ECONOMIC REPORT

Newsletter of the National Confederation of Industry

Year 26 • Number 01 • January/March 2010 • www.cni.org.br

Economy is expected to grow strongly in 2010

Brazilian economy will grow above world average

Brazilian economy began 2010 on a strong upward path. GDP is expected to grow once again at a higher rate than the world economic growth, as in 2007 and 2008.

Industry will be the sector that will contribute most to this economic performance in 2010. Manufacturing production in March of this year rose by 19.7% in relation to the same month the year before (PIM-PF/IBGE). CNI estimates that manufacturing production will grow at a rate of about 12.0% in 2010, resulting in an 8.0-percentage point increase in industrial GDP. Apart from production, investments are also expected to grow strongly, meaning that the industrial sector has been responding well to the supply needs of the economy.

Labor market is also recovering. Formal jobs are up once again, amounting to 1.7 million jobs throughout Brazil in the 12-month period up to March.

Inflation continues to accelerate. In January alone, the 12-month figure for the Consumer Price Index (IPCA) is already above the center of the inflation target pursued by the Central Bank. It should be stressed that this upward trend is due to the rising prices of food, beverages and services. No significant pressures from the industrial sector were detected.

With the aim of curbing price hikes, the Monetary Policy Committee (Copom) increased the Selic rate (basic interest rate) in April. This trend is expected to continue in the next Copom meetings. However, the impact of interest rates on food products – a component that has been pressuring inflation – is limited. On the other hand, the impact on demand for industrial products and credit will be significant and, as a result, the Brazilian economy investment and growth rate is likely to decrease throughout the year.

As opposed to the monetary policy, fiscal policy continues to be marked by strong expansionist features in 2010. Public sector spending grew strongly in the first quarter of the year, even though the effects of the international economic crisis on activity levels have been appropriately addressed.

This increase in public spending has not caused significant impacts on the fiscal result so far due to a higher revenue. Resumption of economic growth and the reduction in tax incentives granted during the crisis are the main factors behind this higher tax revenue.

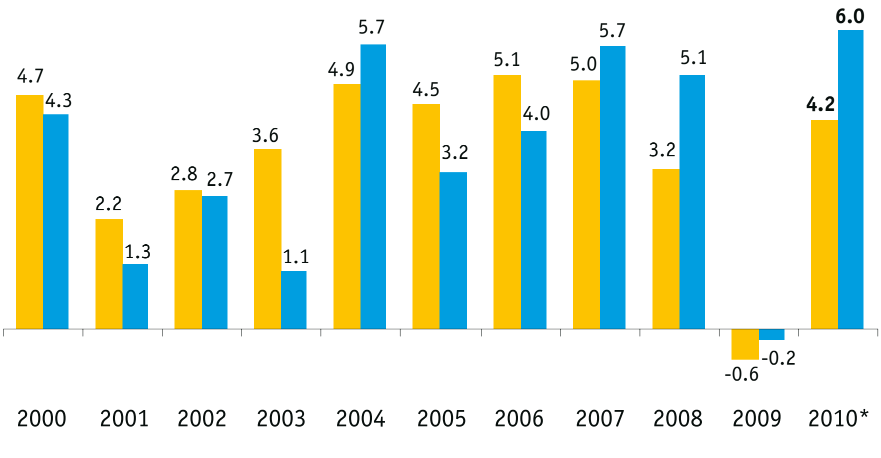
However, to achieve the primary surplus goals set for 2010, both the Federal Government and regional governments will need to reduce their spending growth pace over the next few months. We are expecting a primary surplus of 2.5% of GDP for the consolidated public sector.

Foreign trade shows signs of recovery, but imports are growing at a much higher rate than exports. These grew by 25% in the first four months of the year, while imports rose by 42% over the same period. As foreign demand is recovering much more slowly than domestic demand, coupled with strong foreign capital inflows into the country, the dollar is expected to remain at appreciated levels throughout the year.

World GDP and Brazil's GDP Growth

Percentage variation (%)

Effects of the crisis were less intense and recovery was quicker in Brazil



Source: IBGE e FMI. * Projections of 2010: CNI e FMI.

economic activity

Industry leads economic growth in 2010

Higher capacity utilization is accompanied by resumption of investments

GDP data for the first fourth quarter of 2009 indicate that the economy will grow at a fast pace in 2010. The Brazilian economy began the year on a strong upward path and, as a result, GDP will benefit from a significant dragging effect. Even if the economy remained stagnant over all four quarters of the year – which is a discarded possibility – GDP would still grow by 3.1% in 2010.

Preliminary data for the first quarter of 2010 not only confirm a robust growth trend but also indicate a higher economic growth rate. For this reason, CNI revised its GDP estimates upward from 5.5% to 6.0% in 2010.

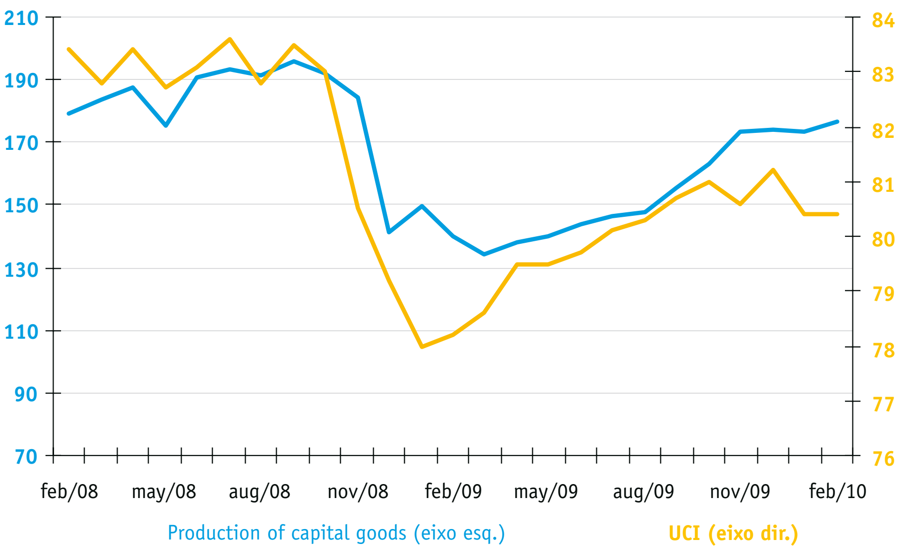
If, on the one hand, industry was the most affected sector by the international crisis in 2009, on the other it will be the one that will contribute most to economic growth in 2010. Production in this sector is already guaranteed to grow by 8.1% on account of the dragging effect. Manufacturing production in March of this year rose by 19.7% in relation to the same month last year (PIM-PF/IBGE). CNI estimates that manufacturing production will grow at a rate of about 12.0% in 2010, leading to an 8.0% increase in the industrial GDP.

