BRAZILIAN ECONOMY

Special Edition of the Economic Report

ISSN 1676-5486
Year 26 • Number 04 • December 2010 • www.cni.org.br

Restrictions on competitiveness limit industrial growth

Brazil has resumed the upward trend that had been interrupted by the international crisis. The 7.6% GDP growth registered in 2010 is the most significant in the decade. Industry had the best performance among all activity sectors.

Nevertheless, there is a gap between the evolution of domestic demand and production. Investments and consumption have been growing at a much stronger pace than manufacturing production. This trend became clear in the second semester, when industry grew less.

Exchange rate appreciation is at the root of this problem. Reversing this process is not a trivial matter. An appreciated exchange rate has some roles to play in the economy. On the one hand, it helps control inflation and favors access to imported goods and inputs. On the other hand, it allows foreign savings to be absorbed in an economy marked by low savings rates.

This situation threatens sustained growth. The likely increase in interest rates in response to accelerating inflation will raise the pressure on the exchange rate, thus making it more difficult for Brazilians products to compete in foreign markets.

An analysis of manufacturing activity two years after the crisis shows that industrial segments subject to international competition, both in global and domestic markets, are still facing difficulties. Losses are concentrated in industry, making it more difficult for society to perceive them. Should this trend continue, industry will shrink and become less diversified.

Apart from reflecting an unfavorable international economic scenario, these difficulties also show that little progress has been made in advancing the competitiveness agenda, which had been forgotten in the economic growth cycle preceding the crisis. Resuming this agenda is crucial for the long-term strategy of consolidating a high value-added, diversified industry that is truly integrated into the global market.

The challenge for the economic policy is to make this strategy compatible with the necessary short-term actions to ensure economic growth. It is crucial to review the macroeconomic tripod (inflation target, floating exchange rate, and fiscal targets) by adopting credible and daring fiscal targets with the aim of minimizing the monetary policy effort. This new configuration requires firmness in implementing the 2011 federal budget, with a more solid financing programming for current expenditures.

BRAZILIAN ECONOMY 2010

CNI

2010 balance

Domestic demand boots GDP in 2010

After dropping by 0.6% of GDP in 2009, Brazilian economy is expected to grow by 7.6% in 2010. This recovery was mainly driven by domestic demand.

The strong increase in demand was brought about by cash transfer policies, an upward adjustment in the minimum wage, an increase in formal employment, and a growth in total earnings and personal credit. All of these indicators are above pre-crisis levels.

Driven by these factors, household consumption, which will rise by 7.9% in 2010, accounts for most of GDP growth in 2010. Another determining factor behind the increase in demand was the positive performance of investments across the year.

In this sense, CNI estimates that the gross formation of fixed capital will grow by 24.5% in 2010 and that the share of investments in GDP will amount to 19.6%, raising expectations of a virtuous growth cycle in Brazil.

All economic sectors benefited from the expansion in domestic demand. However, the sharp increase in demand in industry, particularly manufacturing industry – which is more subject to international competition –, was increasingly met by imports.

Manufacturing production is still below pre-crisis levels in 12 of the 26 industrial sectors covered by the survey held by PIM-PF/IBGE. The Electronic materials and communication equipment, Wood, and Primary metal products sectors are among the most affected and deserve special mention.

The service sector, in turn, behaved differently: a strong increase in demand in the sector necessarily led to increased activity. We thus saw that Brazil failed to take full advantage of the strong boost in domestic demand, which grew more sharply in the first quarter this year.

Due to the appreciation of the domestic currency, industry was not able to respond more appropriately and ended up losing market share to imported products. This fact is confirmed by the 35.6% growth in imports in 2010, according to the National Accounts methodology.

The Manufacture of apparel articles and accessories, Automotive vehicles, trailers and bodies, Non-metallic minerals products, Electrical equipment and appliances, Furniture and miscellaneous industries, and Textile sectors were the ones for which the sharpest increase in imports was registered.

Despite the slowdown in recent months, industry recorded historical growth levels and even managed to achieve a 10.9% increase in GDP in 2010.

Brazilian trade flow hits record levels

The value of exports grew by about 30% in 2010. The gain in export earnings was led mainly by the hike in international commodity prices.

Exported volumes rose by only 8%, with basic products accounting for much of this growth. In this regard, an inversion observed in the list of exported products deserves special mention. For the first time in over 30 years, exports of basic products will surpass those of manufactured goods.

The exchange rate has a strong bearing on this result. A high inflow of US dollars continues to gradually appreciate the Brazilian currency, posing a significant threat to domestic industry. The cumulative appreciation of the real since late 2008 made room for a strong entry of imported products (intermediate, capital and final goods).

If, on the one hand, this trend brings a noticeable benefit for national consumers – apart from making it easier to control inflation –, on the other hand it entails significant losses to manufacturing production.

The positive momentum in the labor market is also an indication that economy is recovering. 2.4 million formal jobs were created between January and October 2010, twice the figure registered in the same period in 2009.

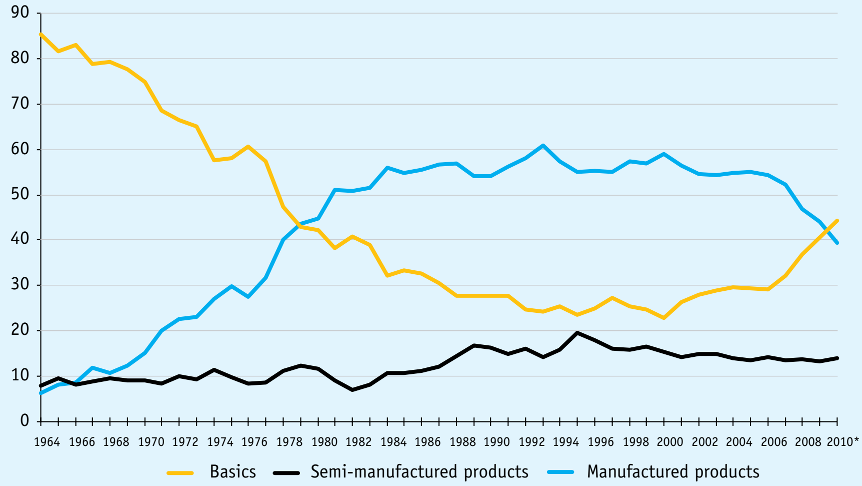
Industrial jobs are up in spite of a downturn in manufacturing activity in the second quarter of 2010. This can be explained, first, by lower idleness rates and, second, by the expansion of the industrial park to meet an increasing domestic demand.

As far as inflation is concerned, it should be highlighted that the increase in the volatility of the Extended Consumer Price Index (IPCA) was mainly brought about by food price fluctuations. This group grew at a rate of 9.2% in the 12-month period ending in November 2010. On the other hand, price volatility of the regulated, industrial and service groups remained relatively stable. Therefore, the IPCA is expected to close the year at 5.8%, above the central target of 4.5% set for 2010.

Brazilian exports by product category

Participation in total (%)

Exports of basic products surpass those of manufactured goods in 2010



Source: MDIC/SECEX
* CNI estimates

As a result of this scenario, the Monetary Policy Committee (COPOM) began to increase the Selic rate in April, fixing it at 10.75% per year in August. In addition, measures to raise bank reserve requirements for the purpose of reducing excessive credit liquidity were also taken in December.

Finally, the increase in demand in 2010 resulted in a strong fiscal expansion. Federal Government's spending rose by 11.4% between January and October 2010 in relation to the same period in the previous year. This growth was even more significant in light of the 2009 expansionary fiscal policy, which was applied as a measure to curb the crisis.

Consequently, it was only possible to meet the primary surplus target due to the inflow of resources from the Petrobras capitalization process. Thus, primary surplus is estimated to hit the mark of 2.30% of GDP in 2010, above the adjusted target of 2.15% of GDP.

