CNI ECONOMIC REPORT

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Economy recovers leveraged by consumption

Low investments and exports limit the intensity of the industry's recovery

Brazilian economy continues to recover. After dropping for two quarters in a row, GDP grew by 1.9% in the second quarter in relation to the previous one.

Two aspects deserve special mention. First, growth was fostered by a rise in household consumption (2.1%). Second, investments have stabilized and interrupted the downward trend observed in the two previous quarters. As a result, our forecast for GDP variation in 2009 rose from -0.4% to zero.

The positive results registered recently do not mean that the crisis is over. As compared to the same quarter in 2008, GDP dropped by 1.2%, meaning that production is still suffering the damages caused by the crisis.

These damages are significant for the industry. Despite the positive result in this quarter, industrial GDP decreased by 7.9% as compared to the same period in 2008. In the first half of the year, this drop hit the mark of 8.6%, reinforcing expectations of a negative performance in 2009. The crisis will be overcome in the industry when production is resumed at the levels registered last year, which is only expected to occur in 2010.

The labor market is also recovering. Jobs have been on the rise for three consecutive months in the six largest metropolitan regions of Brazil. In August, industry was the sector in which most new jobs were created, namely, 135,000. This result suggests that the labor market adjustment process in the industry has been completed.

A higher domestic demand has not been pressuring inflation. After nineteen months above the inflation target, the 12-month accumulated Extended Consumer Price Index (IPCA) is below the center of the target (4.5% a year). The deceleration observed in the prices of industrial products is the main reason explaining this drop. Nevertheless, the Central Bank decided not to reduce interest rates any further. The scenario we anticipate for inflation does not justify this decision.

Foreign trade is still down. Exports dropped by 25% in value in the accumulated figure up till August 2009, while imports decreased by 32%. This slower trade flow reflects a global market depressed by the effects of the crisis.

An appreciated Brazilian real delays the industry's recovery. Since January, it appreciated by 14% (as deflated by the PPI index) in relation to a set of 13 currencies. In relation to the US dollar, it appreciated by up to 15%.

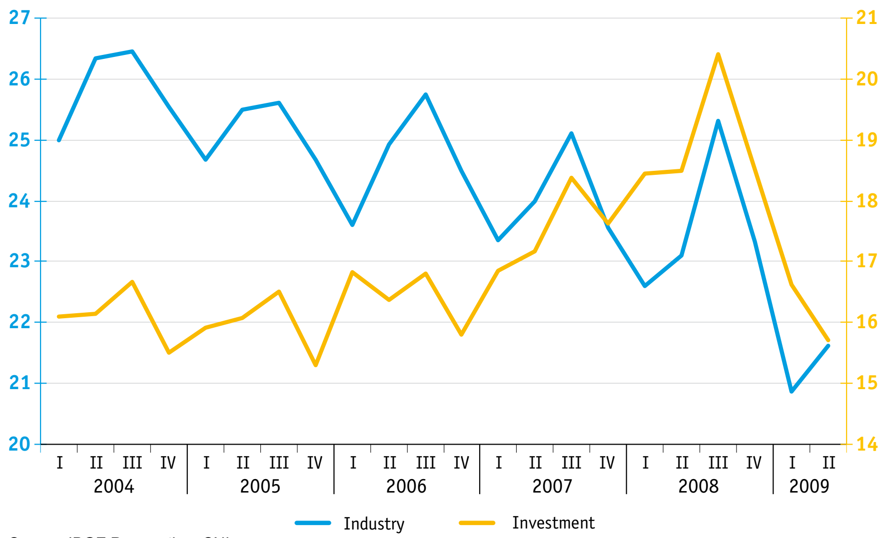
The Federal Government reduced the primary result target for the second time in 2009. This new change will make it possible for the target to be achieved if the public sector reaches a primary surplus of 1.6% of GDP – as opposed to the previous 2.0% target.

Broader fiscal results also suggest deterioration as a result of the crisis. The nominal deficit is expected to hit the mark of 3.6% of GDP this year, against 2.0% in 2008. As a result, the debt/GDP ratio is likely to rise from 38.8% late in 2008 to 44.0% of GDP in December 2009.

Industry and investment in proportion of GDP

% of GDP

Industry and investment are the most affected by the crsis



Source: IBGE Preparation: CNI

Brazilian economy in the third quarter of 2009

economic activity

GDP is stable in 2009

Household consumption keeps GDP from falling

CNI revised its estimate for GDP variation in 2009 up from -0.4% to zero. Despite the lack of reaction on the part of investments in the second quarter, a higher household consumption was the key factor that led to this upward revision.

After falling for two quarters in a row – characterizing an economic recession –, GDP grew by 1.9% in the second quarter in relation to the previous one (seasonally adjusted data). Despite a more dynamic economic activity in the second quarter, GDP is still suffering the impacts of the crisis and decreased by 1.2% as compared to the same quarter the year before.

On the demand side, the positive result observed for GDP in the second quarter was brought about by a 2.1% increase in household consumption (seasonally adjusted). GDP component began to recover in the first quarter of this year, when it grew by 0.7% on the same comparison basis. Household consumption in the second quarter had already fully absorbed the impacts of the crisis and hit a record level (in the seasonally adjusted index).

Domestic consumption is driven by four factors: a) personal credit enhanced its growth; b) total earnings of workers in the public sector – mainly – and in the private sector continued to expand; c) the assistentialist (cash transfer) policy adopted by the Federal Government supported the consumption of low income families; and d) tax exemption measures in some sectors resulted in a higher consumption of durable goods.

GDP evolution in the civil construction and manufacturing industries
Base index 1995 = 100

Even believing that a strong recovery is possible over the next few months, the possibility that industry will grow in 2009 has been discarded

Source: IBGE. Projection: CNI

Lack of reaction on the part of investments delays economic recovery

While household consumption has already exceeded the levels observed before the pre-crisis, no reaction was registered on the part of investments, preventing a more intense GDP growth. After decreasing by 20.3% in the figure accumulated in the fourth quarter of 2008 and first quarter of 2009, gross formation of fixed capital (GFFC – investments) remained stable in the second quarter of the year.