In April, it was seen that industrial entrepreneurs expect demand to grow in an increasingly widespread fashion in industry over the next sixth months (Industrial Survey - Manufacturing and Mining/CNI). They are also optimistic about future exports.

Production of capital goods

Seasonally adjusted (2002 index =100) and CU (in %)

Occupation of industrial park leads to resumption of investments



Source: IBGE. Projection: CNI

Production is increasing in parallel with resumed investments, which are likely to increase by 18.0% this year. Production of capital goods is up by 38.4% in March against the same month in the previous year (PIM-PF/IBGE). The resumption of investments is important for maintaining a sustained growth path. Industry has been filling the capacity of the industrial complex so as to stimulate the resumption of investments without supply pressures. Despite the increase observed in the seasonally adjusted capacity utilization index in 2009 (Industrial Indicators/CNI), this indicator is still 0.6 percentage points below the one registered before the crisis (September 2008).

The construction industry is expected to grow even further in 2010: estimates point to an 8.9% increase in the civil construction GDP. This projection is based on the following factors: the government housing program; an increase in housing credit; and the infrastructure works for the 2014 World Cup and the 2016 Olympic Games. Entrepreneurs in the construction industry are very optimistic. In April 2010, the index for expected activity level in this industry was way above 50 points, indicating that most entrepreneurs are confident.

The strong growth in manufacturing activity in 2010, coupled with an increase in real income, will require more energy and other public-utility services: CNI estimates that the GDP of public-utility industrial services will grow by 5.9%.

CNI also estimates that the foreign trade sector's GDP will decrease by 1.8 percentage points. Because foreign demand has been recovering at a slower pace than domestic demand, Brazilian exports are likely to grow by 9.0% in 2010. The appreciation of the real against the dollar stimulates purchases of imported raw materials, machinery and equipment, which, added to a marked increase in domestic demand, will cause the imports of goods and services to rise by 25.0% in 2010, according to the National Accounts methodology (IBGE).

The positive performance of household consumption was key for the Brazilian economy to recover from the effects of the crisis and will be, on the demand side, the component that will contribute most to GDP growth in 2010. This phenomenon was made possible by a recovery in jobs – particularly formal jobs –, which caused total earnings to grow by 3.1% on the 12-month average in 2009 against the same period the year before. In addition, the increase in loans to individuals and in the government's cash transfer program have also played a major role in sustaining household consumption. CNI estimates that this GDP component will grow by 6.2% in 2010.

As a result of the positive performance of household consumption, services have fully recovered from the impacts of the crisis. Particularly, real retail sales (IBGE) in March 2010 increased by 15.7% as compared to the same month in the previous year – the highest rate, on this comparison basis, in the historical series of the survey. Services are likely to grow by 5.0% not only in the trade sector, but also in other sectors – such as transportation (estimated increase of 7.3% in 2010) and financial intermediation (growth of 6.4%). If confirmed, this growth will be more than twice as high as the one registered in 2009.

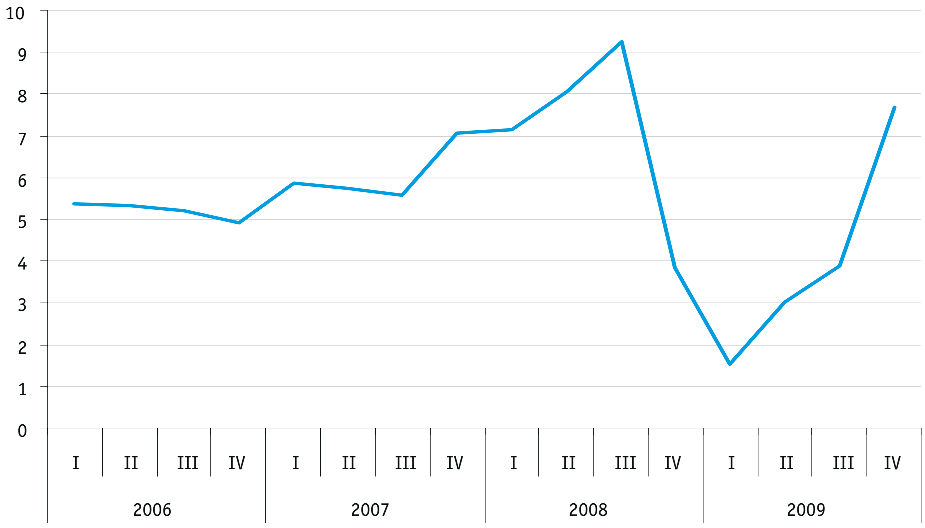
In the first quarter of 2010, GDP will rise by 2.0%

GDP is expected to grow significantly in the first quarter of 2010 due to the positive performance of key economic sectors. The seasonally adjusted manufacturing production on the average from January to March 2010 grew by 3.0% against the fourth-quarter 2009 average. Retail trade grew at a rate of 4.9% over the same period. Household consumption will grow strongly early this year, given an accelerated growth in total earnings in February 2010. In a scenario of increased investments, domestic demand will play a significant role in stimulating the Brazilian economy, which is expected to grow by 2.0% in relation to the previous quarter, according to seasonally adjusted data.