Apart from making it more difficult to meet the fiscal target, the strong increase in public spending imposed higher costs on monetary policy for controlling inflation.

special topic: industry two years after the crisis

Situation is heterogeneous among industrial sectors

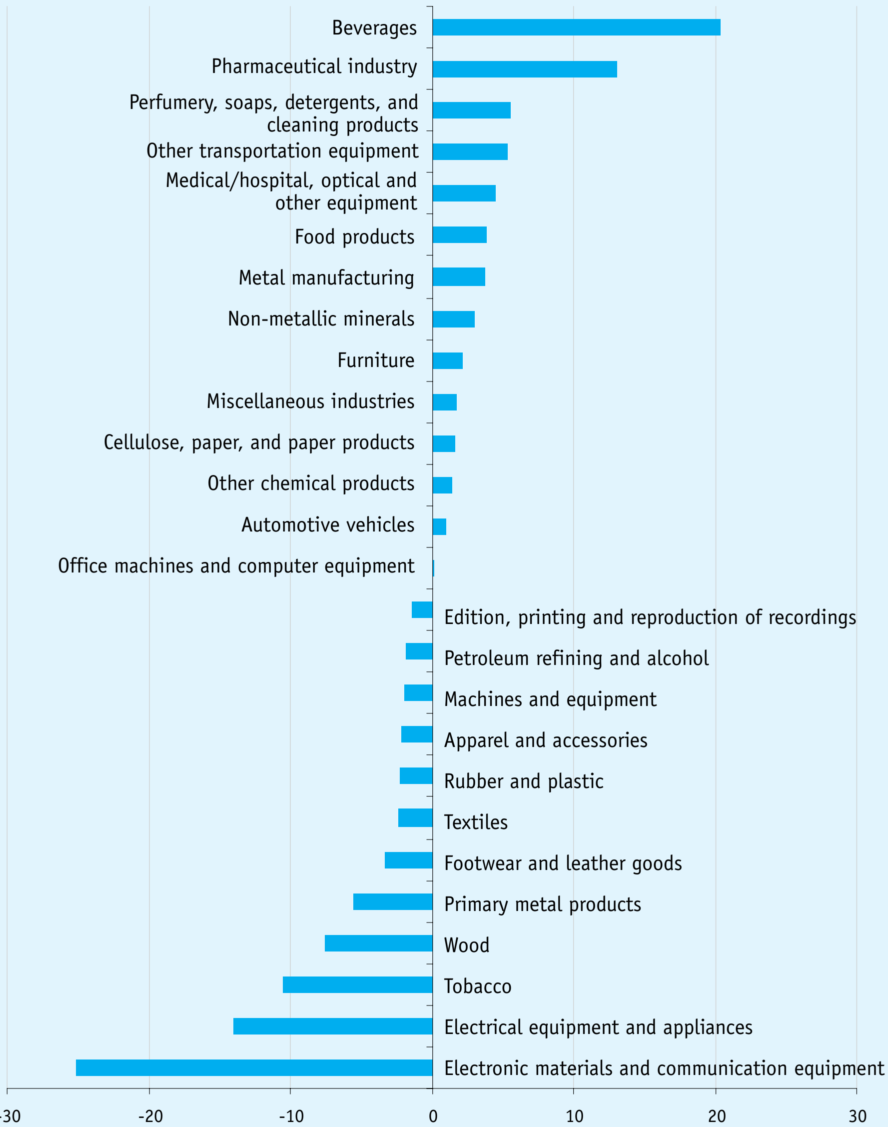
The international crisis that broke out after September 2008 brought about a series of problems to the Brazilian manufacturing industry. Two years later, one can check the situation of different industrial sectors by analyzing data for production, exports, imports, revenues, and employment.

The main conclusion is that the different manufacturing sectors are recovering in a very heterogeneous way in relation to the pre-crisis period (from January to September 2008). It can be seen that there is space for production and exports to recover in certain sectors and for a significant entry of imported products into various industrial segments.

Production growth rate in the manufacturing sectors

Variation from Jan-Sept 2010 to Jan-Set 2008 (%)

Several sectors have not yet fully recovered from the crisis



Source: PIM/IBGE

Sectoral production recovers partially from the crisis

Analyzing the effects of the crisis on each sector based on their indicators for manufacturing production (PIM-PF/IBGE), we have the following scenario: as compared to 2009, production is up in 24 of the 26 sectors considered in the survey, with emphasis on Machines and equipment, Automotive vehicles, Metal manufacturing, and Primary metal products – all of which grew by more than 20% when comparing January and September 2010 and 2009.

The first two sectors were strongly stimulated by public policies during the crisis period – e.g. taxes (Tax on Industrial Products - IPI) were reduced and/or interest rates were lowered. When comparing 2010 and 2008, however, production is down in 12 of the 26 surveyed sectors, meaning that they are not yet back to pre-crisis levels.

The main industrial sectors with production levels below the ones observed in the pre-crisis period are Electronic materials and communication equipment, Electrical equipment and appliances, Tobacco, Wood, and Primary metal products – all of which are down by 5.0% in relation to 2008. On the same comparison basis, the Beverages, Pharmaceutical industry, Perfumery, soaps, detergents and cleaning products, and Other transportation equipment sectors were the ones for which the strongest recovery was registered – with growth rates in excess of 5.0%. These sectors (except for Other transportation equipment) were directly influenced by upturns in the domestic economy and by the increase observed in the lower middle class purchasing power.

Exports are below 2008 levels

Another important indicator for the evolution of industrial sectors is the value of exports and imports (SECEX/ MDIC). Data on exports accumulated from January to September show that only 2 of the 22 sectors covered by the survey recorded a decline between 2010 and 2009. As compared to the same period in 2008, exports are down in 19 of these 22 sectors. This situation highlights the fact that national industries lost foreign markets, reflecting both an appreciated exchange rate and a downturn in international trade.

The Other transportation equipment, Electronic materials and communication equipment, Wood products, Manufacture of apparel articles and accessories, Primary metal products (one of the main sectors accounting for national exports), and Edition, printing and reproduction of recordings sectors were the ones for which the sharpest decrease (of more than 20.0%) in exports as compared to 2008 was registered. In relation to 2008, exports are up in the Cellulose, paper and paper products, Food products and beverages, and Chemical products sectors – all of which account for a large share of Brazilian exports.

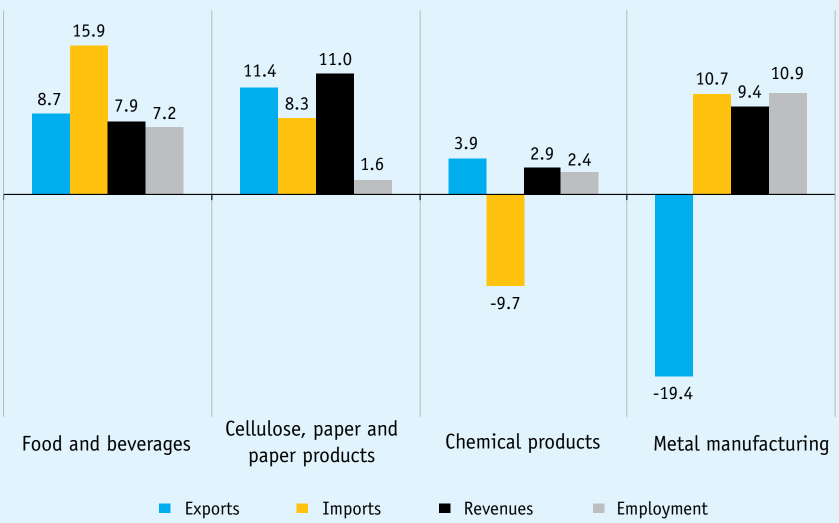
Imports are above pre-crisis levels in most sectors

As for imports, imported values are up in all sectors as compared to 2009. In relation to the same period in 2008, imports are up in seventeen of the twenty-two sectors considered in the survey. This shows an increased entry of imported products from different manufacturing sectors into the domestic economy, mainly as a result of an appreciated exchange rate and the upturn in the domestic market. Imports are above pre-crisis levels by more than 20.0% in the Manufacture of apparel articles and accessories, Automotive vehicles, trailers and bodies, Non-metallic mineral products, Electrical

Sectors with the best performance after the crisis

Variation from Jan-Sept 2010 to Jan-Set 2008 (%)

Some sectors are recovering well from the effects of the crisis



Source: SECEX / MDIC and CNI.
Preparation: CNI

special topic: industry two years after the crisis

equipment and appliances, Furniture and miscellaneous industries, and Textile sectors. Most of these industrial sectors are focused mainly on meeting demand in the domestic market.

With respect to revenues (CNI Industrial Indicators), the indicator grew in 17 of the 19 sectors surveyed in relation to 2009. The Edition and printing, Machines and equipment, and Automotive vehicles sectors stood out the most on this comparison basis. On the other hand, the indicator is up in 14 sectors in relation to 2008. The indicator grew most strongly (by more than 15.0%) in the Edition and printing, Other transportation equipment, Leather and footwear, and Apparel sectors. The sectors that have not yet recovered from the crisis are the Wood, Primary metal products, Refining and alcohol, and Electronic and communication materials sectors. Production and exports are still below 2008 levels in these industrial sectors.

