ECONOMIC REPORT

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Increased investment boosts GDP and industry in 2013

The recovery of industrial activity seems to be guaranteed in 2013. As with industrial GDP, which will likely rise by 2.6%, Brazilian GDP is expected to grow by 3.2%. A more significant growth rate is likely to be seen again as investments respond to measures designed to reduce costs and increase competitiveness. CNI estimates that investments will increase at a rate of 4.0% in 2013, contrasting with a 4.0% drop last year.

Recent experience shows that the modest growth in recent years is not due to a lack of household demand, as consumption is still on the rise. The low growth rate can be explained by weak investments, which are negatively affected by institutional and bureaucratic barriers that undermine agents' confidence and reduce the expected profitability of industrial projects.

This situation must change urgently if Brazil is to experience a more robust and vigorous recovery than that predicted for 2013, especially in the case of manufacturing. The competition with foreign products, both in third markets and in the domestic market, is still fierce and evolving in an unfavorable manner. This loss of competitiveness is not an isolated issue, but rather a reflection of modest productivity growth and increased production costs observed since before the international crisis.

The positive point is that the diagnosis of low competitiveness has become a consensus. Apparently, the main difficulty is to implement measures focused on reducing production costs in Brazil effectively and timely.

Inflation resistance is a noteworthy issue. While within the upper band limit, the inflation rate remains high and way above the world average. This difference, accumulated over the years, ends up resulting in higher domestic costs of services and inputs, thereby reducing competitiveness of industrial products.

The expected decrease in the second half is a result of specific factors with temporary effects. It is necessary to base inflation expectations on sound long-term fundamentals. Tax load increased in 2012 despite the tax relief granted by the government, and yet fiscal conditions have worsened. A lower primary surplus, revenue anticipations and the increasing use of financing fiscal operations with an impact on gross debt can negatively affect the fiscal strength, creating difficulties to keep interest rates at the current level.

In sum, the growth rate for 2013 is still unsatisfactory, as it is lower than that expected for emerging economies. With the aim of intensifying this growth, the measures designed to enhance competitiveness and boost investments must continue in place, always with an eye on the inflation path. Brazil cannot be forced once again to choose between inflation and growth.

Brazilian economy in the first quarter of 2013

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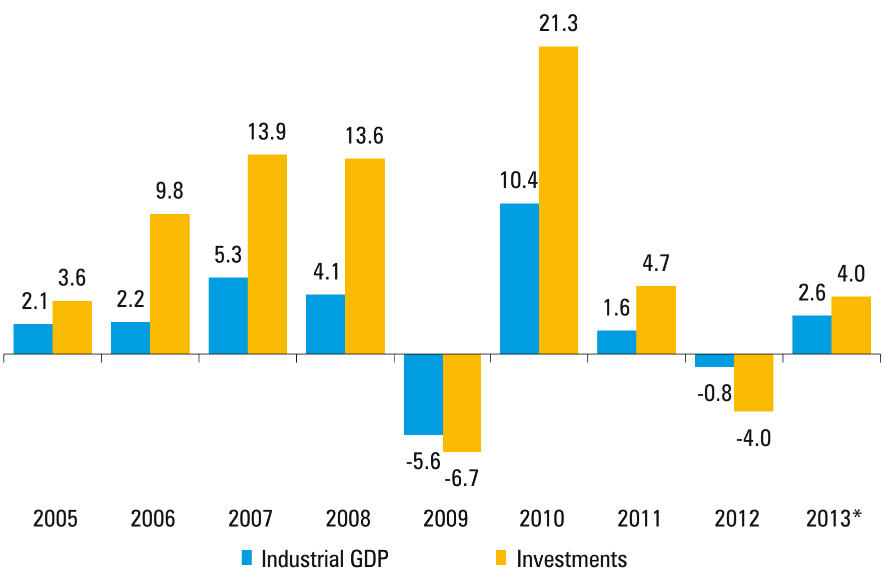
Annual variation of industrial GDP and investments GFFC

Actual annual growth rate (%)

Increased investments lead to higher industrial GDP



Source: IBGE Estimates for 2013: CNI

economy activity

More balanced GDP growth between consumption and investment

Greater industrial growth will not be sufficient to prevent industry's share in GDP from declining

After struggling for two years, manufacturing activity posted robust and widespread growth in January 2013 as compared to the month before.

Over the year, however, the rise will likely not be as pronounced as in January, since the monthly evolution may oscillate in coming months.

CNI estimates an increase of 2.6% for industrial GDP and of 3.2% for the Brazilian economy.

Positive signs of recovery early in the year

There are positive signs showing that this year will be better for industry than the last two years.

The long stock adjustment process has come to an end. The indicator for actual-usual stock levels (CNI Industrial Survey - Manufacturing and Mining) has been close to the 50-point dividing line (indicating adjusted stocks) since September 2012. In February, this indicator stood at 49.7 points.

Adjusted stock levels are crucial for an increased demand for industrial products to accelerate the manufacturing production rate. In this regard, manufacturing production showed a positive response in January and rose by 2.5% from the previous month (Monthly Industrial Production - Physical Production - PIM-PF/IBGE), according to the seasonally adjusted indicator. The growth was widespread among the industrial sectors (in 18 of the 27 considered in the survey) and in all use categories.

An increased manufacturing activity resulted in lower idleness in the sector. The seasonally adjusted indicator for capacity utilization (CNI Industrial Indicators) is up by 1.1 percentage points from the month before and amounted to 84.0% in January. As a result of this growth – the second highest in the series initiated in 2003 – the indicator is now closer to its highest level in the series (84.4% in January 2008).

A higher capacity utilization is an important condition to bring investments back.

