumer Price Index
Insee	*Institut National de la Statistique et des Études Économiques*
INSS	National Social Security Institute
IOF	Financial Operations Tax
IPA	Wholesale Price Index
IPA-DI	Wholesale Price Index - Domestic Supply
IPA-OG-DI	Wholesale Price Index - Overall Supply - Industrial Products
IPA-OG-PI	Wholesale Price Index - Overall Supply - Industrialized Products
IPC	Consumer Price Index
IPC	*Índice de Precios al Consumidor*
IPCA	Broad National Consumer Price Index
IPC-Fipe	Consumer Price Index issued by the Institute of Economic Research Foundation
Ipea	Institute of Applied Economic Research
IPI	Industrialized Products Tax
Ipim	*Índice de Precios Internos al por Mayor*
IPM	*Índice de Precios al por Mayor*
IPO	Index of Occupied People
IPP	Producer Price Index
IR	Income Tax
IRF-M	Market Fixed Income Tax
IRRF	Withheld Income Tax
Isac	Synthetic Index of Construction Activity
Isae	*Istituto di Studi e Analisi Economica*
ISM	Institute for Supply Management
IVA	Tax on Aggregate Value
IVF	Index of Physical Volume
Laia	Latin American Integration Association

LBTR	Gross Settlement in Real Time
LDL	Postponed Net Settlement
LDO	Budget Guidelines Law
Lecops	Province Liability Cancellation Bill
LFT	Treasury Financing Bills
LRF	Fiscal Responsibility Law
LSPA	Systematic Farm Production Survey
LTN	National Treasury Bills
MAA	Ministry of Agriculture and Supply
MAE	Electricity Wholesale Market
Mapa	Ministry of Agriculture, Livestock and Supply
mdb	million barrels per day
MDIC	Ministry of Development Industry and Foreign Trade
Mercosul	Southern Common Market
Moderfrota	Program of Modernization of the Fleet of Farm Tractor and Associated Implements and Harvesters
MTE	Ministry of Labor and Employment
Nafta	North-American Free Trade Association
NAPM	National Association of Purchasing Managers
NBCE	Banco Central Notes - Special Series
NCM	Common Mercosul Nomenclature
NFSP	Public Sector Borrowing Requirements
NTN-B	National Treasury Notes - Series B
NTN-C	National Treasury Notes - Series C
NTN-D	National Treasury Notes - Series D
OCDE	Organization for Economic Development Cooperation
OFPUB	System of Electronic Formal Public Offers
OMC	World Trade Organization
Opec	Organization of Petroleum Exporting Countries
p.a.	per annum
p.b.	Base points
PAF	Financial Assistance Program
Pasep	Program of Formation of Civil Service Asstes
PCC	Job Position Classification Plan
PEA	Working Population
Pesa	Special Program for Asset Reordering
PIS	Social Integration Plan
PLE	Required Net Worth
p.m.	per month
PMAT	Program of Tax Administration Modernization and Management of Basic Social Sectors
PMC	Monthly Trade Survey
PMI	Purchasing Managers Index
PNB	Gross National Product
p.p.	percentage point
PPE	Specific Price Share
PPI	Producer Price Index
PR	Reference Worth

Procera	Special Program of Credits to Agrarian Reform
Proex	Export Financing Program
Proinfa	Program of Incentives to Alternative Electricity Sources
Pronaf	National Program of Strengthening Family Farming
PSBR	Public Sector Borrowing Requirements
p.y.	per year
RCC	Resolution and Collection Corporation
Refis	Fiscal Recovery Program
RGPS	General Social Security System
RJU	Single Juridical System
RMSP	Metropolitan Region of São Paulo
RV	Sale Registration
SCC	Swap Contract with Periodic Adjustment
Selic	Special System of Clearance and Custody
SFH	Housing Financial System
SGP	Generalized System of Preferences
Simples	Integrated System of Tax and Contribution Payments by Micro and Small Business
Sindimaq	National Union of the Machine Industry
Sitraf	Fund Transfer System
SIUP	Public utility industrial services
SPB	Brazilian Payments System
SPC	Credit Protection Service
SRF	Supplementary Reserve Facility
STR	Reserve Transfer System
TEA	Scheduled Electronic Transfer
TEC	Common External Tariff
Tecban	Banking Technology Corp.
TED	Available Electronic Transfer
TJLP	Long-Term Interest Rate
TN	National Treasury
TR	Reference Rate
UE	European Union
ULC	Unit Cost of Labor
VAT	Value Added Tax
WTO	World Trade Organization