Household consumption

Variation in relation to the same quarter the year before

Household consumption will be the main factor contributing to GDP growth



Source: IBGE

GDP Estimate – Percentage variation and components' contribution to GDP growth

	GDP Components	2010 Growth Rate (%)	2010 Contribution (p.p.)
Demand Side	Household consumption	6.2	3.9
	Government consumption	4.3	0.9
	GFFC	18.0	3.0
	Exports	9.0	1.0
	(-) imports	25.0	2.8
Supply Side	Agriculture/Livestock	6.0	0.4
	Industry	8.0	2.0
	Services	5.0	3.4
	GDP pm	**6.0**	

jobs and income

Occupation rate grows driven by formal jobs

Private sector stands out in creation formal jobs

The labor market has been recovering rapidly from the impacts of the international crisis. The negative impacts on formal jobs during the crisis were less severe then the deterioration observed in informal jobs. The number of new formal jobs is already way above one million throughout Brazil in the 12-month period up to March (Caged/MTE).

Total employment in the six largest Brazilian metropolitan regions had decreased by 0.3% in October 2009 against the same month in the previous year (Monthly Job Survey - PME/IBGE). After this decrease, the labor market recovered in such a way that jobs rose by 3.5% in March 2010, on the same comparison basis. This annual job growth rate is already higher than the one registered before the crisis.

Formal jobs in the private sector were the main drivers of this positive performance. First, because the negative impacts of the crisis on this group were less severe than on the others. While formal jobs dropped by 0.3% in October 2009 against the same month last year, informal jobs fell by 7.4% over the same period. Second, because formal jobs began to grow rapidly again in the following months. Formal employment in the private sector grew at a rate of 7.2% in March against the same month in the previous year, the highest growth rate since July 2008.

While formal jobs are on the rise again, informal employment has shown an inverse trend in 2010. Informal jobs in the private sector dropped, against the same month the year before, during the period from December 2008 to February 2010. In March, the number of informal workers grew by 0.6%. On the other hand, the number of self-employed workers increased at a slow rate. In March, this group of workers rose by 2.8% on the same comparison basis.

The General Registry of Employed and Unemployed Persons of the Ministry of Labor and Employment (MTE) points to a similar recovery in formal jobs. The index for the number of jobs created throughout the country in the last 12 months hit the mark of 1.7 million in March 2010. In comparison terms, this index amounted to only 300,000 in October 2009.

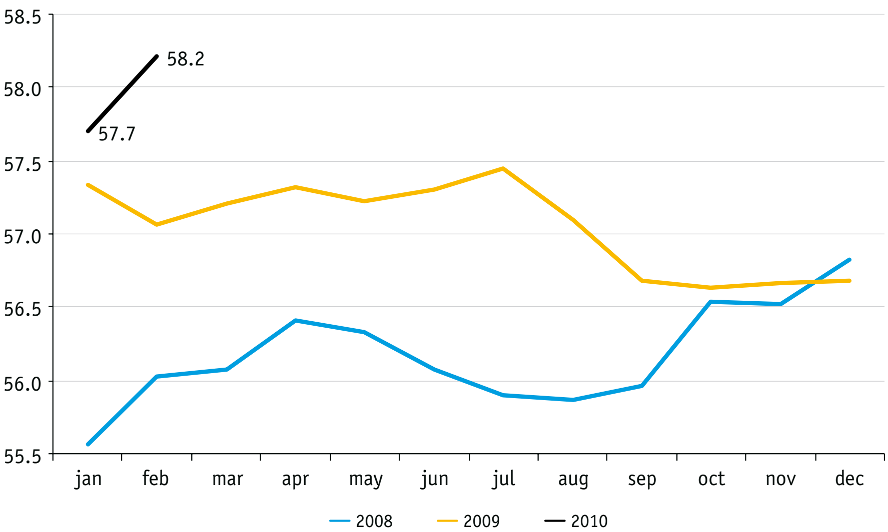
Industry shows a more intense recovery in formal jobs in 2010. In the first quarter of the year, this sector – made up of the mining and quarrying, manufacturing, construction, and public-utility services sectors – created 342,000 jobs. Job creation in industry in the first three months of 2010 was 20% higher than the flow of new jobs in the trade and services sector together.

The fact that the labor market is absorbing more jobs led the search for jobs to increase. The Economically Active Population (EAP) in the six largest metropolitan regions in Brazil grew by 2.2% in March in relation to the same month the year before, meaning that an additional 501,000 people entered the labor force in the last twelve months. This scenario is quite different from that observed in October 2009, when 682,000 people had left the labor force in the 12 previous months.

Formality index

12-month figure (in thousand units)

Rapid recovery in formal employment leads the formality indicator to its highest level in the last seven years



Source: IBGE Estimate: CNI

Job growth boosts real total earnings

The average real income of metropolitan workers grew by about 1.0% both in January and February as compared to the previous month.

Despite growing at a slower rate in March (increase of 0.4%), real income increased in relation to the same month the year before, from 0.9% in February to 1.5% in March. Likewise, the rapid recovery in employment caused actually received total earnings to grow by 6.0% in February (last data available) against the same month last year. The increase in total earnings has been key to sustaining household consumption.