And there are signs of this return. Production of capital goods (PIM-PF/IBGE) experienced an 8.2% increase in January as compared to December, in seasonally adjusted terms – the sharpest growth on this comparison basis in the post-crisis period (since 2008).

The fact that the Brazilian basic interest rate (*Selic*) has been sustained at its lowest historical levels and that payroll tax cuts have been granted to an increasing number of industrial sectors can produce competitiveness gains for the Brazilian industry.

In the same way, the reduction of electricity rates and the tax exemption on diesel fuel will also contribute toward reducing costs and stepping up production.

Strong activity in January is no guarantee that uptrend will continue

After a strong growth in manufacturing activity in January, leading indicators point to a drop in manufacturing production in February, as a result of which the growth rate in coming months remains uncertain. Sales of corrugated paper (Brazilian Association of Corrugated Paper - ABPO) dropped by 8.4% in February from January, meaning a 2.2% drop in seasonally adjusted terms. Vehicle production (Brazilian Association of Automobile Manufacturers - Anfavea) decreased by 17.9% in February on the same comparison basis. Adjusted for working days, car production posted drop of 4.9%.

Industrial business confidence has yet to trend upward. In March, the Business Confidence Index (ICEI/CNI) fell by 1.0 point, standing at 57.1 points. The fact that this indicator has oscillated around 57.3 points over the last seven months suggests a slower recovery pace in coming months.

In addition, many competitiveness problems still pervade the productive environment, such as: high tax load and distortions in the tax system; appreciated exchange rate; excessive bureaucracy; regulatory uncertainties; difficulty to access credit; inflexible labor market; increased labor costs due to low productivity and the logistics and infrastructure issues that push production costs up, reduce Brazilian industry's competitiveness and limit its growth.

Economy to grow by 1.2% in first quarter

The Central Bank Activity Index (IBC-Br) – which estimates month-on-month GDP variations – recorded growth of 1.3% in January from the previous month. The increase in industrial production in January played a crucial role in GDP growth in the month. Even considering a drop in industrial production in February, the figure for industrial GDP in the quarter is still expected to be positive and above 1.0%, on account of a low comparison basis in 2012.

Industry's positive performance, coupled with a strong growth in agriculture in the quarter (according to IBGE estimates), will require the service industry to step up its activity, which is also likely to grow in the period. As a result, CNI is estimating GDP to grow by 1.2% in the first quarter.

Greater GDP growth depends on more investments

A sustained economic growth stems from a more balanced growth between consumption and investment on the demand side. Considering the labor market momentum – which generates real income gains – household consumption is estimated to keep advancing in the year (3.5% as estimated by CNI). Hence, the fundamental issue to ensure continued economic growth is increasing investments.

After dropping for four successive quarters, investments, as measured by the gross fixed capital formation (National Accounts/ IBGE), grew by 0.5% in the fourth quarter of 2012 from the previous quarter.

The difficulty to increase investments is intrinsically linked to the relatively low business confidence and to low savings rate. The low willingness of Brazilians to save money results in few resources available for investment. The share of savings in GDP in 2012 was only 14.8% – close to the figure for 2002.

CNI estimates an increase of 4.0% in investments in 2013, considering the impact of government's measures for the concession of highways, railroads and airports. A more robust GDP growth will depend directly on a greater reaction of investments in the year.

Estimates for 2013

Services GDP will keep growing more (3.2%) than industry. As imports expanded by 5.5% and exports by 3.7%, the foreign trade sector is expected to have a negative contribution of 0.3 percentage points to GDP, according to IBGE's National Accounts methodology.

The industrial sector's share in GDP will continue to decline and is expected to amount to 26.1% in 2013 (taking the four industrial segments together).

Considering a growth of 2.6% of GDP for manufacturing, the share of this segment in GDP would drop to 13.2%, which would represent the lowest share since 1947, when GDP and its components began to be calculated.

CNI's GDP estimate
Percentage variation and components' contribution to GDP

	GDP components	2013 Growth rate (%)	2013 Contribution (p.p.)
Demand side	Household consumption	3.5	2.2
	Government consumption	2.8	0.6
	Gross formation of fixed capital	4.0	0.7
	Exports	3.7	0.5
	(-) imports	5.5	-0.8
Supply side	Agriculture/livestock	6.5	0.3
	Industry	2.6	0.7
	Mining and quarrying	1.5	0.1
	Manufacturing	2.6	0.3
	Construction	2.5	0.1
	Public administration. health. and public education	4.0	0.1
	Services	3.2	2.2
	GDP	**3.2**	

employment and income

Lack of skilled labor to characterize labor market in 2013

Job growing at slower pace

In the wake of economic activity recovery, the labor market is set to create a greater number of jobs in 2013. CNI is expecting formal employment to grow more than GDP, which will continue to generate gains in workers' average real earnings.

Metropolitan employment grew by 2.8% in January from the previous month (Monthly Job Survey - PME/IBGE). Formal jobs in turn grew in a more significant fashion (4.1%) than economy (3.8%) on the same comparison basis – according to Central Bank's IBC-BR. On the other hand, informal jobs in the private sector experienced a 1.6% drop also as compared to January 2012.

Labor market formalization on a steady rise

This continuous uptrend has led to an increase in the metropolitan labor market's formalization. CNI's formality index – which is calculated by the sum of all formal, military and statutory jobs divided by all occupations – has grown in recent years and hit the mark of 62.1% in January 2013. This was the greatest share of formal jobs in the metropolitan labor market since the beginning of the IBGE series in March 2002.

The higher increase in formal jobs in a buoyant labor market may boost the gains in workers' average real earnings, thus ensuring the growth of household consumption in 2013.