Despite a higher demand, investments have not recovered so far. The Machines and Equipment industry – which mainly produces products for investment purposes – suffered a drop of 17.3% in real turnover in July in relation to the same month in the previous year. This behavior is mainly associated with idleness in the industrial complex. In July, capacity utilization amounted to 79.9%, 3.2 percentage points down from the level registered before the crisis (September 2008). This situation continues despite an increase in capacity utilization in the first seven months of 2009.

Industry recovery is insufficient to overcome crisis

The 2.1% industrial GDP growth observed in the second quarter suggests that manufacturing activity is recovering. Manufacturing production (PIM-PF/IBGE) grew in all the first seven months of the year – according to seasonally adjusted data – and accumulated a variation of 12.0% over the period. This consistent growth in manufacturing production shows that process of adjusting undesired stocks has been completed.

Despite the positive performance of industry as a whole, some of its components, such as the manufacturing and civil construction sectors mainly, have recovered to levels below the necessary to overcome the effects of the crisis before 2009 is over. Despite a 2.1% increase in the manufacturing industry production in July in relation to the previous month, production levels in July are still 12.0% below the ones registered in the pre-crisis period (September 2008). The civil construction industry grew by only 0.4% in the second quarter of the year after dropping by 3.5% in the first quarter of 2009. In both cases, the comparison is made in relation to the previous quarter (data seasonally adjusted by CNI).

For the service industry, the crisis is over

The service industry (particularly commerce) was able to resist the crisis and was back on a growth path in first quarter of this year already. After growing by 0.8% in the first quarter of 2009, it grew further to 1.2% in the following quarter. Growth in services continues to be driven by a rising household consumption. Considering retail sales, a growth of 0.5% was registered in July as compared to the previous month in the seasonally adjusted indicator.

As for foreign trade, exports grew by 14.8% in the second quarter in relation to the previous one. This positive result exceeded our estimates and is attributed to higher sales of basic products. As expected, imports stopped dropping in the second quarter, but no significant increase was registered for them: 1.5% in relation to the previous quarter.

Estimates for the economy in 2009

The rapid recovery observed in household consumption led us to revise our estimates for economic growth in 2009. Even without any additional increase over the next two quarters, the statistical effect is enough to ensure a 1.6% growth in household consumption in 2009. Considering this effect and factors sustaining domestic demand, we are projecting an increase of 2.4% for this GDP component in 2009 – as opposed to the previous 0.7% projection.

However, reductions in the IPI (Tax on Industrial Products) may have led consumers to buy items before they actually intended to in some cases. Individuals who intended to consume products such as household appliances and automobiles may have taken advantage of the IPI reduction to buy these items before they had planned to.

As for government spending, the stability of this GDP component in the second quarter led us to revise our growth forecast down from 3.0% to 2.6%.

While on the one hand household consumption has increased, the behavior of investments is a source of concern. For the investment levels registered in 2008 to be achieved, GFFC would have to grow by 15.9% in the two last quarters of the year. For this reason, we lowered our GFFC estimate for 2009 from -9.0% to -12.8%.

On the supply side, industry would need to grow significantly (12.0%) over the next few months to overcome the impacts of the crisis. Therefore, we estimate that industrial GDP will decline by 4.0% in 2009, mainly because the re-estimation in the GDP estimates for the manufacturing (-5.6%) and civil construction (-5.7%) industries.

The service industry is expected to grow at a more robust pace over the next quarters. We therefore believe that this GDP component will increase by 3.0% in 2009. Once again, it should be mentioned that this dynamic behavior may lose strength if the tax reduction measures still being applied are lifted.

Finally, we believe that the foreign trade sector will make a positive contribution of 0.5 percentage points to GDP in 2009 as a result of a 7.7% drop in exports and a decrease of 11.2% in imports (based on the National Accounts concept).

CNI estimates that GDP will grow by 1.5% in the third quarter, but with a negative 1.2% rate as compared to the same quarter the year before. However, the Brazilian economy may grow at a faster pace in the last quarter of the year (4.0%), reverting the negative rate in relation to the same quarter in the previous year. With this performance, GDP will experience a zero growth in 2009 in relation to 2008.

Estimated growth for GDP and its components in 2009

	GDP Components	2009 Growth Rate (%)	2009 Contribution (p.p.)
Demand Side	Household consumption	2.4	1.5
	Government consumption	2.6	0.5
	GFFC	-12.8	-2.4
	Exports	-7.7	-1.1
	(-) imports	-11.2	-1.6
Supply Side	Agriculture/Livestock	-2.6	-0.2
	Industry	-4.0	-1.1
	Services	3.0	2.0
	GDP pm	**0.0**	

CNI

jobs and income

Labor market is warming up again

Labor market adjustment in the industry comes to an end

The negative impacts of the international crisis gave place to a gradual labor market recovery. However, the labor market is recovering in a heterogeneous way in sector terms, mainly with respect to industry.

Data from the Ministry of Labor and Employment (Caged) registered a constant monthly increase in the number of formal jobs in the private sector since the beginning of the second quarter. Despite these new hires, the flow was consistently lower than the one registered in the same month last year. The exception was in August, when 242,000 jobs were created – slightly above the figure of 239,000 in August 2008.

Job recovery has not yet brought positive impacts in the 12-month accumulated job creation indicator. This indicator, which hit its highest mark in September 2008, 2.1 million new jobs, decreased to 329,000 in August 2009. This is the lowest figure in 12 months since the beginning of Caged. As for manufacturing, the 12-month accumulated indicator dropped to 292,000 jobs in August.

According to CNI Industrial Indicators, after dropping for eight months in a row, jobs in manufacturing remained stable in July in relation to the previous month (seasonally adjusted data). Nevertheless, jobs decreased by 5.0% in July as compared to the same month the year before and declined at a two-digit rate in five manufacturing sectors: Wood (-20.2%), Electronic Materials and Communication Equipment (-17.8%), Automotive Vehicles (-12.1%), Machines and Equipment (-11.5%), and Primary Metal Products (-10.4%).