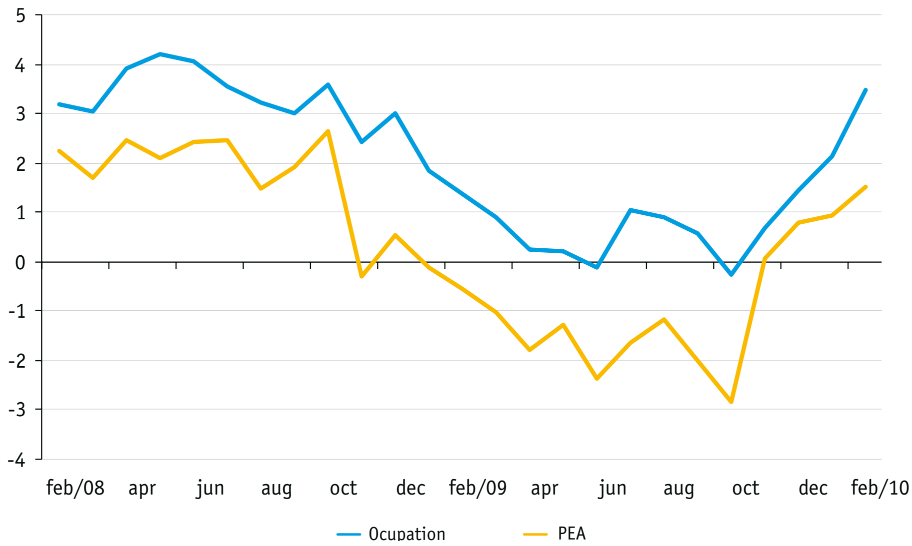
Average annual unemployment rate to hit a record low in 2010

In a scenario of strong job growth, the unemployment rate amounted to 7.6% in March, 1.4 percentage points below the figure calculated in the same month the year before. If the labor force continues to rise below the job growth rate, CNI estimates that the average unemployment rate will drop by 7.2% in 2010, the lowest figure since the beginning of the historical series of the survey.

Job and labor force growth

(%) variation in relation to the same month the year before

Jobs are growing at a faster pace than the labor force

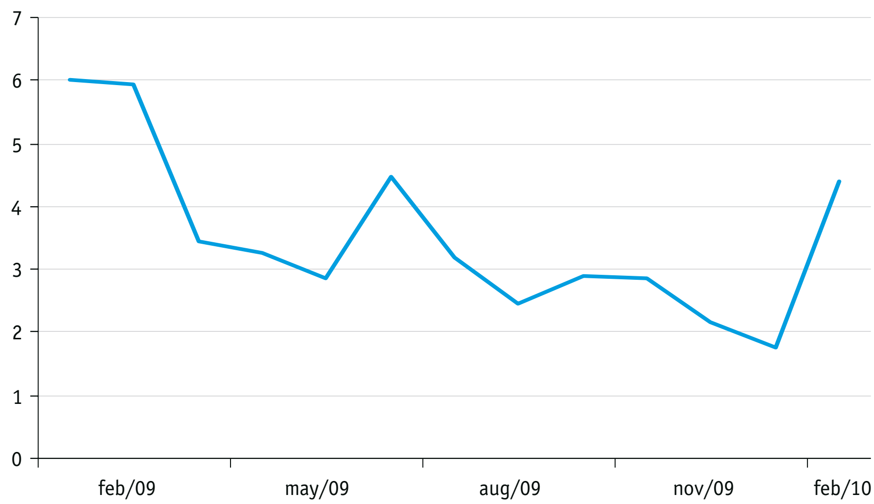


Source: PME/IBGE

Habitually received real total earnings

(%) variation in relation to the same month the year before

Real total earnings are strongly up



Source: PME/IBGE

inflation, interest rates and credit

Food and services keep inflation high

12-month Consumer Price Index (IPCA) is above the central target

The official inflation index, the IPCA, began to increase early this year. In January, the 12-month figure for the index was already above the inflation target set by the Central Bank at 4.5% per year. In April (last data available), inflation is already at 5.26% per year in 12 months.

This trend toward higher prices is not widespread. The hike is based on sporadic and seasonal components. Basically, two major IPCA components led the index up: Food and beverages, and services. Taken together, these two components account for about 47% of the IPCA. Regulated and industrial-product prices are stable and below the target.

The food and beverages group accounts for about 23% of the IPCA. Usually, this group sets the trend observed for the index as a whole. This was the case in 2008, when the IPCA closed the year at 5.9% per year and the food and beverages group at 11% per year, as well as in 2009, when the IPCA was calculated at 4.3% per year against 3% for food and beverages.

If 2009 was marked by lower food prices, 2010 tends to be the opposite. Climate factors (such as excessive rainfall, which damages crops) and a heated demand have caused food prices to increase more significantly. This trend was already seen in the first months of the year: while in December 2009 the 12-month figure for this group was close to 3% per year, in April 2010 it is almost at 7% per year.

It was known since last year that service prices would go up. In recent years, the 12-month inflation figure for this group has been above the central target, due to the high degree of indexation in this sector's prices. In 2009, the index average was calculated at about 7% per year. In the first four months of 2010, services inflation has been once again close to the 2009 average, in spite of a slight drop at the end of last year. This increase was mainly brought about by price adjustments in the education, medical services, and residential rent groups.

Regulated prices, in turn, are not likely to increase throughout the year. The main index (General Market Price Index - IGP-M) applied to this group was negative last year: -1.7% per year. Early in 2010, public transportation and postal services were the components for which the sharpest rises in prices were registered. The 12-month figure for regulated prices is below both the IPCA and the central inflation target.

Pressure was less intense on industrial prices. Since late 2008, the 12-month figure for this group has been below 4% per year. This was essentially a result of the effects of the crisis on the sector: a lower demand that accompanied a sharp drop in supply prevented prices from rising.

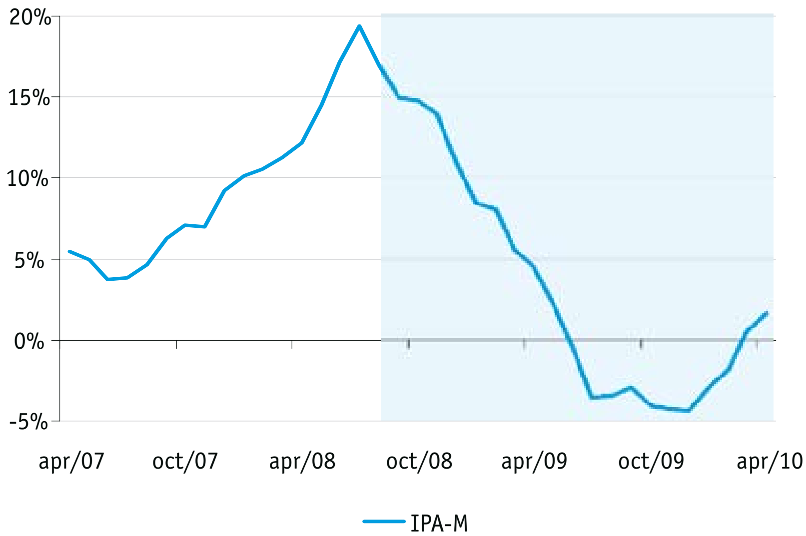
This trend is also likely to continue in 2010. The process of recovering from the crisis is gradually increasing the occupation of idle capacity, and thus demand can be met without pushing prices up. The recovery observed in investments increases the productive potential of enterprises. However, a reversal in the movement of producer prices (the 12-month figure for the Wholesale Price Index - IPA-M was positive in March) may prevent industrial product prices from rising, but only at the end of the year.