Average unemployment rate holding steady in 2013

Jobs have grown systematically more strongly than the labor force (PEA) – consisting of employed persons and unemployed individuals actively looking for a job – in recent years. The more employment grows in relation to the labor force, the faster the unemployment rate declines.

Job growth, however, has lost momentum since 2011, while the growth rate of labor force has been holding relatively steady.

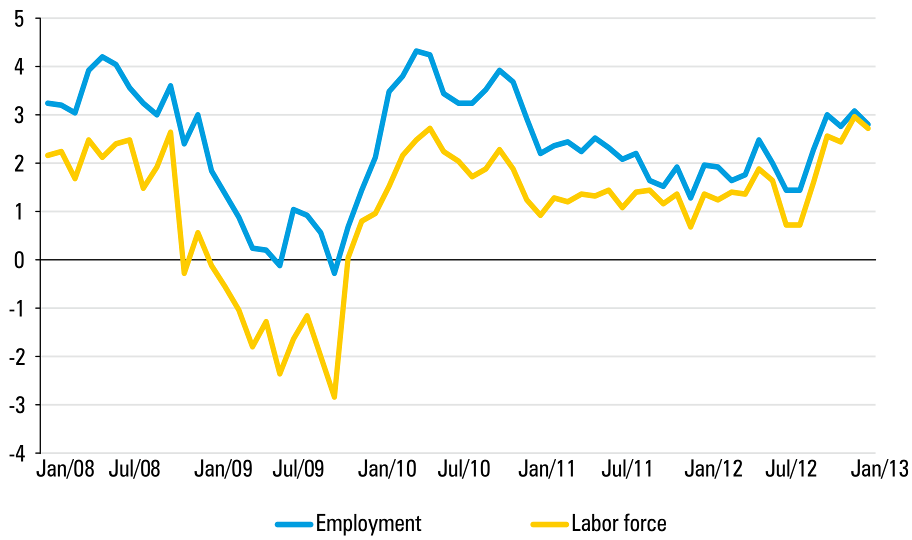
In the second half of 2012, both indicators began again to intensify their growth rate so that the annual employment variation rate matched that of the labor force.

Annual variation curves for employment and labor force have been so close that they almost aligned with each other in January 2013.

Employment and labor force (PEA)

Year-on-year variation (%)

Employment and labor force to keep growing at similar rates in 2013



Source: IBGE

The increased economic growth is estimated to generate more jobs and keep boosting workers' income gains. This scenario will likely attract more people looking for a job into the labor market.

Both jobs and the labor force are thus expected to keep growing at similar rates, as a result of which the average unemployment rate will hold relatively steady in 2013 as compared to last year's indicator.

Industry managing to retain workforce despite decline in sector's GDP

In 2012, the industrial labor market showed a different behavior from the other sectors. Despite a 2.5% drop in manufacturing's GDP, the sector kept its staff virtually unchanged. Manufacturing jobs decreased by only 0.4% in 2012 (CNI Industrial Indicators).

Dismissal costs in Brazil are very high. For this reason, this option is only considered as a last resort, that is, when it is inevitable. In addition, industry's expectations on demand for its products increased over the second half of 2012 (CNI Industrial Survey - Manufacturing and Mining). These optimistic expectations can lead to additional staff being hired. As a result, industry chose to retain its workforce in that period.

Another factor influencing the retention of staff in industry is the issue of lack of skilled workers. Even though economy is growing slowly, the problem of lack of skilled workers gained importance in the third and fourth quarters of 2012 (CNI Industrial Survey - Manufacturing and Mining). Approximately one-third of industrial enterprises mentioned this as one of the three greatest problems facing industry.

The decision to retain workers has led to a reduction in industry's profit margins. The CNI Industrial Indicators Survey shows that while manufacturing's real sales grew by only 1.2% in 2012 from the previous year, real wages paid to workers in the sector expanded at a rate of 5.0% during the same period. In the last four years, only in 2010 did industry's real sales perform better than real total payroll.

Issue of lack of skilled workers to increase in importance in 2013

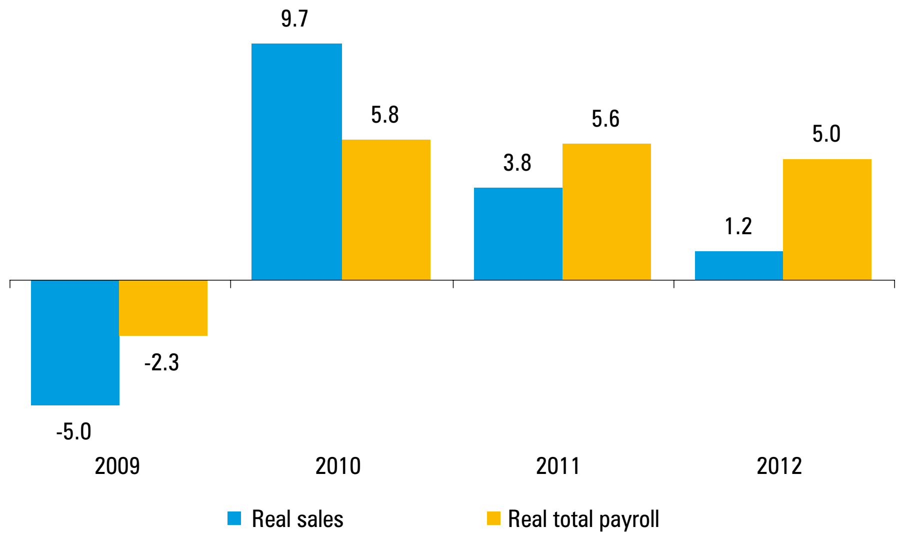
The scenario of stepped-up manufacturing activity and historical low employment rate is expected to further intensify the problem of lack of skilled workers. There will be increased wage pressures in the labor market as workers' bargaining power increases.