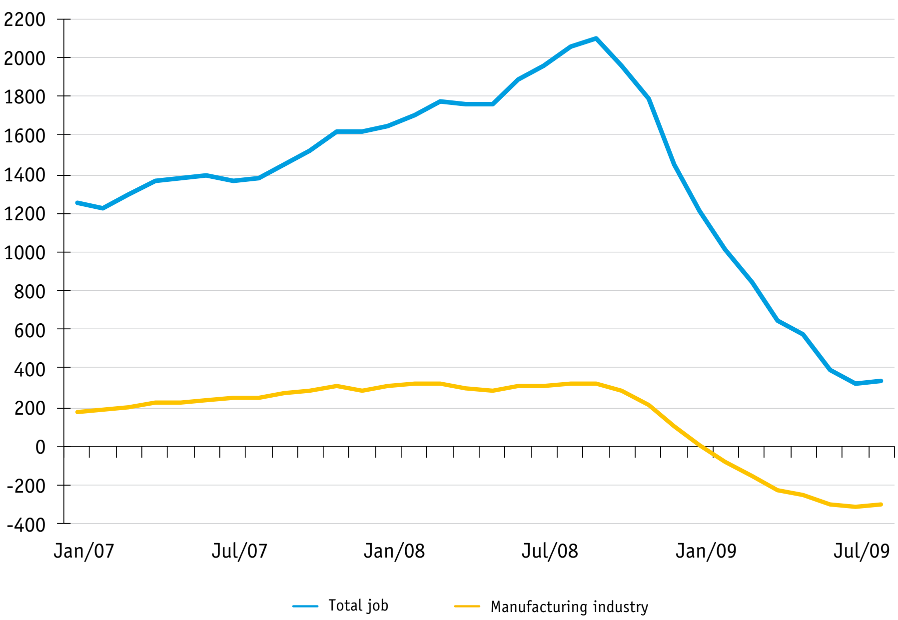
Considering the employment data of the six largest Brazilian metropolitan regions (PME/IBGE), a pronounced growth in industrial jobs (135,000) was observed in August as compared to the previous month. Industry was the largest employing sector in August.

Formal jobs in the private sector grew by 2.8% in August in relation to the same month in the previous year. During the same period, informal jobs dropped by 8.6%. In the public sector, jobs rose more intensely: by 6.7% on the same comparison basis. Jobs in the public sector are growing at the fastest rate as compared to other occupations.

Figures for total job creation and new jobs in the manufacturing industry

12-month accumulated

Drop in jobs in the industry shows that the impacts of the crisis hit this sector more intensely



Source: Caged/MTE

Less intense search for jobs prevents unemployment rate from increasing

Despite a weak metropolitan job growth (0.9% in August in relation to the same month in the previous year), the unemployment rate remained stable from June to August. This phenomenon was the result of a less intense search for jobs over the period. As compared to August 2008, labor force (which consists of people who are either employed or seeking employment) is down by 1.2%. In relation to the same month the year before, however, the reduction in the labor force is losing strength. The indicator dropped by 2.4% in June.

Growth of total earnings is driven by the public sector

Real total earnings grew by 2.7% in July as compared to the same month in the previous year. It should be highlighted that the increase in jobs and a higher average wage in the public sector were the key to achieving this outcome. According to the last data available, while the average income of public-sector workers rose by 6.4% in August in relation to the same month in the previous year, the income of private-sector formal workers dropped by 0.2% on the same comparison basis. With the low inflation and the expected job growth in the next few months, total earnings are expected to keep growing at the same pace.

Labor market will only be back to normal in 2010

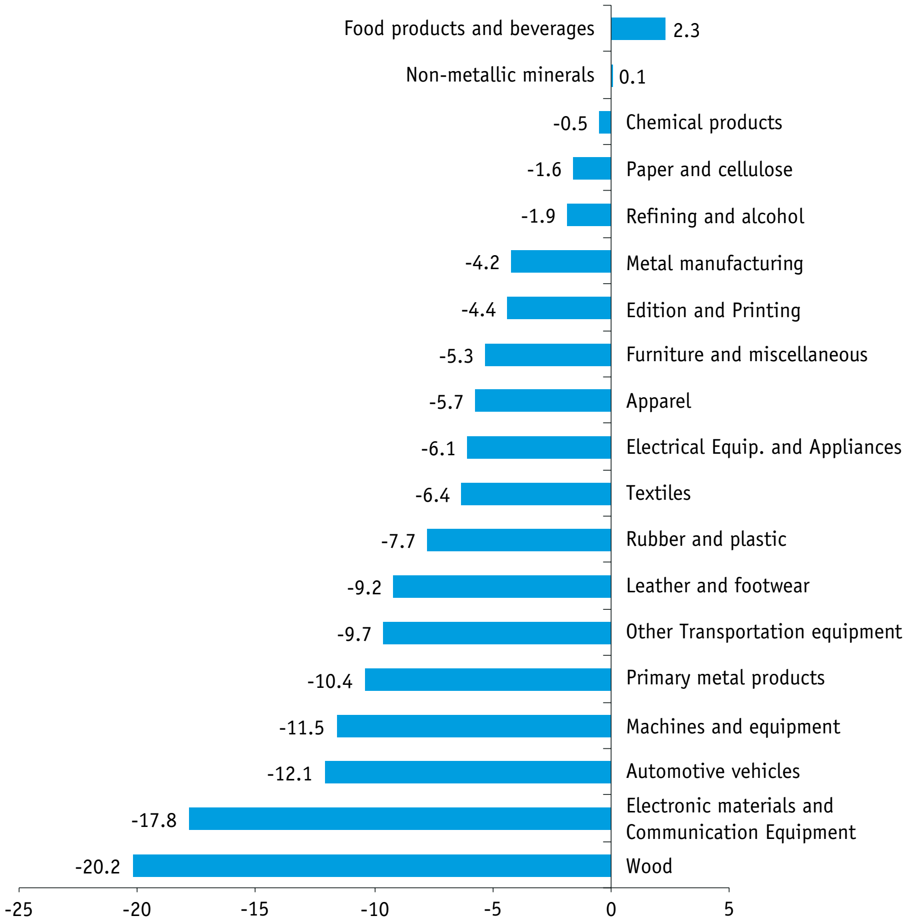
Jobs are expected to grow over the next few months, confirming the labor market recovery. The labor force behavior is what will determine the unemployment rate path. If labor force begins to grow more intensely, the unemployment rate may increase.