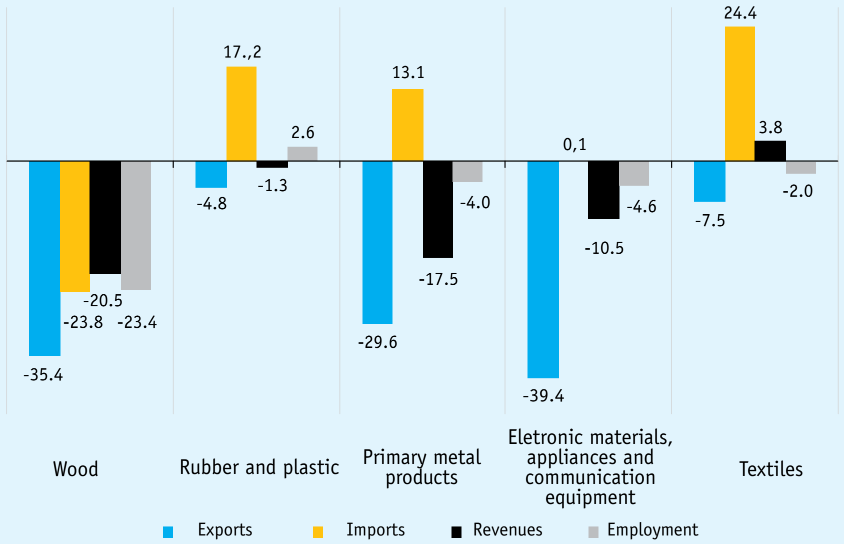
The situation is different for the employment indicator (CNI Industrial Indicators): the number of employees in 18 of the 19 sectors is above that observed in 2009. The Metal manufacturing, Electronic and communication materials, Leather and footwear, and Electrical equipment and appliances sectors stood out the most in this regard.

Employment is up in 11 sectors in comparison with 2008. The Metal manufacturing, Food and beverages, Non-metallic minerals, and Electrical equipment and appliances sectors were the ones in which employment grew more significantly – all at a rate in excess of 5.0%. Both revenues and production increased in these sectors (except for Electrical equipment and appliances) as compared to 2008. Jobs are still below 2008 levels in the Wood, Apparel, Other transportation equipment, Electronic and communication materials, and Primary metal products sectors.

Sectors that have not yet fully recovered from the crisis

Variation from Jan-Sept 2010 to Jan-Set 2008 (%)

Some sectors have experienced greater difficulty in recovering from the effects of the crisis



Source: SECEX / MDIC and CNI.
Preparation: CNI

Sectors accounting for a large share of production are performing better

By analyzing the different indicators above, it can be seen that the Food and beverages, Chemical products, Metal manufacturing, and Cellulose, paper and paper products sectors are in a more favorable position in relation to the pre--crisis period. These sectors account for a significant share of production and exports (except for Metal manufacturing) in the domestic economy. The analyzed data showed that both production and exports are up in these sectors in relation to January-September 2008. Other industrial sectors have not yet managed to fully recover from the crisis, namely: Wood, Electronic materials, appliances and communication equipment, Primary metal products, Textile, and Rubber and plastic.

OUTLOOK FOR 2011

GDP growth in 2011 will be lower than in 2010

After the financial crisis and the euphoria of economic recovery seen early this year, the Brazilian economy is now converging to its growth potential.

CNI estimates that the economy will grow by 4.5% in 2011. Three factors explain this growth rate:

i. Household consumption: the strong increase in domestic demand will continue to support growth, as the labor market is expected to keep expanding. As a result, household consumption will continue to grow, also sustained by a higher availability of credit and by cash transfer programs.

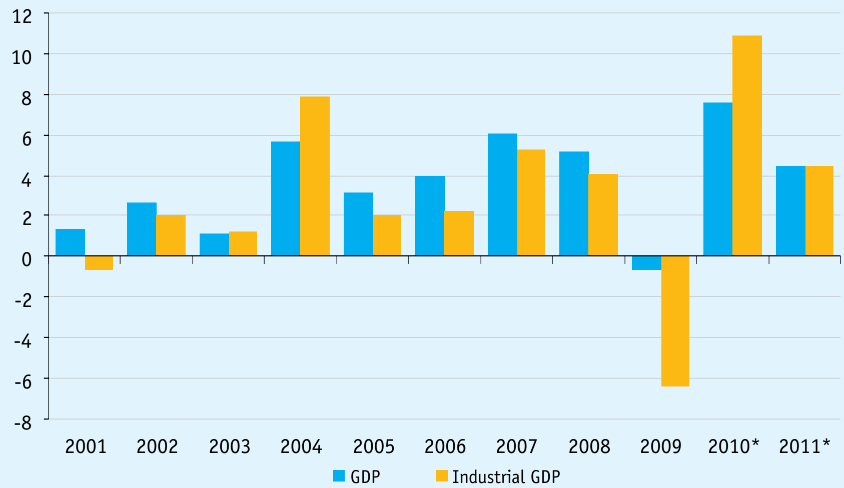
ii. Investments: this GDP component is not expected to grow as it did in 2010, but industrial enterprises have positive expectations about new investments for next year, which would contribute significantly toward enhancing productive capacity in 2011. Manufacturing activity is therefore estimated to grow by slightly more than 1.0% on average per quarter throughout 2011, with industrial GDP growing at a rate of 4.5%.

iii. Foreign trade sector: the adverse effects of the leakage of domestic demand abroad are expected to continue. The fact that imports have increased at a pace faster than that of manufacturing production will result in the loss of industry's share in the domestic market. In addition, the weaker reaction of exports reduces the trade balance.

GDP and industrial GDP

Variation in relation to the year before (%)

Growth rates of total and industrial GDP coincide in 2011



Source: IBGE
* CNI estimates

outlook for 2011

CNI estimates that imports will grow less significantly in 2011 (from 35.6% in 2010 to 23.3% in 2011). Exports, in turn, are likely to keep growing at a pace very similar to the one observed in 2010.

These trends will cause the foreign sector contribution to GDP growth to increase from -2.7 percentage points (p.p.) in 2010 to -2.0 p.p. in 2011.

Exchange rate scenario to remain virtually the same in 2011

The inflow of direct foreign investments will remain strong in 2011 due to the increased attractiveness of Brazil on the world stage. This will be an important condition to finance the current account deficit, which reduces the probability of a crisis in foreign accounts in the short run.

However, the inflow of foreign capital will continue to appreciate the real, thus making it difficult for domestic manufacturing production to grow more in a more pronounced fashion.

Direct foreign investments stood at US$ 25.9 billion in 2009. The Central Bank projects that the figure will amount to US$ 30 billion in 2010 and to US$ 45 billion in 2011. This amount finances part of the current account deficit, which is currently at about 48 billion dollars in the 12-month accumulated figure.

Government will keep insisting on short--term restrictive measures designed to prevent the real from appreciating in 2011, such as accumulation of reserves and higher taxation on portfolio investments in Brazil.

With the aim of curbing this trend, Government could focus on long-term measures to increase domestic savings, starting by restricting the growth of public sector's current spending.

The trade balance is expected to continue to reflect the exchange rate appreciation. It stood at US$15 billion in 2010 and is projected to hit the mark of US$ 4 billion in 2011. On the other hand, the current account deficit will likely reach 3.0% of GDP in 2011, a significant increase over the 2.4% figure registered in 2010.

Changing inflation dynamics in 2011

The Central Bank's measures to restrict credit and the likely increase in the Selic rate will change the inflation scenario in 2011. While inflation gained momentum in 2010, prices will experience a downward trend in 2011. For this reason, the IPCA is expected to remain close to the central target (4.5% per year), accumulating a 5% increase in 2011.

A reduction in the expansionary nature of the fiscal policy will probably require a lower increase in the basic interest rate. CNI estimates that the Selic rate will close 2011 at 12.00 % per year.

Expenditures will need to be revised in 2011

If no amendments are made to the budget bill, the expansionary nature of the fiscal policy is likely to continue next year and, once again, the bill for controlling inflation might have to be footed by the monetary policy.

However, achieving the fiscal target requires a R$19-billion cut in expenditures provided for in the budget bill. As a result, spending will probably increase at a rate close to that of the expected real GDP growth, reducing the expansionary character of the fiscal policy.

CNI estimates that the public sector will achieve a primary surplus of 2.2% of GDP. The decline in primary surplus and the increase in interest costs in relation to 2010 will cause the nominal deficit to increase to 3.2% of GDP.