In the first four months of 2010, the IPCA grew more than the market had anticipated. As a result, even if regulated and

Wholesale Price Index Evolution

12-month figure

Producer prices are rising again on 2010



Source: FGV / Conjuntura Econômica

industrial-product prices perform well over the year, they will not prevent inflation from exceeding the central target of 4.5% per year, on account of the food and beverages group. For this reason, CNI estimates that the IPCA will close 2010 at 5.4% per year, i.e. above the center but still within the inflation target.

Copom increases interest rates due to external factors

The inflation target system, which is the focus of the monetary policy, led to an increase in the Selic basic interest rate in April (from 8.75% per year to 9.5% per year). This trend is likely to continue in the next Copom meetings. CNI estimates that the rate will increase by 2.25 percentage points (p.p.) in 2010 and that it will remain at 11.00% a year until the end of 2010.

Decisions are being made to contract monetary supply, such as anticipating the recomposition of compulsory deposits. However, this analysis is only based on a higher-than-usual IPCA, without taking the index components into account.

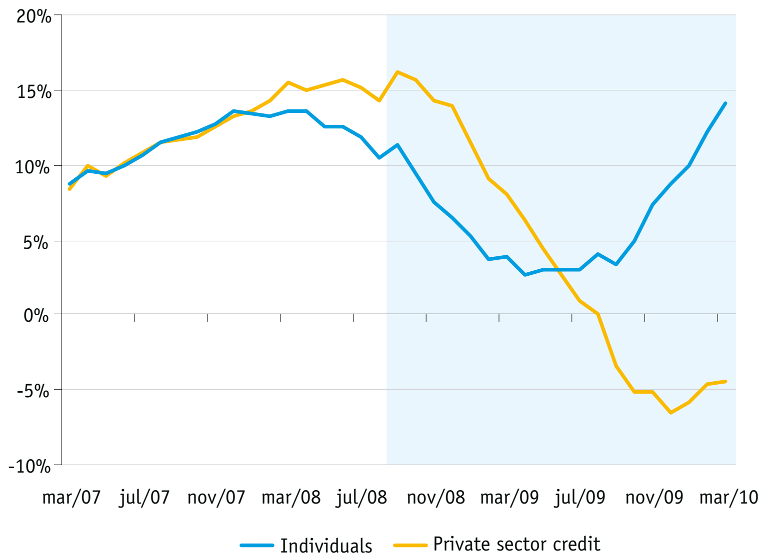
It should be stressed that in other countries that have successfully managed to adopt an inflation target regime, the price index set as a parameter does not include high volatility items or items that are easily influenced by external shocks, such as food products. This is not the case in Brazil.

Inflation is increasing mainly as a result of rising prices of food products. Considering how essential these goods are, the demand for them will only be slightly affected. Therefore, higher interest rates will not have any major effects on the source of rising prices. On the other hand, the group of industrial products, whose 12-month figure remains below 4% per year, will be directly affected due to the lower demand resulting from monetary supply contraction.

Credit without specific destination to individuals and companies

Average of the last 12 months on the previous 12 months

Effects of the crisis on credit to companies was strong and persistent



Source: Central Bank of Brazil

Higher interest rates directly affect demand for credit. As a result of more expensive credit, demand for goods drops, controlling price hikes in this process. However, higher interest rates do not tackle the source of rising prices and jeopardize sectors in which prices are not under pressure.

Credit is returning to enterprises, but higher interest rates threaten the future

Credit to enterprises, which was strongly affected by the crisis, is returning. In 2010, there was an inversion in the downward trend observed since the crisis broke out in 2008 in the granting of non-earmarked resources, whose origin is the banking institution itself and which have no specific destination.

This return of credit, albeit modest, indicates that the situation is improving as compared to the scenario faced by companies in 2009. The crisis affected loans to companies and individuals in different ways. The graph above, which compares the average observed in the last twelve months with the average in the previous twelve months in terms of credit with non-earmarked resources, corroborates this analysis.

Credit to individuals began to be rationed even before September 2008, when the crisis hit in Brazil. However, it dropped much less intensely than business credit. In addition, it also began to recover earlier, in mid-2009 already.

Nevertheless, the recovery of business credit may slow down over the next few months. The imminent increase in the Selic rate will make credit more expensive. As a result of higher costs, investment projects which rely on third-party resources will be, once again, reduced, postponed or cancelled.

fiscal policy

Strongly expansionary fiscal policy in the beginning of 2010

Although economic growth was resumed, public spending keeps growing

Public spending grew significantly in the first quarter of 2010, even though the effects of the international economic crisis on activity levels have been positively addressed. As a result, the fiscal policy resumed the procyclical nature that characterized it in recent years, but not in 2009.

The Federal Government's primary spending followed the trend observed in 2009 and increased by 13.7% between January and March 2010 against the same period the year before. This higher spending was mainly driven by the defrayal and capital item, which grew by 31.4% on the same comparison basis. It is worth mentioning that this increase was mostly brought about by discretionary spending, with investments increasing by 106.0% and defrayal growing by 15.9%.

For regional governments, spending is estimated to increase by 8.3% in real terms in the first three months of 2010 as compared to the same period in 2009. As opposed to what has been observed for the Federal Government, spending by states and municipalities is on the rise again. In 2009, estimated spending increased by only 0.6% in real terms, as a result of a 2.2% drop in revenues.