CNI estimates that the unemployment rate will finish the year slightly below 7.0%, resulting in a 8.8-percent average annual rate. As labor market continues to recover, total earnings are likely to continue to grow and thus support household consumption, which is the main factor driving GDP growth.

Jobs in manufacturing

% variation as compared to the same month the year before

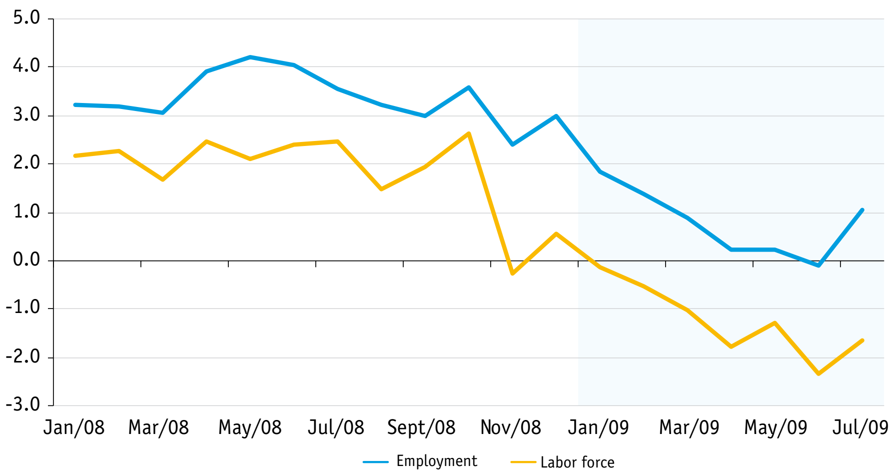
Jobs are down in almost all industrial sectors



% Variation in the labor force and Employment

in relation to the same month the year before

Labor force decreases in all of the first eight months of 2009



Source: PME/IBGE

Inflation below the target center after 19 months

Deceleration in industrial prices leads to convergence of the Extended Consumer Price Index (IPCA) to the target

The 12-month accumulated Extended Consumer Price Index (IPCA) – dropped below the inflation target center (4.5% a year) in August 2009, when it hit the mark of 4.36%. The rate has been above the target center since January 2008 and peaked in October of that year, when it rose to 6.41%. Convergence toward the target has been associated with the negative effects of the international crisis on economic activity in Brazil.

The drop observed in the 12-month accumulated IPCA is mainly explained by the evolution of industrial product prices, which rose by only 2.67% in 12 months. As a comparison, services accumulated an increase of 7.02% over the same period.

The crisis affected the prices of industrial products negatively as a result of both demand and supply effects. On the demand side, a decrease in jobs and fears that the crisis would worsen reduced consumers' willingness to consume. On the supply side, a drop in foreign demand led products intended for export to be sold in the domestic market. In addition, reductions in the Tax on Industrial Products (IPI – Brazil's federal excise tax) also led to a drop in the prices of these products.

> Industrial prices will rise with the return of IPI and demand increase

Therefore, deflation was observed for some industrial products in the year, such as for automotive vehicles – which registered an accumulated drop of 6.57% between January and August 2009. It should be highlighted that this effect was not felt in other segments, such as in the service industry, which accumulate a hike of 5.12% in the year. As a result, the IPCA rose by 2.98%, against 1.16% for industrial products.

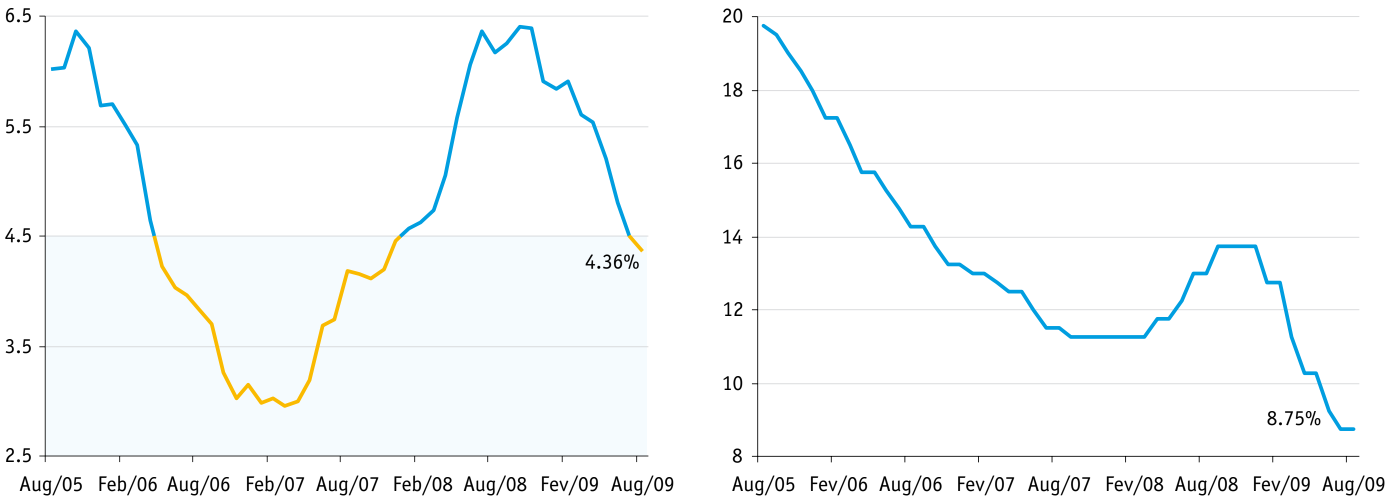
This behavior of industrial prices can be reverted in the final months of the year with the return of IPI and demand increase. However, this movement poses no threat for the inflation target, which is virtually guaranteed. CNI maintains its inflation forecast at 4.20% a year in 2009.