Notwithstanding, GDP growth is expected to result in a slight reduction in the debt/GDP ratio, which will likely close 2011 at 40.4% of GDP.

economic activity

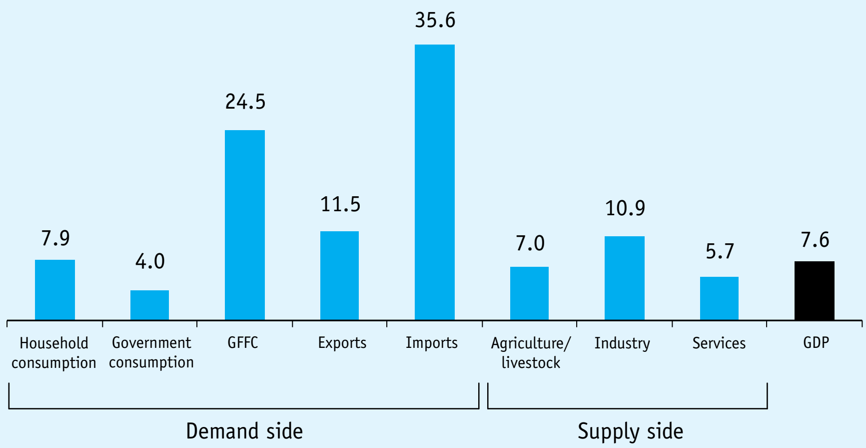
GDP growth is the highest in the decade

Brazilian economy grew strongly in 2010, with GDP increasing by 7.6% (CNI estimates). This strong economic growth took place despite a downward trend that began in the second quarter. Basically, two factors prevented GDP from growing even more: a) most tax exemption measures were suspended late in the first quarter; and b) the appreciation of the real led domestic demand to be partly met by foreign markets (through increased imports).

Estimated growth rates of GDP and its components in 2010

Variation in relation to the previous year (%)

Increased domestic demand boosts imports



Estimates: CNI

Household consumption was the demand-side component that boosted GDP the most in 2010

Domestic demand was key to ensuring economic growth. Household consumption is expected to increase by 7.9% in 2010, i.e. the highest growth rate since 1995. This behavior results from a marked growth in employment – mainly formal employment – and an increase in total payroll, in credit, in government's cash transfer programs, and in the minimum wage.

When sustained by more investments, economy grows on an ongoing and sustainable basis and increasingly close to its potential rate. The gross formation of fixed capital rose by 25.6% in the first three quarters of the year in relation to the same period last year. Imports of machinery and equipment accounted for a great share of the increase in investments in 2010. While domestic production of capital goods (PIM-PF/IBGE) grew by 24.0% from January to October in relation to the same period the year before, imports (in quantum) of these goods are up by 42.1%. The performance of investments in 2010 deserves special mention: CNI estimates that the gross formation of fixed capital will rise by 24.5% this year and, as a result, the share of investments in GDP, which had dropped to 16.9% in 2009, will grow to 19.6% in 2010.

Added to the appreciation of the real, the strong increase in domestic demand caused imports to grow by 35.6% (national accounts) in 2010. Since exports grew at a much lower rate (estimate of 11.5%), the foreign trade sector is expected to contribute negatively to GDP by 2.7 percentage points.

Industrial GDP grows by 10.9% and is back to pre-crisis levels

Despite experiencing a downtrend throughout the year, industry continued to produce at historical high levels – at pre-crisis levels. If industry was the most affected sector by the crisis in 2009, it will

atividade econômica

also be the sector that will increase the most (by 10.9%) in 2010 and, therefore, the one that will contribute most– on the supply side – to GDP growth this year.

The construction industry had a remarkable performance in 2010. The activity indicator for the sector (CNI Construction Industry Survey) remained above 50 points throughout 2010 (figures above 50 points indicate increased activity in the sector as compared to the previous month). According to the National Accounts methodology, the construction industry GDP rose by 13.6% in the first three quarters of the year in relation to the same period the year before. CNI estimates that this GDP component will grow at a rate of 13.0%.

When taking into account only manufacturing (PIM-PF/IBGE), production increased by 11.7% from January to October 2010 in relation to the same period in the previous year. Real sales in the sector (CNI Industrial Indicators) rose by 10.4%, while employment (CNI Industrial Indicators) increased by 5.4% over the same period.

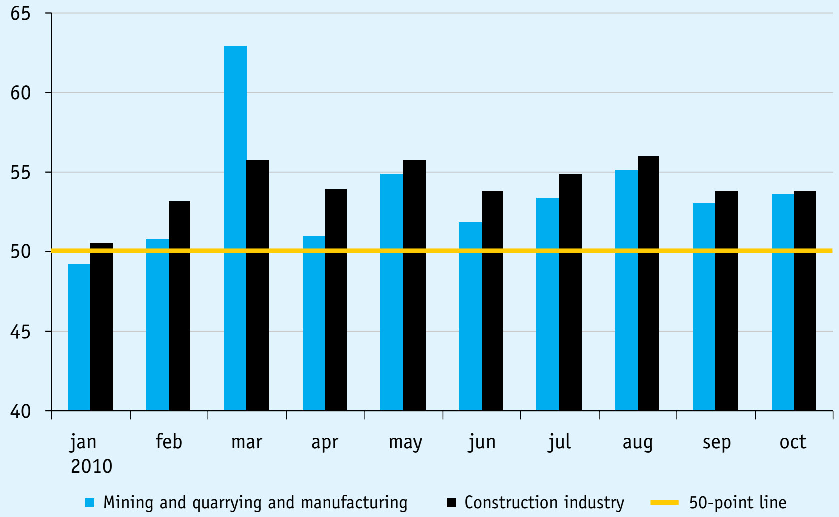
It is important to consider that even in a period of moderate activity in manufacturing after the first quarter of the year, employment in this sector kept growing, which may point to investments in the industrial park.

While industry reduced its idle capacity steadily in 2009, reflecting a

Index for manufacturing production and for construction industry activity

Diffusion index*

Manufacturing activity in construction industry was more intense than in manufacturing

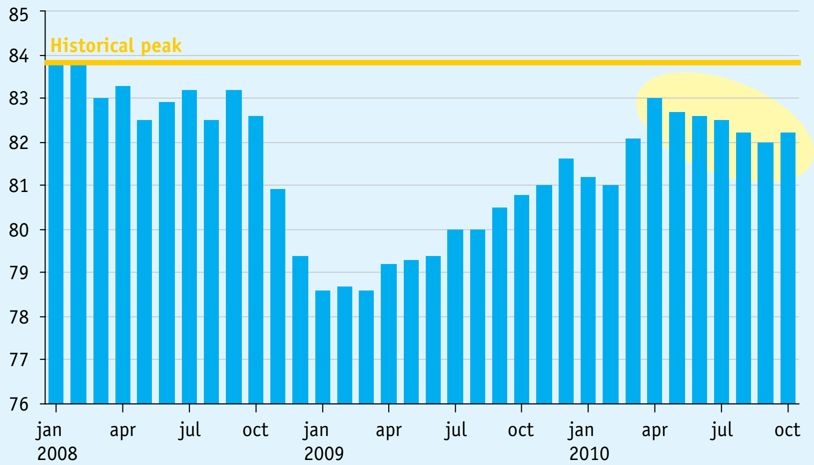


Source: CNI Industrial Survey - Manufacturing and Mining
* Figures above 50 points suggest an increased production or manufacturing activity

Capacity utilization in manufacturing

In (%)

Slowdown in capacity utilization allows industry to meet sudden spikes in demand



Source: CNI Industrial Indicators

recovery from the crisis, the greater flow of investments in 2010 led to an expansion of the industrial park. Capacity utilization experienced a downward trend from May to September 2010, when it was calculated at 82.0%. Despite the slight increase in capacity utilization in October, to 82.2%, it is still below both the pre-crisis level (83.2%) and the historical peak (83.8% in February 2008). This difference indicates that the industrial sector will have flexibility to meet sudden demand surges.

The dynamism in household consumption also stimulated activity in the service sector, which rose by 5.7% in the year-accumulated figure up to October in relation to the same period the year before. Given positive expectations for strong holiday-season sales, CNI estimates that the 5.7% growth rate will remain at the same level at the end of 2010 as compared to 2009.

The agriculture/livestock sector recorded significant growth in different agricultural and animal slaughter products that had a better performance in 2010 (based on IBGE estimates) than in 2009. CNI projects that GDP in the agriculture/livestock sector will rise by 7.0% in 2010.

Economy to grow by 4.5% in 2011

CNI believes that, albeit more moderately, economy will keep growing in 2011. The estimate that GDP will increase by 4.5% next year points to a reduction in the output gap (difference between actual and potential GDP). Based on projections, potential GDP is set to increase by between 4.1% and 4.3% in the average figure for the last 5 years.