Revenues increase as a result of economic growth and less tax incentives

O The significant increase observed in spending had no major impact on the fiscal result due to an increase in tax revenue made possible by the resumption of economic growth, less tax incentives, and non-repetition of high tax credit compensations in 2009.

In the Federal Government, the net revenue increased by 11.6% in real terms between January and March 2010 against the same period in 2009. The resumption of economic growth contributed for much of this increase in tax revenue to come from value-added taxes on goods and services (PIS - Social Integration Program, Cofins - Contribution to Social Security Financing, IPI - Tax on Industrial Products) and total earnings (Social Security Contribution). In addition, tax credit compensations for the PIS, Cofins, and CIDE-Fuels (Contribution for Intervention on the Economic Domain) in the first quarter of 2009, which amounted to R$ 3.7 billion, reduced the comparison basis. Finally, the increase in IPI and IOF collection can be explained by the fact that rates are higher than those observed in the first quarter the year before.

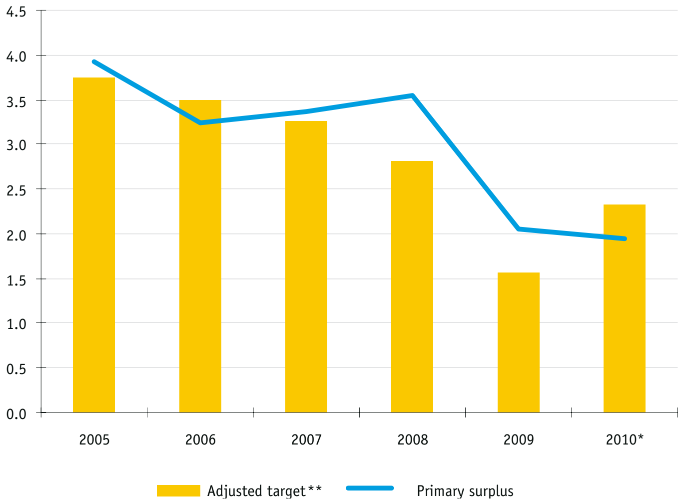
For states and municipalities, estimates based on preliminary data indicated a real growth of 8.6% in revenue in the first three months of 2010 over the same period in 2009. This growth can be largely explained by the effect of the resumption of economic activity on the ICMS (Value-Added Tax) collection, which rose by 11.5% in real terms on this comparison basis.

Fiscal results are still far from the targets set for 2010

The growth rate of spending and revenue continues to keep the Federal Government's and regional governments' primary surplus far from the targets set for 2010. In the Federal Government and its state-owned

Primary surplus for the private sector and fiscal targets
(% of GDP)

Primary surplus in the 12-month period up to March is 0.4 p.p. of GDP below the 2010 target



Source: Central Bank of Brazil and Ministério do Planejamento, Orçamento e Gestão

* 12-month period ending in March
** Without considering Petrobras, PAC, PPI and payments due in the accrual regime of public accounts for extraordinary credits granted in previous years

enterprises, the primary result for the twelve-month period ending in March 2010 amounted to 1.15% of GDP, against an adjusted target of 1.4% of GDP – without considering costs related to the Growth Acceleration Program (PAC) and payments due in the accrual regime of public accounts for extraordinary credits granted in previous years. In regional governments and its state-owned enterprises, the primary surplus for the last 12 months was calculated at 0.8% of GDP, against a target of 0.95% of GDP.

Targets require lesser fiscal expansion

To meet their primary surplus targets for 2010, both the Federal Government and regional governments will have to reduce their spending growth rate over the next few months.

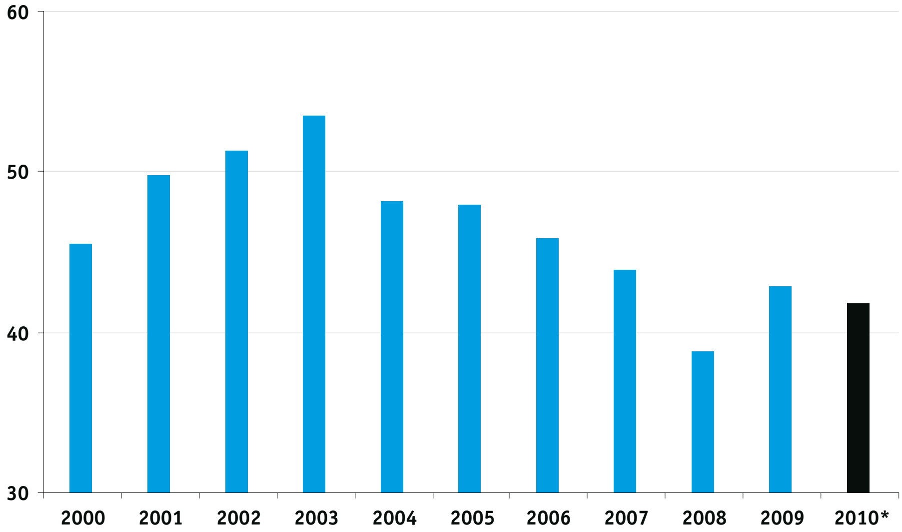
For the Federal Government, the possibility of subtracting the amount of R$ 33.6 billion (1.0% of GDP) - related to PAC and payments due - from the primary surplus enabled the financial programming of R$ 21.8 billion, made in March, and of R$ 10 billion, announced in May, to be more than sufficient to meet the target.

For this reason, the growth rate of federal government spending is expected to decrease by the end of the year, down from the current 13.7% to 6.0% in real terms. However, this reduction will not prevent spending from increasing slightly as a percentage of GDP, as it is up from 18.2% in 2009 to 18.4% in 2010. The Federal Government achieved the adjusted primary surplus target easily mainly because of its higher net revenue, which is expected to rise by 7.6% in real terms and grow from 19.5% to 19.9% of GDP.