Industry will see a rise in its production costs, which will hamper productivity gains in the medium run. As a result, industry will face one more challenge in 2013: gaining international competitiveness in a scenario of increasing lack of skilled labor.

Real sales and real total payroll

Year-on-year variation (%)

Sector's competitiveness down as total payroll increases more than industry's sales



Source: CNI

inflation, interest rates, and credit

Tax exemptions allow inflation target to be achieved

Acceleration in food prices pushes up Extended Consumer Price Index (IPCA)

Inflation began the year on the rise. The 12-month figure for the IPCA ended 2012 at 5.84%, close to the target's upper limit of 6.5%. In February, the index moved even closer to the target ceiling and stood at 6.31%. However, CNI estimates that the hike in food prices in late 2013 will be less pronounced than at the end of 2012. As a result, the IPCA will converge to values below the target's ceiling until December, closing the year at 5.7%.

Industrial product prices experienced a light uptrend early this year, up from an accumulated figure of 1.8% in December to 3.3% in February. Part of this increase can be explained by the partial reinstatement of the Tax on Industrial Products (IPI) on automobiles. In addition, the increase in IPI on cigarettes also pushed up the index for industrial products.

On the other hand, a more appreciated exchange rate early this year (as compared to the second half of 2012) allowed for a less pronounced increase in industrial product prices. No further uptrend is expected to be seen by the end of the year, which will cause the 12-month figure for the group to close 2013 at 4.2%.

Service prices continue to contribute to sustaining the IPCA at a high level, a situation observed since early 2011. The 12-month for the group totaled 8.6% a year in February. For the next months, however, we are expecting to see a slight deceleration, with the group ending the year at 7.9%.

Regulated prices behaved in an atypical fashion early this year, due to the combined impact from an increase in fuel prices and a reduction of charges levied on the electricity bill. Nevertheless, the decrease in energy prices more than offset the rise in fuels, causing the group to experience deflation in 2013. Consequently, the 12-month figure for the group dropped from 4.2% in December to 2.0% in February and is expected to close the year at 1.7%.

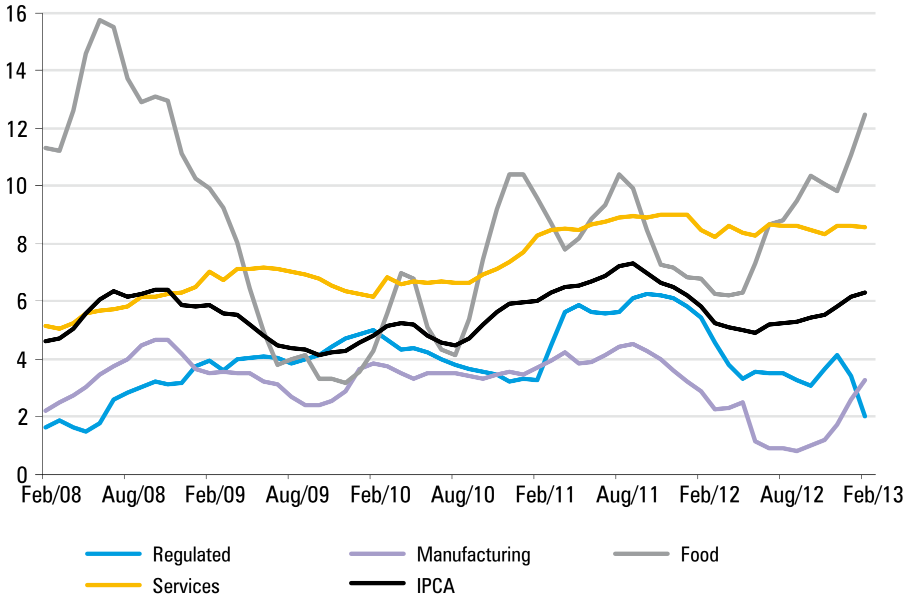
The group exerting the greatest pressure on the IPCA is that of food prices. The 12-month figure for the group reached 12.5% in February, the highest rate since the 2008 crisis. This upturn, observed since September last year, has intensified: the increase in the year's first two months is a significant 3.5%. However, one can expect to see a deceleration in coming months, which will not prevent food products from experiencing the sharpest increase among the groups, estimated at 9.7% in 2013.

Food inflation will decline for two reasons. First, on account of a less significant increase in late 2013 as compared to the year before. Second, due to the tax relief on the basic food basket promoted by the government, which affected mainly food products and industrial products for personal hygiene. It is still unclear the extent to which general price levels will decrease, as final prices incorporate costs

IPCA by groups

12-month figure (%)

Food prices at 2008 crisis levels



Source: IBGE - Preparation: CNI

that are not included in the basis for calculating exempted taxes and the market balance of each product will determine the degree to which they will be passed on to consumers.

Yet, CNI estimates that the tax exemption applied to the basic food basket will lead the IPCA to decline by 0.3 p.p.. This impact will spread over the next three to four months, owing to the replacement of in-stock products. This movement will not stop the IPCA from moving away from the target ceiling. In fact, it can even exceed this ceiling until July, but will end the year within that limit.

It should be stressed that, albeit within the target, the year's inflationary level is delusional and disturbing. The target will be achieved more as a result of specific tax relief measures (on electricity and basic food basket) than of a broad and sustained downward trend in price levels in the economy.