The labor market will continue to generate more formal jobs, stimulating consumption, given the greater security provided by this kind of occupation. The fact that a high number of people are being hired will allow for total earning to keep growing, albeit at a slower pace. Added to the increased availability of credit, this is the necessary condition for household consumption to remain on an upward trend, growing at a rate of about 5.1%. The increase in household consumption will also lead to the service sector to perform better: CNI projects that GDP in services will increase by 4.8% in 2010, which represents a more significant growth rate than that for GDP.

Investments will grow less than in 2010 – largely on account of the comparison basis–, but will keep enhancing productive capacity in 2011. The Investments in Industry Survey, carried out by CNI with entrepreneurs in the sector from October to November, points out that 92.0% of all companies considered in the survey have plans to invest in 2011. CNI projects a 13.5% increase in the gross formation of fixed capital next year.

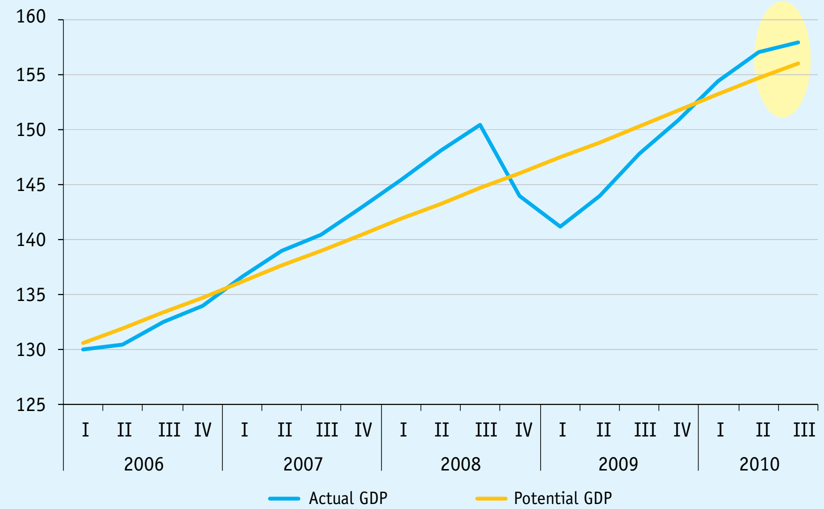
Optimism about future demand depends more on the domestic market than on foreign markets

The negative contribution of the foreign trade sector to GDP growth will fall to 2.0 percentage points in 2011, given the less

Actual and potential GDP

1995 base-index number = 100

GDP is converging to its growth potential

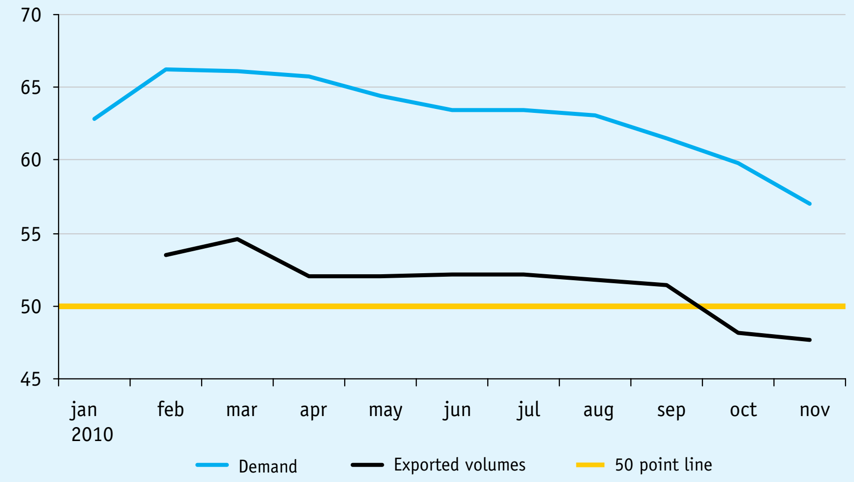


Source: IBGE
Preparation: CNI estimates for potential GDP based on simulations with the Hodrick-Prescott filter

atividade econômica

Expectations of industrial entrepreneurs in relation to an increase in demand and exported quantities over the next six months
Diffusion index*

Domestic market is leading to optimism with future demand



Source: CNI Industrial Survey - Manufacturing and Mining
* Figures above 50 points suggest an increased production or manufacturing activity

GDP estimates

Variation (%) and contribution of GDP components (p.p.)

	GDP components	2011 Growth Rate (%)	2011 Contribution (p.p.)
	Household consumption	5.1	3.2
Demand side	Government consumption	3.0	0.6
	GFFC	13.5	2.6
	Exports	11.0	1.3
	(-) Imports	23.3	3.3
	Agriculture/livestock	4.0	0.2
Supply side	Industry	4.5	1.2
	Mining and quarrying	5.0	0.1
	Manufacturing	4.0	0.7
	Construction industry	6.0	0.3
	SIUP	4.2	0.1
	Services	4.8	3.2
	GDP mp	**4.5**	

Elaboração: CNI

significant difference between the growth rates of exports (growth estimate of 11.0%) and imports (23.3%).

Manufacturing activity will likely grow by slightly more than 1.0% on average per quarter throughout 2011, with industrial GDP rising at a rate of 4.5%. Prospects for the sector are positive (CNI Industrial Survey - Manufacturing and Mining), as the indicator for expected increase in employment is above 60 points (indicators above 50 points indicate an expected increase in jobs). It should be emphasized that expectations about future demand growth remain positive, though less optimistic than early this year, which is consistent with the slowdown in demand growth in 2011. It is worth mentioning that the expected increase in future demand is more focused on domestic demand, as exported quantities are expected to drop.

The appreciation of the Brazilian currency and the possibility that interest rates will begin to increase in 2011 deserve special mention. These factors may further undermine competitiveness in the industrial sector next year and reduce the economy's growth rate.

employment and wages

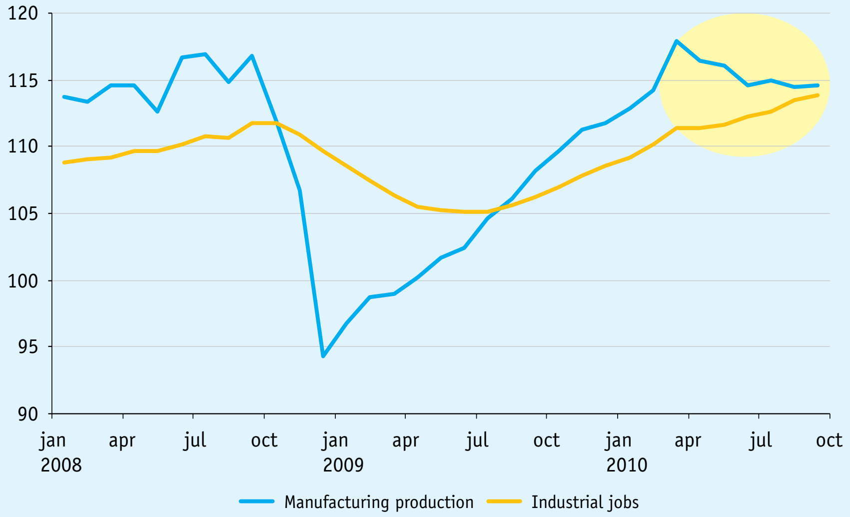
Labor market at its best moment

After the effects of the international crisis dissipated, the labor market experienced an unprecedented upturn in 2010. Metropolitan employment is strongly up again (PME/IBGE) and the indicator for the number of jobs created in the last 12 months is above pre-crisis levels, meaning that the total number of jobs lost due to the crisis has been reestablished and exceeded.

Employment and production in industry

Base-index number Jan/2005 = 100 - seasonally adjusted

Employment kept growing despite a slowdown in manufacturing activity



Source: CNI and IBGE

Formal jobs continue to boost growth

The positive momentum in the labor market is evinced by increased formal job creation. Of the 804,000 jobs that became available in the six metropolitan regions over the last 12 months up to October, 804,000 were filled by employees formally hired by the private sector. This is to say that formal employment accounted for 96% of all new jobs created in the last 12 months. In relative terms, formal employment grew strongly throughout 2010, hitting the mark of 8.4% in October in relation to the same month the year before. In this context, informal jobs dropped by 0.7% and self-employment decreased by 1.0% during the same period.