Over the next few months, the sequence of negative variations registered in the Market General Prices Index (IGP-M) since March 2009 is likely to be interrupted, as occurred in September. These variations were basically caused by a decrease in wholesale prices (IPA). The expected reversion of the IPA path before

Evolution of the official inflation rate IPCA (left) and of the Selic rate (right)

Accumulated in 12 months (left) and percentage for the year (right)

IPCA convergence toward the target center is in tune with the cuts in the *Selic* rate



Source: IBGE and Central Bank of Brazil

the end of the year will drag the IGP-M with it. This index, which accumulated a 2.02% deflation until August 2009, is expected to close the year at about zero.

Central Bank decides not to continue to reduce interest rates

With inflation down and the prospects of adjustment to the target center, the Central Bank began to reduce the Selic rate in 2009, reverting its increases throughout 2008. Since July, the Selic rate has been at its lowest historical level: 8.75%. It accumulated a drop of 5.00 p.p. during the year.

As anticipated in the previous Report, the Central Bank has indicated in its September meeting that the sequence of reductions is over. CNI maintains its projection that this rate will remain at the same level until the end of this year, meaning that the real interest rate will close 2009 at 5.00% per year.

The drop in the Selic rate reduced the yield of investments in government bond funds. As a result, the yield of some of these funds has dropped to lower levels than that of savings accounts – which are exempt from income tax and yield 6.17% a year.

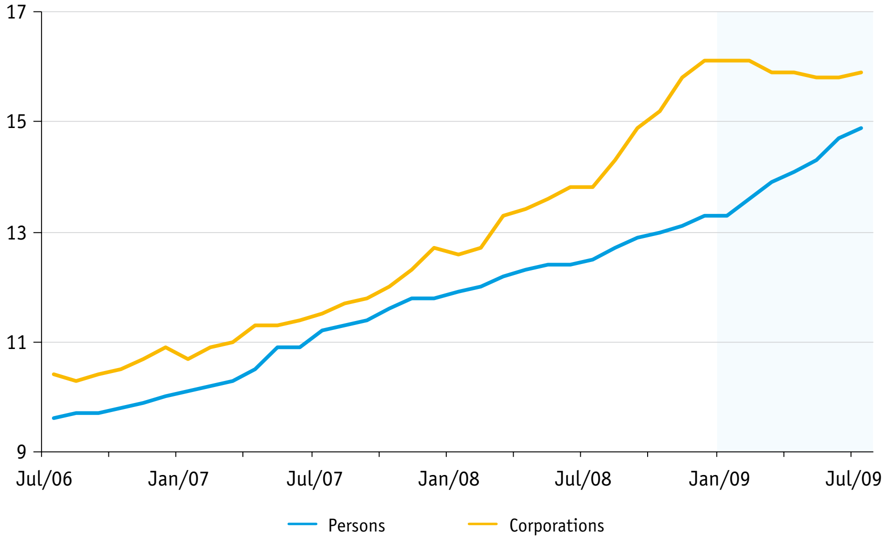
> Net deposits in savings accounts in 2009 have virtually equaled those made during the whole year of 2008

The difference in yield has led to a migration of investments from those funds to savings accounts. Between May and September 2009, net deposits in savings accounts have virtually equaled those made during the whole year of 2008 (R$ 17.4 billion, against R$ 17.7 billion in 2008). In order to avoid this movement, the government is considering the possibility of charging income tax on large sums deposited in savings accounts.

Credit with non-earmarked resources

% of GDP

Credit for corporations stops growing in 2009



Source: Central Bank of Brazil

Credit for corporations' drops by 0.2 p.p. of GDP in 2009

Despite the common feeling that the impacts of the international financial crisis on the Brazilian economy are over, credit evaluations reveal that there is a difference between the situation of persons and corporations.

Data provided by the Central Bank show that credit with non-earmarked resources for persons in relation to GDP rose by 1.6 p.p. in 2009, increasing from 13.3% in December 2008 to 14.9% in July 2009. A different situation was observed in relation to credit for corporations, which decreased by 0.2 p.p. of GDP during the year. Therefore, it was seen that, as opposed to the situation for corporations, credit for persons was only slightly affected by the crisis.

Credit for companies had experienced a marked expansion – exceeding the increase registered for persons – in 2008. Credit for corporations in relation to GDP grew every month since January 2007 – when it hit the mark of 10.7% – until December 2008, when it reached its highest level: 16.1%. With the crisis, the rate stagnated and began to drop until it stabilized at 15.9% of GDP in July.

The credit scenario for corporations was not worse only because of the expansion of earmarked credit, particularly of BNDES. This was particularly observed in June and July 2009. In the latter, credit available was 41.0% higher than in July 2008. According to BNDES, disbursements were 11.0% higher in the first half of 2009 than in the same six-month period the year before. On the same comparison basis, specific disbursements for industry grew by 8.0%.

For credit with non-earmarked resources the situation is the opposite, namely, a decrease was observed every month from January to July as compared to the same month the year before – except in March. In July, credit was 8.1% lower than in the same month in 2008. This situation makes it difficult for companies to recover – particularly industrial enterprises.

Primary surplus expected to be the lowest one in 11 years

Fiscal expansion is expected to increase as a result of a new downward revision of the primary surplus target

The Federal Government reduced the target for the primary result for the second time in 2009. This new change allows for the target to be achieved if the public sector primary surplus amounts to 1.6% of GDP – the previous target was 2.0% of GDP.

This reduction in fiscal effort made it possible for the Federal Government to make up for lower-than-expected revenues and still increase its spending forecasts. The result will be a fiscal expansion greater than previously expected in the fourth quarter and the lowest primary surplus since 1998.

To achieve the required primary surplus before the new change, the public sector would have to make a greater fiscal effort in the final months of the year. This is so because the 12-month accumulated result until July 2009 was 1.8% of GDP.