Inflation within the target will keep the *Selic* rate unchanged until the end of the year

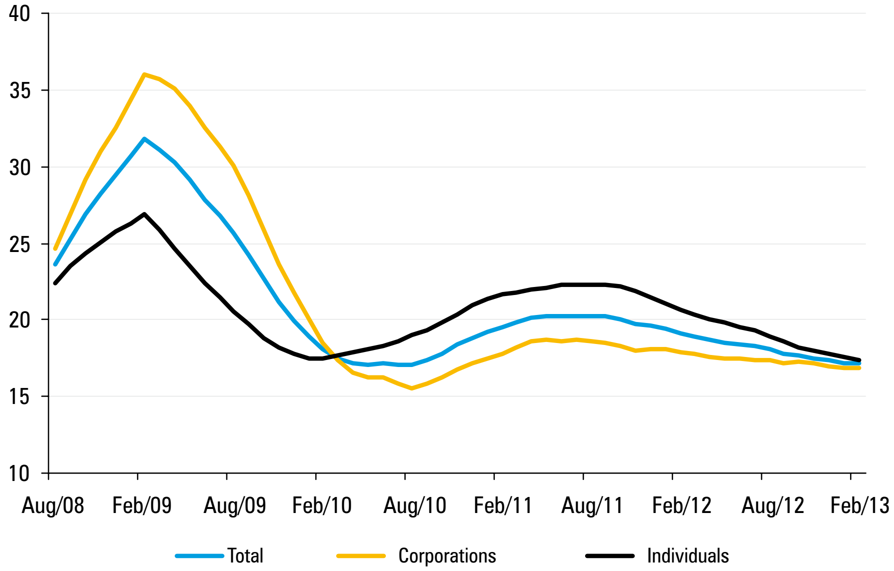
The Brazilian basic interest rate (*Selic*) was reduced to 7.25% per year in October 2012, and since then the decision has been to keep it at that level (three Copom meetings). Despite the acceleration in general price levels, Copom understands that a rise in interest rates could hinder economic growth recovery, which is still uncertain.

Thus, instead of increasing the basic interest rate, the government has adopted alternative measures to control inflation, such as granting tax exemptions for electricity bills and for the basic food basket.

Balance of credit operations

Average for the last 12 months from the 12 previous months

Credit expansion slowing down since late 2011



Source: Central Bank of Brazil - Preparation: CNI

With inflation within the upper target limit, CNI is expecting the *Selic* rate to remain at the current level (7.25% per year) until the end of 2013. At this level, and given the expected inflation for the year, the average real interest rate will likely drop to 0.9%

Lower interest rates not leading to higher availability of credit

The reduction in the basic interest rate observed last year contributed to reducing the final interest rate charged to borrowers. Within a year, the average interest rate for individuals dropped from 31.1% per year to 24.9% per year (between February 2012 and 2013, respectively). For corporations, the rate dropped from 18.2% per year to 14.0% per year during the same period.

Credit expansion, however, has not accompanied the reduction in interest rates. In February 2013, loans to individual borrowers increased by 17.4% (last 12 months compared to the 12 previous months). In August 2011, however, this figure amounted to 22.3%, showing a deceleration. On the same comparison basis, the growth rate of lending to corporations slowed down from 18.7% in July 2011 to 16.9% in February 2013.

This situation shows that there is space for credit expansion, mainly with the renegotiation of loans and financing contracted in periods where the interest rates were higher than the current ones. Under the current high inflationary scenario, the government can be expected to take measures to avoid a more substantial lending expansion. The government may take macroprudential measures again, generating the desired effect without the need to increase the *Selic* rate.

fiscal policy

Federal Government accelerates spending growth rate

Expansionary fiscal policy leads to sharp drop in primary surplus

The Federal Government further increased the expansionary character of its fiscal policy in the first quarter of 2013, in response to the weak economic growth observed in 2012. On the one hand, the spending growth rate has accelerated as compared to 2012; on the other, a number of new or extended measures have been taken to reduce taxes on consumption. As in 2012, state and municipal governments are also expected to contribute toward a pronounced increase in public expenditures this year. This scenario is likely to lead to a strong decrease in the primary surplus until the end of the year.

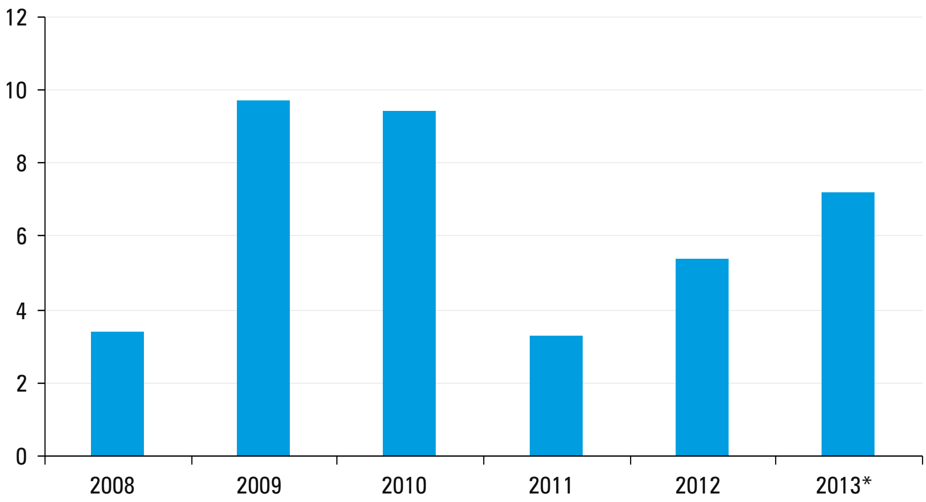
Federal Government's total spending, which posted real growth of 5.4% in 2012, accelerated its growth pace to 7.2% in the first two months of 2013 from the corresponding period in 2012.