The rise in formal jobs to the detriment of informal employment leads to an increase in the labor market's formality index. This indicator – which is calculated by the sum of all formal, statutory and military jobs divided by all occupations – is at the highest level (58.8%) in the historical series of the Monthly Job Survey (PME). Data from the General Registry of Employed and Unemployed Persons (Caged/ MTE) show the strong pace at which formal jobs are being created across the country. From January to October 2010, over 2.4 million formal jobs were generated. For comparison purposes, this volume of new jobs is twice as high as that registered over the same period in 2009.

Industry created 42.0% of all formal jobs in 2010. Taking the four industrial sectors together (manufacturing, mining and quarrying, construction, and public-utility industrial services), the total number of formal jobs created from January to October 2010 amounted to 1 million.

employment and wage

Employment is up despite a slowdown in manufacturing activity

Industrial jobs (CNI Industrial Indicators) kept growing in spite of a downturn in manufacturing production since April this year. This apparent discrepancy can be explained by investments intended to enhance productive capacity. Business confidence (INEC/ CNI) remains high. Although the indicator declined from 68 points in January (historical peak) to 62 points in November, it still remains above its historical average (figures above 50 points indicate optimism, while figures below 50 points suggest pessimism).

Sharp drop in the unemployment rate is unusual

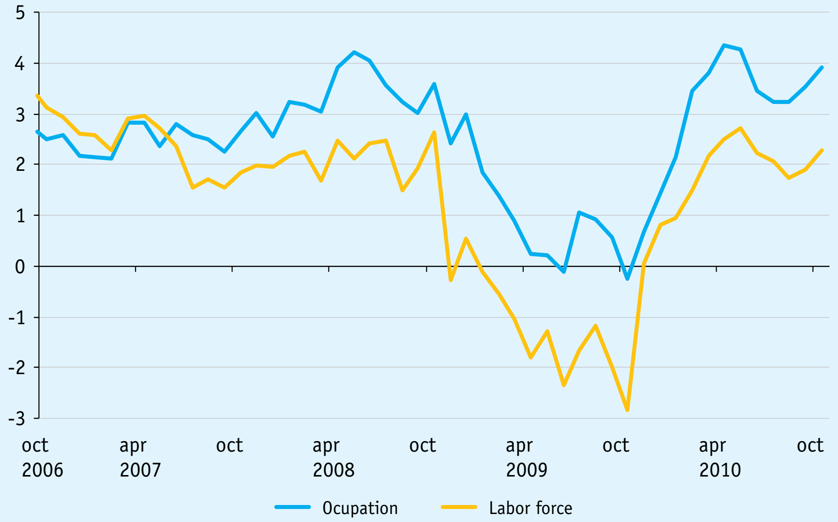
As opposed to previous years, the unemployment rate in metropolitan regions declined almost steadily. Historically, unemployment tends to decrease in the second quarter, but not in such a continuous and intense way as in 2010.

This movement results not only from an increase in job creation, but also from lower job search intensity. Labor force – economically active population (PEA) – has increased at a rate lower than that of employment since mid-2007, creating a gap between these growth rates. The higher the

Occupation and labor force

Variation against the same month the year before (%)

The fact that the employment growth rate is higher than that of labor force reduces pressure on the unemployment rate

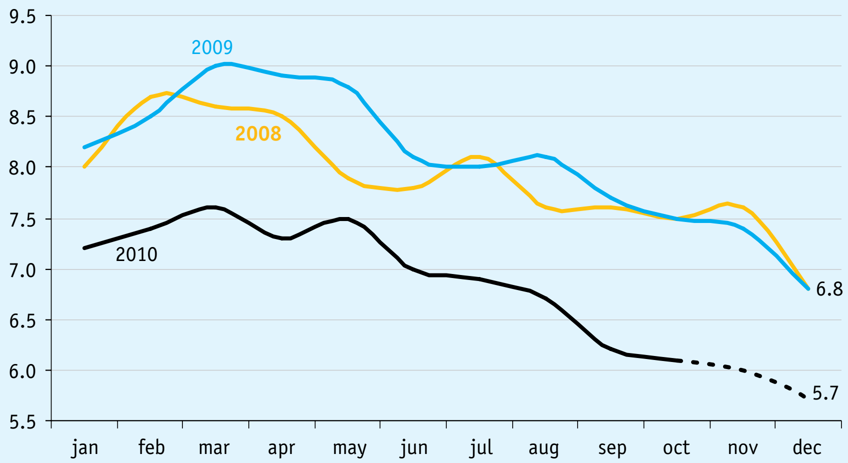


Source: PME/IBGE

Metropolitan unemployment rate

Variation against the same month the year before (%)

Unemployment rate decreased steadily and rapidly in 2010



Source: IBGE. Projection: CNI

gap, the lower the pressure on the unemployment rate.

CNI estimates that the unemployment rate will hit the mark of 5.7% in December (lowest historical level), which would result in an average annual rate of 6.8%. The annual downward trend observed in the unemployment rate is likely to continue in 2011. CNI projects that the average indicator will stand at about 6.0% in 2011.

As the projection for GDP growth in 2011 is close to the economy's growth potential, the unemployment problem in Brazil lost importance and some industrial sectors are now facing difficulties to find skilled labor. In the construction industry, for example, lack of skilled workers ranks first in the ranking of main problems faced by the sector (Construction Industry Survey - CNI).

Higher purchasing power will ensure increased domestic demand

The usual average real income (PME/IBGE) in the six main Brazilian metropolitan regions is significantly up. This indicator grew at an increasing rate throughout the year until it hit an 8.0% growth over the same month in the previous year – the highest increase since the beginning of the historical series, in March 2002.

Real total earnings, which are calculated by multiplying average real wages by the total number of occupied persons, have been increasing at a more significant rate and recorded a 10.7% growth in October 2010 as compared to the same month the year before. As a result of this upturn, the figure for average total earnings accumulated from January to October 2010 is 7.2% above the one calculated in the same period in 2009.

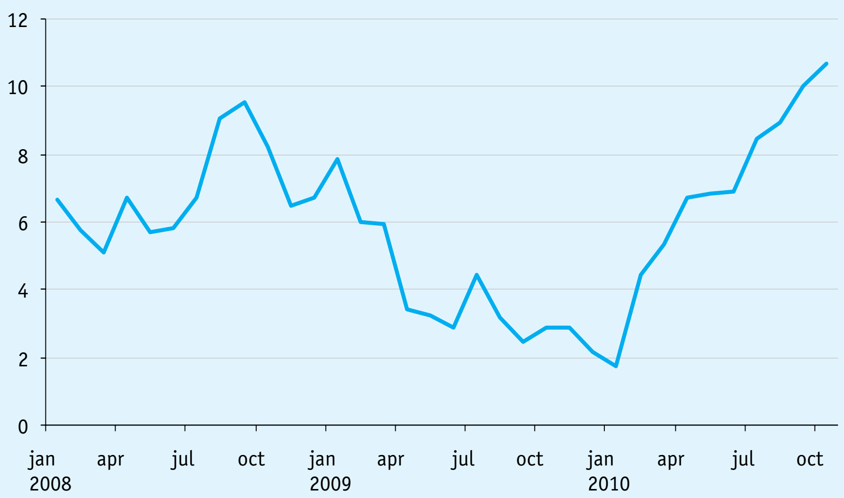
The continuous increase in formal employment - which results in higher consumer confidence -, the strong growth in total earnings and a higher availability of credit continue to sustain domestic demand, which will keep growing at a pace much faster than that of global demand.

Future prospects for the labor market are quite positive. CNI estimates that the labor market will continue to hire and create formal jobs in 2011, with positive effects on total earnings and, therefore, on domestic consumption. Labor force will keep growing less strongly than employment in 2011, which will likely further reduce the unemployment rate that year.

Usual metropolitan real total earnings

Variation against the same month the year before (%)

Record growth in total earnings



Source: IBGE. Calculation: CNI

inflation, interest rates and credit

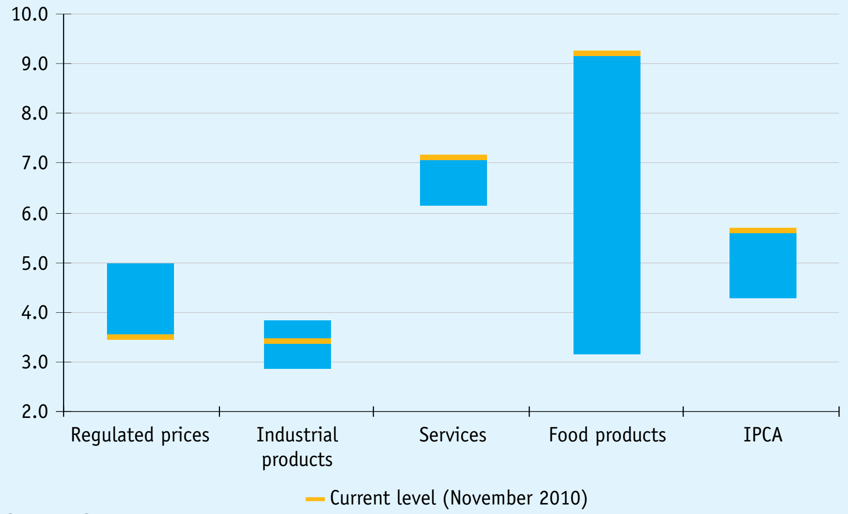
Food prices dictate inflation in 2010

The year of 2010 was characterized by high volatility in the official inflation index, the IPCA. From January to November, the index rose from 4.59% to 5.64% in the 12-month accumulated figure. August was the only month in which the index achieved the central inflation target of 4.5% per year. Inflation experienced an upward trend in the last months of the year. However, the movement in prices was heterogeneous among the four main IPCA components: food products, services, regulated prices, and industrial products.