Fiscal expansion is more pronounced in the Federal Government

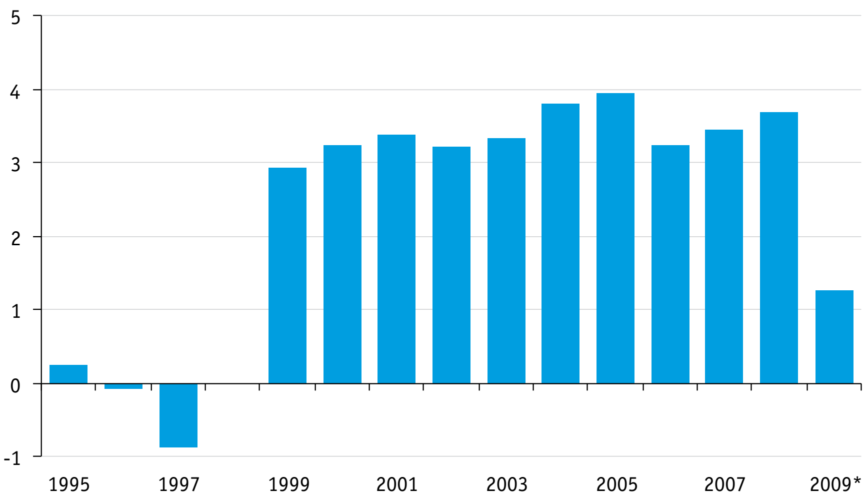
As compared to the primary surplus registered in December 2008 – 3.7% of GDP –, the result in July reveals the size of fiscal expansion in 2009. This movement was stronger in the Federal Government and its state enterprises, for which the primary result declined from 2.6% to 0.8% of GDP between December and July. For regional governments and their state enterprises, the drop was 0.1 percentage point of GDP on the same comparison basis.

In both cases, the reduction in the primary surplus was not only caused by lower revenues, but also by higher spending.

Evolution of the Consolidated Public Sector Primary Surplus

% of GDP

Primary surplus is expected to drop by 2.4 p.p. of GDP in 2009 and to hit the lowest level since 1998



Source: Central Bank of Brazil - Preparation and Projections for 2009: CNI

Federal Government: primary surplus falls because of the reduction in the tax burden and higher spending

In the Federal Government, net revenue dropped by 6.8% in real terms between January and July 2009 in relation to the same period in 2008. This drop is explained by conjunctural factors, such as less intense economic activity and lower profitability among enterprises and by the Government's option to fight the effects of the economic crisis through tax exemptions.

Federal Government spending rose by 10.1% in real terms between January and July 2009 as compared to the same period in 2008. Some sources pressuring spending up had already been identified before the economic crisis, and they involve compulsory expenses. These include salary adjustments granted to civil servants and a raise in the minimum wage, which have an impact on social security benefits and social assistance, unemployment insurance and special salary raises.

However, there was also a real increase in non-compulsory expenses, showing that the Federal Government sought to complement tax policies through direct stimulus on demand. The defrayal of the public apparatus and programs rose by 12.8% and investments grew by 11.0% between January and July 2009 in relation to the same period in 2008.

Regional governments are affected by drop in transfers and in the value-added tax ICMS

For states and municipalities, estimates based on preliminary data point to a real drop of 1.1% in revenues in the first six months of 2009 as compared to the same period in 2008. This decrease is explained by the effect of a less intense economic activity on value-added tax (ICMS) collection (-3.3%) and by the impact of tax exemptions on transfers from the Federal Government (-3.1%).

As for spending, we estimate a real growth of 1.7% for regional governments in the first six months of 2009 in relation to the same period in 2008. As opposed to the Federal Government, states and municipalities have to maintain a strict balance between their revenue and spending growth pace. Apart from suffering greater restrictions imposed by the Fiscal Responsibility Law, a percentage of their revenue is earmarked for debt payments with the Federal Government.

What can be expected from fiscal results in 2009?

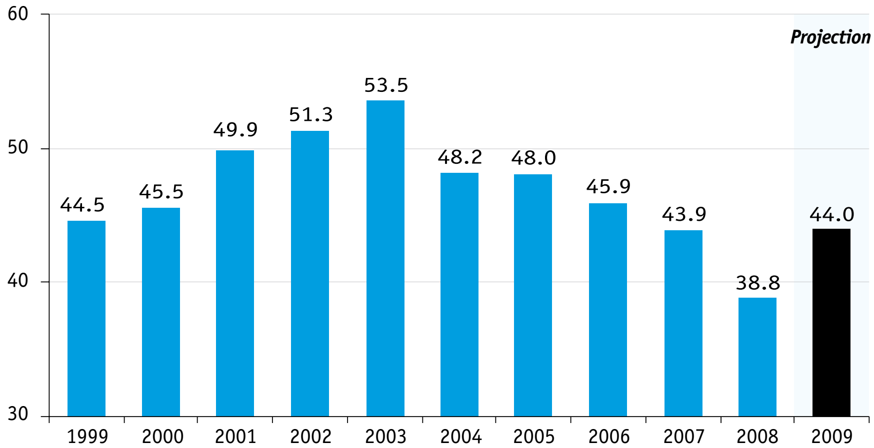
The new rule for the primary surplus target allows for deductions of up to R$ 28.5 billion (0.9% of GDP as estimated by the Federal Government) in the spending under the Growth Acceleration Program. In practice, the Federal Government may comply with this requirement by achieving a surplus of 0.5% of GDP. The previous rule limited this discount to R$ 15.6 billion (0.5% of GDP) for the Pilot Investment Project, which required a surplus of 0.9% of GDP.

The change in rules allowed for an increase of R$ 5.6 billion in authorizations for non-compulsory spending in the Federal Government. This increase, added to our estimate for net revenue, based on a zero real growth in GDP in 2009, leads us to project a primary surplus of 0.2% of GDP for the Federal Government.

Evolution of the Public Sector Net Debt/GDP Ratio

% of GDP

Public debt under 5 p.p. of GDP as a result of expansionist tax policy, lower economic growth and exchange rate adjustments



Source: Central Bank of Brazil - Preparation and Projections for 2009: CNI

However, since the change took place near the end of the year, it is likely that not enough time will be left to pay for all the authorized non-compulsory spending, particularly in investments. Therefore, the Federal Government may have a slightly higher primary surplus than the one we had estimated.