The composition of these increased expenditures, with discretionary spending accounting for a greater share, confirms that this is a deliberate move by the Federal Government in an attempt to boost the economy. Defrayal expenses jumped from a real growth of 12.2% in 2012 to 20.4% increase in the first two months of 2013. Investments in turn (Expense Nature Group of the Federal Government Integrated System for Financial Management - GND 4 of SIAFI), which grew by 6.0% in real terms in 2012, posted real growth of 10.5% in the first two months of 2013. Although part of these increases results from a postponement of payments from late 2012 so as to bring the primary result closer to the target, data point to a trends of a less strict fiscal policy.

Growth of Federal Government's spending

Year-to-date real growth rate (%)

Growth of Federal Government's spending in 2013 is almost two percentage points above the increase observed in 2012



Source: National Treasury
Preparation: CNI

* Accumulated figure for Jan-Feb 2013 from Jan-Feb 2012

In the case of expenditures by states and municipalities, we can only estimate their behavior in January, when they grew by 3.3% in real terms. Even though this increase is below the 5.4% growth observed in 2012, this slowdown will likely not be seen in coming months. The spending growth rate is expected to accelerate. This is due to the expansion of revenues in coming months and to a mismatch between revenues and expenditures observed in recent years as regional governments became eligible to take new loans/debts.

Federal Government revenues growing slowly

While expenditures accelerated their growth rate, the Federal Government's net revenue posted real growth of only 0.8% in the first two months of 2013 from the same period in 2012. This result shows a slowdown in the growth pace as compared to the 2.2% real increase observed in 2012. Much of this decline can be explained by the 22.7% reduction in revenues not administered by the Internal Revenue Service in January and February 2013 from the same months in 2012. The reduction of almost R$ 5.0 billion in dividends received by the Federal Government in the first two months of 2013 was the main reason behind this pronounced drop.

As with the Federal Government, expenditures by states and municipalities began 2013 on a slow uptrend. Real growth, which stood at 2.6% in 2012, declined to 0.5% in January on a year-over-year basis.

This drop can be mainly attributed to the 6.1% decrease in transfers received from the Federal Government. However, the spending growth rate is expected to increase in coming months, driven both by transfers and by the collection of the Tax on Circulation of Goods (ICMS).

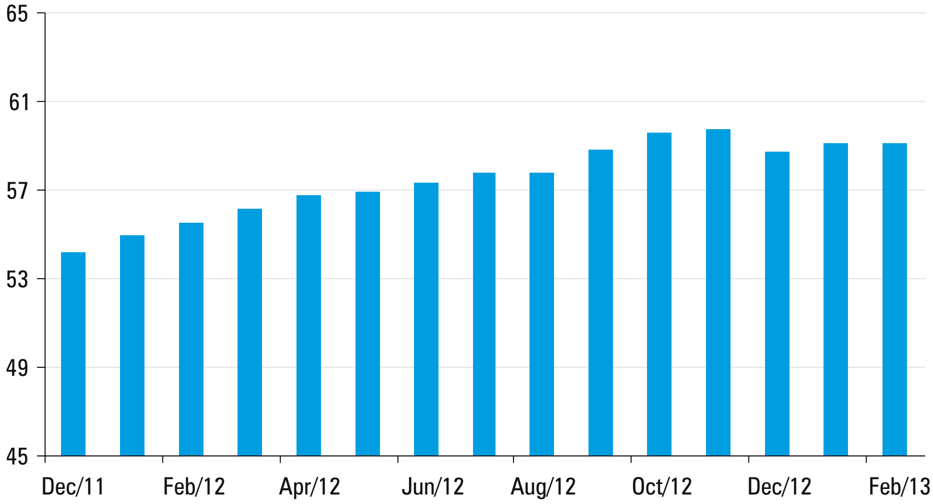
The increase in Federal Government's spending and the modest growth in revenues led to a reduction in the primary surplus. The primary result for the Federal Government in the last twelve-month period dropped from 2.0% in December 2012 to 1.8% of GDP in February. For states and municipalities, the primary surplus fell from 0.45% to 0.4% of GDP on the same comparison basis. As a result, the consolidated public sector primary surplus dropped from 2.4% in December 2012 to 2.2% of GDP in February.

As a result of the drop in the primary surplus, the nominal deficit in the last 12 months grew from 2.5% in December 2012 to 2.7% of GDP in February, with interest expenses holding steady at 4.9% of GDP. The increase in the nominal deficit and the upward pressure from exchange rate adjustments in domestic and foreign debts caused the Net Debt/GDP ratio to increase from 35.2% in December 2012 to 35.7% in February. The Gross Debt/GDP ratio, in turn, continues to trend upward and amounted to 59.1% of GDP in February. This indebtedness indicator closed 2012 at 58.7% of GDP, an increase of 4.5 percentage points over the 54.2% of GDP figure recorded in December 2011.

Evolution of the Public Sector Gross Debt

In relation to GDP (%)

Gross Debt/GDP ratio accumulating an increase of almost five percentage points of GDP since late 2011



Source: Central Bank of Brazil

Exclusion of atypical factors likely to reduce primary surplus in coming months

The trend is that fiscal policy will remain expansionary over the coming months. The Federal Government's spending growth rate is slightly up. The acceleration will probably be more pronounced in expenditures by regional governments. For its part, the rise in the revenue growth rate at federal and regional level will offset the increase in expenditures. However, certain atypical factors observed in late 2012 will be excluded until the end of the year, resulting in a lower primary surplus. Such factors are the R$ 12.4 billion withdrawn from Brazil's Sovereign Fund and the R$ 7.0 billion in interim dividends paid by BNDES (Brazilian Development Bank) and by Caixa Econômica Federal (Brazilian federal bank) that were accounted for as Federal Government revenue in December 2012.