Volatility of IPCA components

Minimum, maximum and current variation accumulated over the past 12 months (%)

Food products led to a strong volatility in the IPCA in 2010



Source: IBGE
Preparation: CNI

Increase in food prices jeopardizes the achievement of central target

Food prices increased over the year, from the 3.6% 12-month accumulated figure in January (lowest figure in the year) to 9.2% per year in November. Inflation of regulated prices and industrial products remained relatively stable and within the inflation target. Services inflation also remained stable, but at a higher level: average of 6.7% in the 12-month accumulated figure.

The IPCA followed the trend registered for food products. These items, with 23% of the total weight, essentially contributed to make the IPCA more volatile. Regulated and industrial-product prices, which account for about 52% of the total index, contributed little to the inflationary pressure seen in the last months. Services, which represent about 25% of the total index, sustained IPCA at a level high.

Regulated prices were strongly influenced by lower inflation in 2009. The international crisis had deflationary effects in Brazil, to the point of resulting in negative variations in inflation indices in 2009. The General Market Price Index (IGP-M/FGV) closed 2009 down by 1.71% per year. Thus, prices adjusted based on this kind of index experienced a controlled increase in 2010.

Inflation of industrial prices remained low throughout the year (average of 3.5% per year in 2010 up to November) on account of two factors: the effects of the policy of increasing interest rates adopted by COPOM in mid-2010 and an appreciated exchange rate.

Industrial products are the most affected by the increase in the Selic rate. The response to increased interest rates in credit operations affects demand for this kind of good. Even though the increases applied by COPOM during the year were not the main factor pushing the IPCA up, they had a major influence on industrial prices.

A highly appreciated exchange rate is another factor contributing to this scenario: imported products, which are cheaper because of the exchange rate, are strongly competing with domestic products.

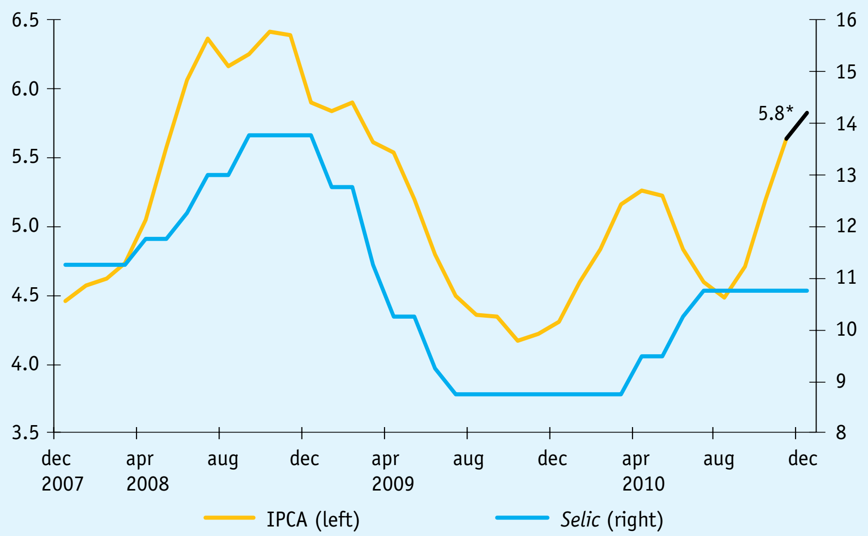
As in previous years, inflation in services prices is at a high level. The twelve--month accumulated rate for the index of this subgroup has been above 6% since mid-2008. Although its volatility is low, the index's level sustains the increase in the IPCA, showing that it is little affected by variations in interest rates.

Food prices behaved differently from the others. They were strongly influenced by different issues, such as international commodity prices, harvest problems, and seasonal fluctuations. Because of these issues, prices kept increasing strongly until April. After the harvest season backed to normal and rain-related problems ceased to exist, this movement reversed, and a downtrend was experienced until August. However, the sudden hike in international commodity prices since June contributed to increasing domestic prices (the IMF food price index rose by 17.4% between June and October). Missing only the December variation, the IPCA has been virtually defined for 2010. The measures to restrict credit adopted in early December are probably already having effect, but will not prevent the index from rising. For this reason, CNI projects that the IPCA will close the year at 5.8% per year.

IPCA and *Selic*

12-month accumulated variation in the IPCA and annual *Selic* rate (%)

Accelerating inflation points to restrictive monetary measures



Source: IBGE and Central Bank of Brazil / Preparation: CNI
* CNI estimate

Higher interest rates have not prevented volatility in the IPCA

COPOM was not oblivious to the inflationary pressures seen in the IPCA. The year began with a strong increase in food prices, whose inflation rose from 3.6% per year in January to almost 7% per year in April. As a result of the effect on the IPCA, COPOM started a new cycle of increases in the Selic rate: 2 p.p. from April to July, amounting at 10.75% per year.

In April, the IPCA began to fall again, hitting the central target in August. This movement resulted more from the return of a regular food supply (which experienced a deflationary trend during the period) than from a decrease in interest rates. However, food prices began to grow once again in the last months of the year, leading to a higher IPCA.

This pressure resulted in the adoption of measures designed to control liquidity in the economy. Early in December, the Central Bank announced measures to restrict consumer credit and increase reserve requirements (which were reduced during the crisis), thus removing R$ 61 billion from the economy. The expected result is not immediate, but it will have a bearing on the inflation rate over the next few months.

With the Selic rate at 10.75% per year and taking into account CNI's forecast for inflation this year, the average real interest rate is set to amount to 4.6% per year in 2010.

Inflation, interest rates and credit

Gap between credit to natural and legal individuals

A The increased granting of credit, particularly with non-earmarked resources (own funds of the financial institution), indicates that both natural and legal persons experienced the same trend: a decline after the crisis broke out and recovery across 2010. Yet, the intensity of their decline and the time of their recovery were different.

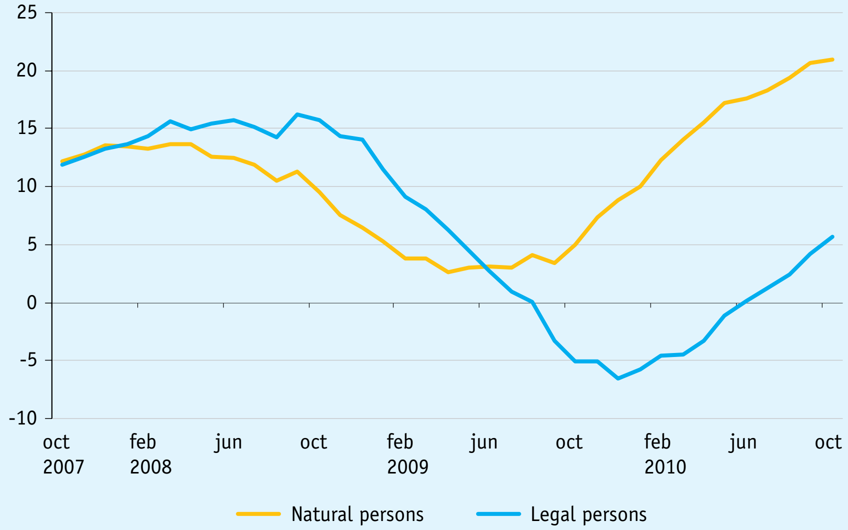
After slowing down during the entire period after the beginning of the crisis, the growth rate of credit with non-earmarked resources to legal entities took an upward turn once again in recent months, but has not yet returned to pre-crisis levels. On the other hand, credit to natural persons, which fell less strongly, was already above pre-crisis levels early this year.