Evolution of the Public-Sector Net Debt/GDP Ratio

(% of GDP)

Lower nominal deficit and strong economic growth are likely to reduce the public debt in relation to GDP



Source: Central Bank of Brazil *Preparation and Projections for 2010: CNI

As opposed to what is expected for the Federal Government, it will be difficult for federal state enterprises to achieve the primary surplus target equivalent to 0.2% of GDP. In 2009, the primary deficit of these companies amounted to 0.06% of GDP and, in the last 12 months, of 0.09% of GDP. If these companies repeat the last year's result, the Federal Government and state-owned enterprises are likely to achieve a primary surplus of 1.55% of GDP.

In regional governments and its state-owned enterprises, the primary result has improved since late 2009 and higher revenues, combined with restrictions imposed by the Fiscal Responsibility Law and by debt-renegotiation agreements with the Federal Government, are likely to ensure the achievement of the target of 0.95% of GDP. In this scenario, we estimate a primary surplus of 2.5% of GDP for the consolidated public sector in 2010, which represents an increase in relation to the one calculated in 2009 – 2.05% of GDP.

Although a higher primary surplus is a positive fact for public accounts, the increase in interest costs – from 5.4% of GDP in 2009 to 5.55% of GDP in 2010 – will not allow for significant improvements in broader fiscal results. Therefore, we project that the nominal deficit will drop from 3.3% to 3.05% of GDP. The debt/GDP ratio, on the other hand, is expected to decrease from 42.8% late in 2009 to 41.8% of GDP in December 2010.

foreign trade sector and exchange rate

Brazilian foreign trade is recovering

Trade balance in the first four months of the year is the lowest one since 2002

Brazilian foreign trade remains on a clear upward path, initiated at the end of last year. There is, however, a huge gap: imports are recovering much quicker than exports, thus reducing the Brazilian trade balance.

In the first four months of the year, exports hit the mark of US$ 54.4 billion, an increase of 25.0% against the same period in 2009. Imports, in turn, grew by 42.0% on the same comparison. As a result of this difference in the pace of recovery in exports and imports, the year-accumulated figure for trade balance decreased by almost 70%, to US$ 2.1 billion. This is the lowest balance in the period since 2002.

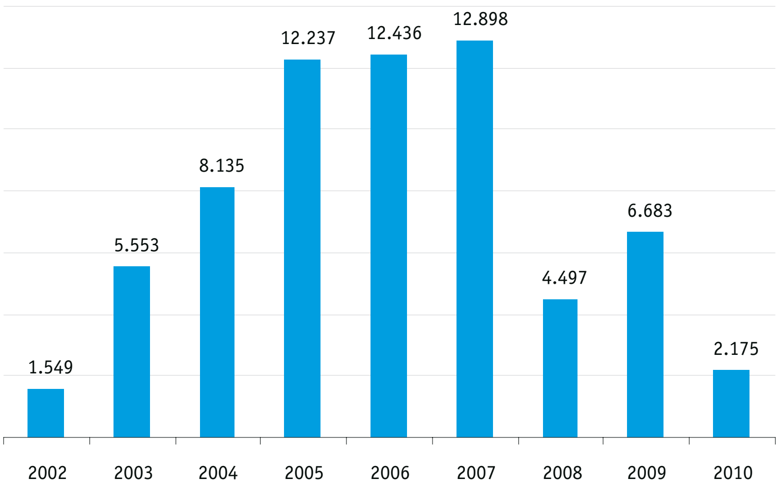
This difference is mainly due to the different pace of recovery between Brazil and the world economy. Brazil has been showing strong signs of economic recovery, particularly in manufacturing activity (which was the sector that suffered the effects of the 2008/2009 crisis most), which has stimulated imports.

International economic recovery is, in turn, still uncertain and heterogeneous. There are, on the one hand, fears about European countries facing difficulties to pay off their debts, suggesting that economic activity recovery in Europe will remain slow. On the other hand, countries like China and India are recovering in a rapid and sustained manner. Between these two blocks of countries, the United States and Japan show signs of recovery, but some difficulties linger on. That is, some of Brazil's main trade partners, such as the United States and Europe, are recovering more slowly, meaning that their imports will increase at a slower pace and, therefore, it will be more difficult for Brazil to export to these countries.

Brazilian trade balance – 1st quarter

In US$ million

Difference between recovery pace for imports and exports reduces trade balance



Source: Secex

Export prices are recovering rapidly

As a result of improvements in the global economy, international prices are once again on the rise, which has helped recover Brazil's exported value. Export prices are up by 17% as compared to the first quarters of 2010 and 2009. Despite this recovery, however, export prices are still 11% below the level observed before the 2008/2009 crisis.

Exported volumes have also recovered significantly: 15% in relation to the first quarters of 2010 and 2009. Exports of basic products, in particular, grew by 15% on this comparison basis.

As with prices, however, this is just a partial recovery, as pre-crisis levels have not been exceeded yet. If one compares the 12-month figure, exported volumes are down by 6%. Manufactured products, in turn, dropped by 16%. Basic products were the only ones that grew on this comparison: by 4%.

This difference between basic and manufactured products is mainly explained by China's dynamism, one of Brazil's main trade partners in terms of sales of basic products. It is not by chance that China has become Brazil's main partner (13.2% in the first four months of the year) and the share of basic products in exports hit the mark of 41.3% (against 39.6% between January and April last year).

We expect that the volume of exports will continue to increase over the year, as the world economy gathers speed once again. Prices are also expected to rise – the adjustment in iron ore prices, for example, deserves special mention. In a scenario where protectionist measures are not being intensified and demand incentives are being gradually removed, we expect exports to increase by slightly more than 20% and amount to US$ 185 billion in 2010.

Imports of consumer goods are above pre-crisis levels

Imports responded to the economic recovery in Brazil and are growing strongly. The growth registered in the first quarter of the year is exclusively due to imported volumes. Prices dropped by 1% against the same period in 2009, while the imported quantum increased by 38%.