CNI forecasts a real growth of 7.3% in Federal Government's spending in 2013 as compared to 2012. Such forecast includes a financial programming of R$ 35.0 billion in expenditures authorized under the budget approved in March. As for revenues, CNI is expecting to see a real growth of 4.8% in 2013. Under this scenario, the primary surplus for the Federal Government and its state-owned enterprises is estimated to amount to R$ 59.0 billion in 2013 (1.2% of GDP as projected by CNI). While well below the figures observed in recent years, the result estimated for 2013 would meet the adjusted target, which is only R$ 42.9 billion, since investment expenditures and tax cuts can be deducted from the R$ 65.2-billion target.

In regional governments, the primary result will likely increase slightly until the end of the year and reach R$ 24.0 billion (0.5% of GDP). This result will fall far short of the R$ 47.8-billion target. For this reason, we estimate that the consolidated public sector primary surplus will stand at R$ 83.0 billion (1.7% of GDP) in 2013. This result would be lower than both the adjusted target (R$ 90.7 billion) and the figure observed in 2012 (2.4% of GDP).

The expected decrease in the primary surplus is set to push the nominal deficit up to 3.2% of GDP, as CNI is projecting interest rate expenditures to remain at 4.9% of GDP. The increase in the nominal deficit and the exchange rate adjustments to domestic and foreign debts will cause the Net Debt/GDP ratio to grow slightly to 35.4% in December 2013.

foreign trade sector and exchange rate

Growing deficits in foreign accounts

More appreciated real exchange rate in 2013

The exchange rate had been used as a tool to boost industry's competitiveness since April 2012, oscillating between R$ 2.00/US$ and R$ 2.05/US$. In early 2013, however, the exchange rate showed signs that this year it will vary around a new level.

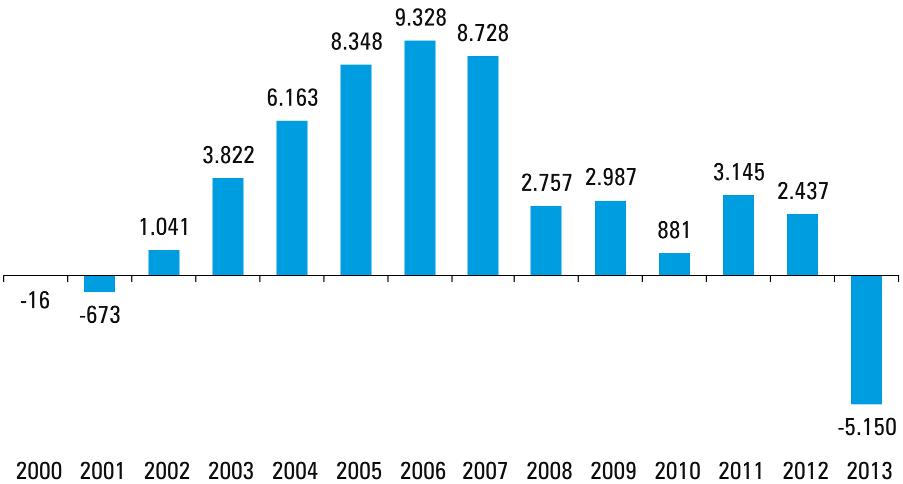
The intensified pressure on prices in the first months of 2013 (see Inflation, Interest rates, and Credit section) brought concerns over the future path of inflation. This scenario led the Government to stimulate an exchange rate appreciation in late January: since then, the Brazilian currency has been closer to the R$ 2.00/US$ mark.

Albeit implicitly, a currency fluctuation band is still being managed. Concerns over the impacts of a new exchange rate appreciation on manufacturing activity and the increasing pressure from the current account deficit (as discussed below) will likely limit the appreciation to below the lower "band" limit. On the other hand, the high penetration of imports in final goods markets and in production chains makes the government afraid of passing this depreciation on to prices.

Under this scenario, CNI projects that the exchange rate will still continue to oscillate at the same current level at least until the middle of the second half, with some occasional exceptions during short periods – owing mainly to external events such as the recent crisis in Cyprus. In the second half, as concerns over prices diminish and the pressure from the current account deficit increases, the exchange rate is expected to exceed the R$ 2.00/US$ mark in a more persistent manner. The average annual rate is estimated to be slightly more depreciated than in 2012: R$ 1.98/US$ against R$ 1.95/US$.

Despite the small difference between nominal exchange rates, it is important to consider that the Brazilian inflation rate will be much higher than in developed countries, resulting in an overvalued real exchange rate. As a result, the stability in the average annual exchange rate in nominal terms will decrease the competitiveness of the Brazilian economy.

Brazilian trade balance (1st quarter)
In US$ million
Trade deficit is highest ever registered in the period



Source: Secex/MDIC

High trade deficit early in 2013

In early 2013, the Brazilian trade balance experienced high trade deficits. In the year through March, Brazil imported US$ 5.1 billion more than it exported. This is the worst result observed for the period. In 2012, a surplus of US$ 2.4 billion was recorded during the same period.

In the first quarter of 2013, imports totaled US$ 55.9 billion, a growth of 11.6% from the same period in 2012 (daily average). On the same comparison basis, exports fell by 3.1%, amounting to US$ 50.8 billion.