Nevertheless, since federal state enterprises are also not expected to achieve the 0.2% of GDP target, it would be insufficient to achieve the primary surplus set for the Federal Government and its state enterprises. We are projecting a 0.4% primary surplus for the Federal Government and its state enterprises, against a 0.7% of GDP requirement.

Finally, we estimate that regional governments and their state enterprises will achieve the primary result target of 0.9% of GDP. In this scenario, we are projecting a 1.3% of GDP primary surplus for the consolidated public sector in 2009.

Wider fiscal results also reveal that the crisis led to deteriorating results in this area. The nominal deficit should amount to of 3.6% of GDP this year, against 2.0% in 2008. Because of the need to finance this deficit and considering the weak performance of the economy and exchange rate adjustments in the public sector net debt, the debt/GDP ratio is expected to increase from 38.8% at the end of 2008 to 44.0% of GDP in December 2009.

Revenue recomposition and significant increase in spending in 2010

The budget for 2010 shows that the fiscal policy adopted by the Federal Government will be brought back to the patterns observed in 2008: strong revenue growth supporting a similar trend in spending.

For the net revenue, the anticipated real increase is of 9.8% in relation to 2009. Since the expected real GDP growth is of 4.5%, the projection considers that increases in the tax load will be resumed and that the tax exemptions granted in 2009 will be eliminated.

On the spending side, a real increase of 6.4% is expected in 2010. Therefore, despite a significant increase in spending in 2009 in relation to GDP, a further increase is expected in 2010.

foreign trade sector and exchange rate

Foreign trade shrinks more intensely in the quarter

Exports of industrialized products are down by 31% this year so far

Brazilian exports dropped by 25% in the accumulated figure up till August 2009 in relation to the same period in 2008. The drop was sharper in the third quarter. During this period (until the third week of September), exports decreased by 29% in the comparison with the same period in 2008. As compared to the first quarters of 2008 and 2009, in turn, they dropped by 23%.

The sharpest drop in exports in recent months is mainly a result of the relatively weaker performance of basic products. In the first quarter, the exports of these products dropped by 8% in value, while in the third quarter (until August) the drop increased to 24%. Exports of industrialized products (manufactured and semi-manufactured products) shrunk by 30% until June. In the third quarter (until August), they dropped even further, to 34%.

According to the Foreign Trade Studies Center Foundation (Funcex), the drop in exports in the 12-month accumulated figure up till August was brought about by both a lower volume (-12%) and lower prices (-14%).

The drop in exported volume is still mainly attributed to lower exports of manufactured products, which declined by 27% in the 12-month accumulated figure until August. The exported volume of semi-manufactured products decreased by 10%. Exports of basic products, in turn, increased by 6% on the same comparison basis.

With respect to prices, semi-manufactured products are still showing the worst results: a 22-percent drop in the 12-month accumulated figure. The drop in prices was also significant for basic products and lower for manufactured products, namely, 18% and 6%, respectively.

A recovery trend in export prices was observed in recent months, although they remain below the record figures registered in 2008. The prices of basic products were the only ones above the level registered in January 2009.

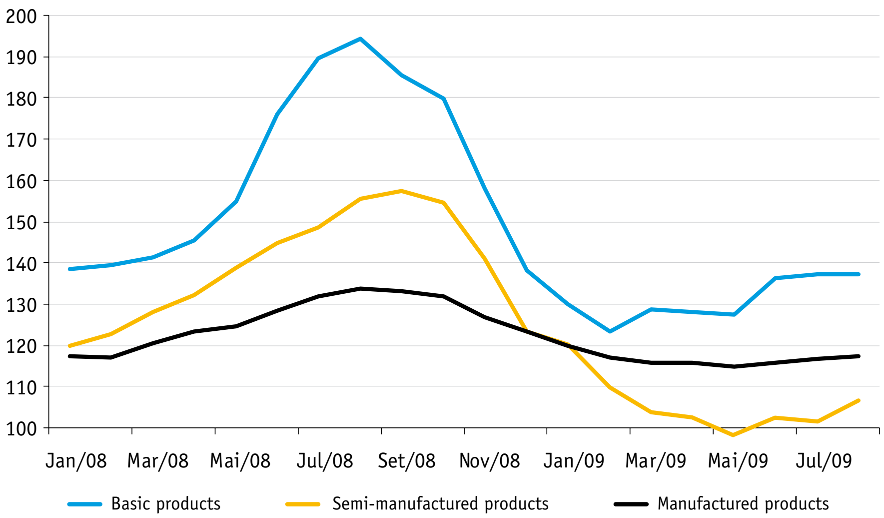
The international scenario is likely to remain unfavorable during the rest of the year. The World Trade Organization (WTO) estimates that the international trade in goods will decrease by 11% in volume in 2009. Although there are signs of improvement in manufacturing activity in some countries, relevant trade partners such as the United States will recover more slowly. As a result, the recovery of foreign sales – particularly of manufactured products – is expected to be slow.

On the other hand, export prices are expected to continue to recover at the same pace observed in recent months. Therefore, we keep our forecast of a US$ 151 billion export figure, which represents a 23-percentage drop as compared to 2008.

Price Index for Brazilian Exports

Index Number 2006 = 100

Product prices recover in the third quarter of 2009



Source: Funcex

Low manufacturing activity explains drop in imports

Brazilian imports shrunk by 32% in the 12-month accumulated figure until August in relation to the same period of 2008, and this reduction has also become more intense in recent months. In the first half of the year, Brazilian imports dropped by 29%, while in the third quarter (until the third week of September) they decreased by 35%.

The more intense drop in imports in recent months is explained by the behavior of capital goods and consumption. Imports of capital goods decreased by 14% in the first half of this year in relation to the first half of 2008. Taking into account July and August, it was a 34.1-percentage drop. Consumer goods, in turn, dropped by 7.7% in the first half and rose to 16.3% in the third quarter.