Higher import volumes were observed in all use categories. The increase in the imports of durable goods, which hit the mark of 84% as compared to the first quarters of 2010 and 2009, deserves special mention. Imports in this use category are already above pre-crises levels. The 12-month figure for these imports is up by 17% in relation to the one registered in September 2008. Imports of non-durable consumer goods are also above pre-crisis levels: they rose by 6% on this comparison.

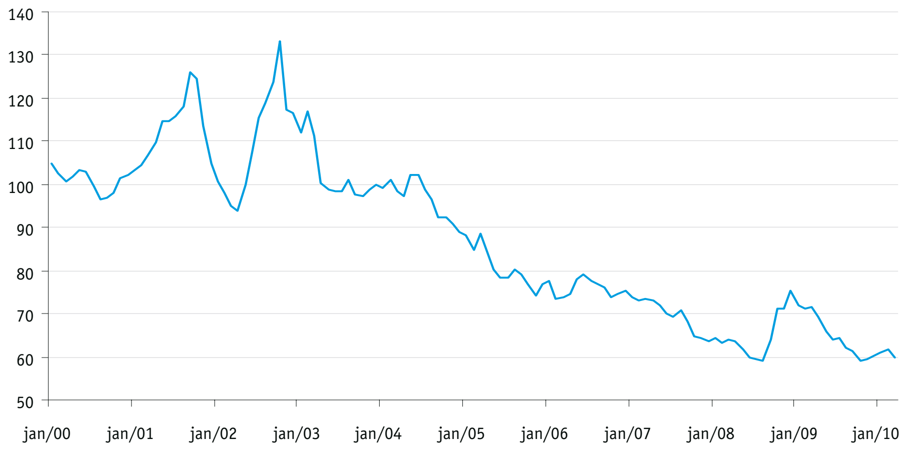
Fuel imports are up by 28% in volume as compared to the first quarter of 2009, while imports of intermediate products grew by 46% on the same comparison.

Over the year, economic activity recovery in Brazil and the appreciation of the real will continue to boost imports. As a result, we project that Brazilian imports will increase by over 30%, amounting to US$ 175 billion. Trade balance will hit the mark of US$ 10 billion.

Effective real exchange rate index

Deflator: IPA - Base: December/2003 = 100

Real oscillates at overvalued levels



Source: Funcex

Real will continue to appreciate

In the five first months of 2010, the real remained at a rather appreciated level and with a slight tendency toward appreciation, despite oscillations. Analyzing the currency basket of Brazil's main trade partners, one can see that the depreciation of the real due to the financial crisis has already been reversed and that the effective real exchange rate is close to that observed at the end of the first half of 2008, when the rate reached its lowest value since the floating exchange rate regime was adopted, a 39% appreciation in relation to the one registered in 2000 and 2004.

Factors leading to the exchange rate appreciation are still active. Brazilian interest rates are still extremely high as compared to the world average and are likely to remain high in 2010, as a result of a restrictive monetary policy. Along the year, both developed economies and Brazil are expected to increase their interest rates, keeping the interest rate differential at high levels.

Nevertheless, the current account deficit is estimated to increase throughout the year, making it more difficult for the real to continue to appreciate strongly over the period. The appreciation of the real and a faster economic recovery in Brazil are increasing the deficit, which amounted to US$ 31.5 billion in the 12-month period up to March, equivalent to 1.86% of GDP. Even though we expect direct foreign investment to increase, the deficit will grow and close the year at about US$ 50 billion.

prospects for the brazilian economy

	2008	2009	2010 previous projection dez/09	2010 projection may/10
Economic activity				
GDP (annual variation)	5.1%	-0.2%	5.5%	**6.0%**
Industrial GDP (annual variation)	4.4%	-5.5%	7.0%	**8.0%**
Household consumption (annual variation)	7.0%	4.1%	5.6%	**6.2%**
Gross fixed capital formation (annual variation)	13.4%	-9.9%	14.0%	**18.0%**
Unemployment Rate (annual average - % of the labor force)	7.9%	8.1%	7.6%	**7.2%**
Inflation				
Inflation (Broad Consumer Price Index - annual variation)	5.9%	4.3%	4.7%	**5.4%**
Interest rates				
Nominal interest rates				
(average rate in the year)	12.45%	10.13%	8.75%	**10.01%**
(year end)	13.75%	8.75%	8.75%	**11.00%**
Real interest rate (annual average and deflated rate: IPCA)	6.4%	5.0%	4.3%	**4.6%**
Public accounts*				
Nominal public deficit (% of GDP)	2.00%	3.30%	1.90%	**3.05%**
Public primary surplus (% of GDP)	3.70%	2.05%	2.60%	**2.50%**
Net public debt (% of GDP)	38.8%	42.8%	40.5%	**41.8%**
Exchange rate				
Exchange rate - R$/US$				
(average in December)	2.39	1.75	1.70	**1.77**
(average in the year)	1.83	1.99	1.72	**1.78**
Foreign trade sector				
Exports (US$ billion)	197.9	153.0	188.0	**185.0**
Imports (US$ billion)	173.2	127.6	175.0	**175.0**
Trade balance (US$ billion)	24.7	25.4	13.0	**10.0**
Current account balance (US$ billion)	-28.3	-24.3	-48.0	**-50.0**

* Does not include Petrobras

ECONOMIC REPORT | Quarterly publication of the National Confederation of Industry - CNI | Economic Policy Unit - PEC | Executive manager: Flávio Castelo Branco | Technical team: Danilo César Cascaldi Garcia, Marcelo de Ávila, Marcelo Souza Azevedo and Mário Sérgio Carraro Telles | Technical information: (61) 3317-9468 | Graphic Design Supervision: Editing Center | Bibliographic Standardization: Shared Information and Documentation Unit - ACIND | Subscriptions: Customer Service - SAC: (61) 3317-9989 - sac@cni.org.br | SBN Quadra 01 Bloco C Ed. Roberto Simonsen Brasília, Federal District - ZIP Code: 70040-903 www.cni.org.br | This report may be copied, provided that the source is mentioned.

Document prepared on May 13, 2010.