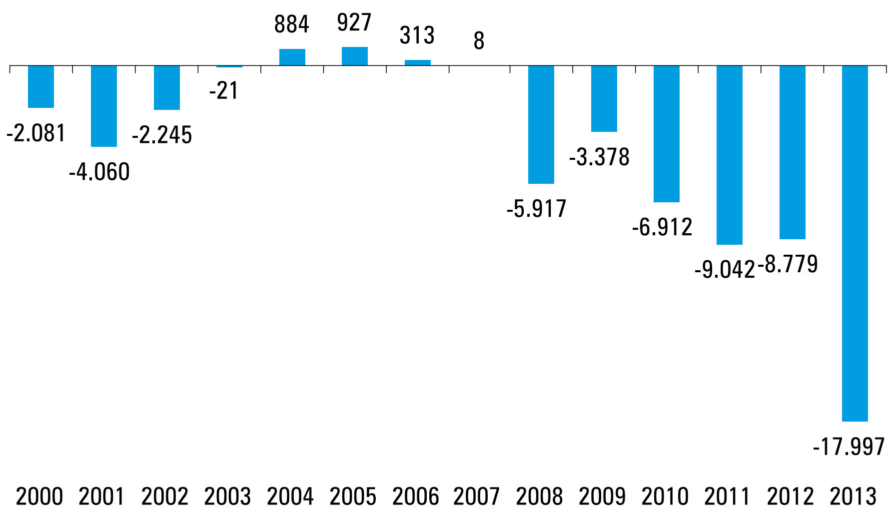
Two main factors are behind this poor performance of exports. First, crude oil sales have been redirected to the domestic market (the exports of these products dropped by 48% in the year's first two months) as a result of the priority given to meeting an increasing domestic consumption and of lower production.

Second, exports to Argentina were once again a negative surprise. Expectations of a relaxation of the restrictions imposed by the Argentine government on foreign purchases have not yet been materialized. The scenario for Brazil's trade balance early in the year and the worsening economic growth expectations for Argentina are preventing the relaxation of the restrictions on foreign purchases, which is greatly affecting Brazilian exports of manufactured products.

In addition to the above-mentioned situational factors, there are also competitiveness problems facing the Brazilian industry and the consequent difficulty to export to countries like USA, Mexico and the European Union.

Brazilian current account surplus (1st two months)
In US$ million

Current account up two-fold from 2012



Source: Central Bank of Brazil

Based on this scenario, Brazilian exports can be expected to increase in 2013, once again on account of commodity sales, driven mainly by positive grain harvest expectations for the year. However, logistical bottlenecks evinced by episodes such as China's decision to cancel the purchase of 2 million tons of soybeans (due to the long line of trucks waiting to unload soybeans at Brazil's ports and the resulting delivery delays) limit the performance of these exports. Under this scenario, exports will probably grow by only 4.5% in 2013, totaling US$ 253.4 billion, still below the exported value in 2011.

Imports will also keep growing. As with capital goods, imports of intermediate goods and raw materials – which account for the greatest share of Brazilian imports – will also be particularly boosted by greater economic growth. In addition, the continuation of policies to stimulate consumption, coupled with the maintenance of an overvalued exchange rate, will support imports of consumer goods. Imports will grow by 8.5% in 2013, totaling US$ 242.1 billion. As a result, the trade surplus will total US$ 11.3 billion, down by 41% from 2012.

Foreign deficit doubles in first two months of 2013

In the first two months of 2013, the current account deficit amounted to almost US$ 18 billion, a 105% growth as compared to the same period last year (US$ 8.8 billion). The deficit in the services account increased by 12.2% and stood at US$ 6.8 billion, while the negative result in the income account rose by 88.9%, to US$ 6.5 billion.

In particular, spending by Brazilians abroad hit a record high in January and February. In the year's first two months, these expenditures totaled US$ 4.1 billion, up by 10.5% from the 2012 figure. It is worth noting that this growth occurred despite a higher dollar compared to February last year. The average exchange rate in February 2013 was R$ 1.97/US$, while it stood at R$ 1.72/US$ in February last year.

During the same period, foreign direct investments totaled US$ 7.5 billion, down by 16.9% from the same period in 2012.

The current account deficit will continue to grow in 2013, exceeding the 2012 figure, which was a record. The gains in employment and income experienced by Brazil will continue to drive the increased spending on services abroad and profit remittances will remain high. All of these factors, coupled with a declining trade surplus, will cause the current account deficit to amount to US$ 68.1 billion. As a result, foreign direct investments may not be enough to finance this deficit, which has not happened since 2001.

prospects for the Brazilian economy

	2011	2012	2013 *previous projection December/12*	2013 *projection*
Economic activity				
GDP (annual variation)	2.7%	0.9%	4.0%	**3.2%**
industrial GDP (annual variation)	1.6%	-0.8%	4.1%	**2.6%**
Household consumption (annual variation)	4.1%	3.1%	3.8%	**3.5%**
Gross fixed capital formation (annual variation)	4.7%	-4.0%	7.0%	**4.0%**
unemployment Rate (annual average - % of the labor force)	6.0%	5.5%	5.3%	**5.4%**
Inflation				
Inflation (IPCA - annual variation)	6.5%	5.8%	5.5%	**5.7%**
Interest rates				
Nominal interest rates				
(average rate in the year)	11.76%	8.63%	7.25%	**7.25%**
(year end)	11.00%	7.25%	7.25%	**7.25%**
Real interest rate (annual average and deflated rate: IPCA)	4.8%	3.1%	1.4%	**0.9%**
Public accounts				
Nominal public deficit (% of GDP)	2.61%	2.47%	2.20%	**3.20%**
Public primary surplus (% of GDP)	3.11%	2.38%	2.30%	**1.70%**
Net public debt (% of GDP)	36.4%	35.2%	33.9%	**35.4%**
Exchange rate				
Nominal exchange rate - R$/US$				
(average in December)	1.83	2.08	2.07	**2.00**
(average in the year)	1.67	1.95	2.06	**1.98**
Foreign trade sector				
Exports (US$ billion)	256.0	242.6	258.3	**253.4**
imports (US$ billion)	226.2	223.1	240.2	**242.1**
Trade balance (US$ billion)	29.8	19.4	18.1	**11.3**
Current account balance (US$ billion)	-52.9	-54.3	-62.1	**-68.1**

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