According to Funcex, the drop in imports in the 12-month accumulated figure up till August was caused by lower import prices (11%) and, particularly, lower imported volumes (23%).

The reduction in imported volume was mainly determined by lower imports of intermediate goods, which decreased by 30% in the figure accumulated until August, following a sharp drop in manufacturing activity. There was also a sharp drop in the imported volume of fuels (-15%), capital goods (-13%), and durable goods (-13%).

The evolution of prices, in turn, is mainly explained by a decrease in fuel import prices: a 47-percentage drop in the figure accumulated up till August in relation to the same period in 2008. Capital and intermediate goods decreased slightly during the period (1% and 3%, respectively).

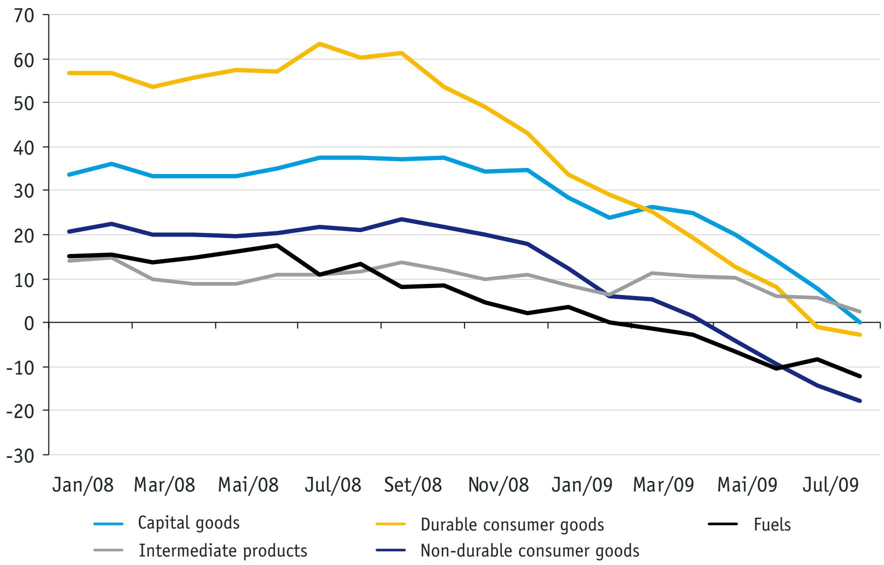
The need to build up raw material stocks due to a more intense manufacturing activity is expected to slow down the current downward trend in purchases of intermediate goods. In addition, the ongoing appreciation of the real will keep imports of non-durable consumer goods at the same levels. As a result, the monthly import drop rate, which is currently above 30% the one registered in 2008, is likely to fall.

Since imported volumes dropped more intensely until August than we expected initially, we revised our forecast for imports in 2009 down to US$ 123 billion – a 29-percent drop in relation to 2008. With the new expected export and import figures, the surplus will be 21% higher than the one registered in 2008, adding up to US$ 28 billion in 2009.

Volume of Brazilian Imports

12-Month Accumulated Growth Rate in Relation to the 12 Previous Months (in%)

Imports of fuels and intermediate goods drop sharply



Source: Funcex

Real appreciates at a less intense rate

Since January, the real appreciated by 14% (as deflated by the wholesale prices index IPA) in relation to a set of 13 currencies with which Brazil trades most. In relation to the US dollar, the real's appreciation hit the mark of 15%.

Several factors are encouraging an inflow of foreign currencies, particularly through financial channels. Lower risk aversion by international investors and a positive performance of the Brazilian stock market are some of these factors.

Apart from these domestic factors, persistently high current-account deficits and the deceleration of the US economy are pressuring the US dollar down worldwide. Therefore, we expect to see an exchange of R$ /US$ 1.77 at the end of the year.

Current account deficit keeps falling

A higher trade surplus, coupled with a reduction in the service and income deficit (a 20-percentage drop in the 12-month accumulated figure up till August), reduced the current account deficit. The 12-month accumulated deficit decreased from US$ 26.9 billion in January 2009 to US$ 17.6 billion in August.

We expect to see an increase in the service and income deficit during the rest of the year. This increase will be partly made up by a higher trade surplus. As a result, the current account deficit is likely to close the year at about US$ 15 billion, as compared to US$ 28 billion in 2008.

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prospects for the brazilian economy

	2007	2008	2009 *previous projection Jun/2009*	2009 *projection*
Economic activity				
GDP (annual variation)	5.7%	5.1%	-0.4%	**0.0%**
Industrial GDP (annual variation)	4.9%	4.3%	-3.5%	**-4.0%**
Household consumption (annual variation)	6.3%	5.4%	0.7%	**2.4%**
Gross fixed capital formation (annual variation)	13.5%	13.8%	-9.0%	**-12.8%**
Unemployment Rate (annual average - % of the labor force)	9.3%	7.9%	9.0%	**8.1%**
Inflation				
Inflation (Broad Consumer Price Index - annual variation)	4.5%	5.9%	4.2%	**4.2%**
Interest rates				
Nominal interest rates				
(average rate in the year)	12.13%	12.45%	10.15%	**10.15%**
(year end)	11.25%	13.75%	8.75%	**8.75%**
Real interest rate (annual average and deflated rate: IPCA)	8.2%	6.4%	5.0%	**5.0%**
Public accounts*				
Nominal public deficit (% of GDP)	2.8%	2.0%	2.8%	**3.6%**
Public primary surplus (% of GDP)	3.5%	3.7%	2.2%	**1.3%**
Net public debt (% of GDP)	43.9%	38.8%	41.9%	**44.0%**
Exchange rate				
Exchange rate - R$/US$				
(average in December)	1.78	2.39	1.88	**1.77**
(average in the year)	1.95	1.83	2.06	**2.00**
Foreign trade sector				
Exports (US$ billion)	160.0	197.9	151.5	**151.5**
Imports (US$ billion)	120.0	173.2	130.0	**123.0**
Trade balance (US$ billion)	40.0	24.7	21.5	**28.5**
Current account balance (US$ billion)	4.5	-28.3	-15.0	**-15.0**

* Does not include Petrobras

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