This difference in dynamics resulted essentially from the anti-crisis measures applied by the Government to the two borrowers. While credit to natural persons was boosted by private resources (measures to reduce reserve requirements, guarantee to small banks, and consumer credit incentives), credit to legal persons was sustained by earmarked resources (BNDES). For this reason, funds that were previously provided by the financial institution itself (such

Granting of credit with non-earmarked resources to natural and legal individuals

Average in the last 12 months against the 12 previous months (%)

Only credit to individuals is growing at pre-crisis rates

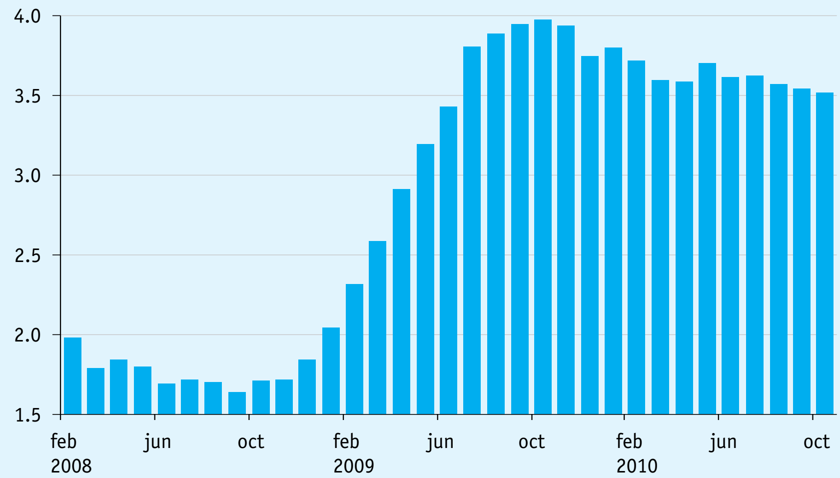


Source: Central Bank of Brazil
Preparation: CNI

Repayment delay for more than ninety days for legal persons

Percentage of total credit (%)

Default rate among companies is slowly declining



Source: Central Bank of Brazil
Preparation: CNI

as working capital) have been partly replaced by other sources.

The rapid recovery in credit to natural persons (as compared to legal entities) can be partly explained by a higher default rate. As a result of the crisis, the indicator for repayment delay of more than ninety days for loans to natural persons is up from 7% of total credit to 8.5%.

However, this indicator has been declining since May 2009, hitting the mark of 5.9% in October 2010. The indicator for legal persons, in turn, rose from 1.7% to 4% due to the crisis and is on a slow downward trend (the indicator was calculated at 3.5% in October).

The average interest rate charged reflects this situation, with rates declining for natural persons and still high for legal individuals.

Lower liquidity in 2011

Dynamics in 2011 will be different than the one observed this year. The growth in domestic consumption and economy in 2010 was strongly influenced by the extent of the effects of governmental measures taken during the crisis. These arrangements have already begun to be dismantled: end of exemptions and reductions in the Tax on Industrial Products (IPI) (except for the construction industry), end of the BNDES-PSI Investment Sustaining Program, restrictions on consumer credit, and reintroduction of reserve requirements.

This situation tends to reduce the consumption growth rate, affecting both price levels and economic growth.

The risk of inflationary pressures on industrial-product prices is low. COPOM will probably not reverse its interest rate policy in the short term, and imported products are likely to continue to generate fierce competition with domestic products. Capacity utilization shows that there is room to increase the supply of products without generating pressures on prices.

Regulated prices, in turn, are expected to increase more significantly, as the indices based on which these prices are adjusted have grown at an increasing rate in 2010 (the 12-month figure for the General Market Price Index (IGP-M) accumulated a 10.27% growth in November 2010).

Prospects for service prices have also not shown any signs of slowdown. Several components in this group are adjusted for inflation, such as rent, education, and health care services. In addition, the lack of skilled labor and low unemployment levels are likely to increase wages of independent professionals, thus contributing to an upward pressure on prices.

The trend in food prices will depend on the behavior of external factors. If there are no harvest shocks, food prices will likely fall throughout the year, only increasing slightly again in late 2011. This trend will probably dictate the volatility in the IPCA as a whole. Under this scenario, CNI projects that the IPCA will be calculated at 5% per year, within the target, but 0.5 percentage points (p.p.) above the center.

Measures to restrict credit are an indication that the monetary policy will be more restrictive in 2011. For this reason – and assuming that the fiscal policy will be less expansionary than the current one, with cuts in expenditures to ensure that the primary surplus target will be achieved –, the interest-rate cycle required to meet the inflation target may be less intense.

Based on this assumption, CNI expects to see an overall increase in the Selic rate of 1.25 p.p. already in the first meetings to be held in 2011, closing the year at 12.00% per year. In this scenario, average real interest rates will rise from 4.6% per year in 2010 to 6.3% per year in 2011.

fiscal policy

Marked increase in public spending imposes higher costs on monetary policy

Public sector spending grew significantly in 2010, to the point of exceeding the growth rate observed in 2009, when fiscal policy was used to reduce the impacts of the economic crisis on activity levels. As a result of the economic growth recovery in 2010, this strong fiscal expansion made it more difficult to achieve the primary surplus target and imposed higher costs on the monetary policy to prevent demand, and consequently inflation, from rising.

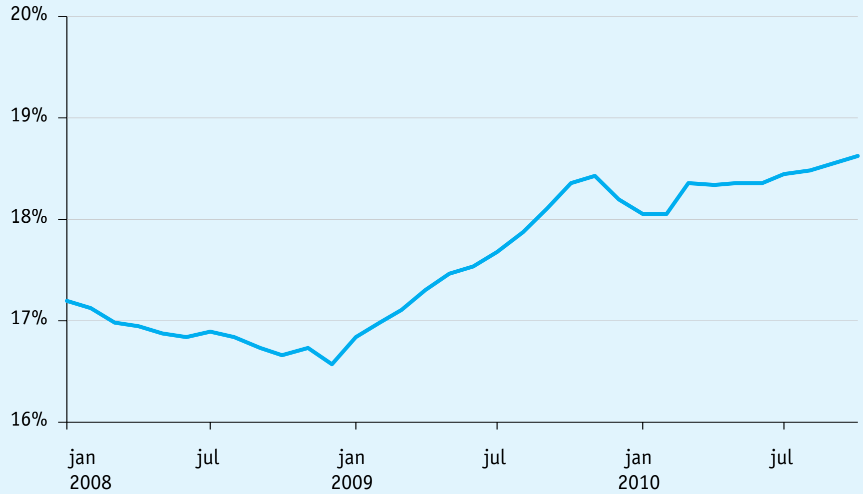
The most significant change in fiscal policy was observed in states and municipalities, which significantly increased their rate of spending growth in 2010, in contrast to the slight increase seen in 2009. The Federal Government, in turn, only accelerated its rate of spending growth, which had already been on the rise in 2009.

As a result, tax efforts made by the consolidated public sector will only ensure the achievement of the adjusted fiscal target, without considering investments and payments due in the accrual regime of public accounts for extraordinary credits granted in previous years. Still, the fiscal target will only be achieved due to the substantial inflow of extraordinary revenues from the Petrobras capitalization process and the exclusion of companies in the Eletrobras Group from the calculation of public accounts.

Evolution of Federal Government's primary spendi

Accumulated in 12 months in relation to GDP (%)

Primary spending up by 2.0 p.p of GDP between December 2008 and October 2010



Source: STN/MF

Federal Government's spending in 2010: strong growth and better composition

The Federal Government's primary spending grew by 11.4% in real terms (IPCA deflator) between January and October 2010 over the same period last year. It is worth mentioning that this variation does not include extraordinary expenses of R$ 42.9 billion relative to the National Treasury's contribution in the Petrobras capitalization process.

Although current spending is significantly up (by 9.6%) on the same comparison basis, it should be highlighted that investments grew much more strongly (by 44.2%). This shows an improvement in the composition of public spending, with investments accounting for a greater share.

Defrayal and capital spending was the item that pushed expenditures up the most, increasing by 20.9% in real terms on the same comparison basis – also excluding expenditures involved in the Petrobras capitalization process. As highlighted before, investments accounted for a significant share of the increase in defrayal and capital expenditures. However, the additional amount invested (R$ 12.0 billion) represented less than half of the increase in defrayal expenses (R$ 28.0 billion).

As compared to defrayal and capital expenditures, the other items making up the Federal Government's primary spending grew much less significantly. Social security spending rose by 8.3% in real terms from January to October 2010 in relation to the same period in 2009. Albeit lower than the growth in defrayal and capital spending, the increase in social security spending is higher than the real growth in GDP expected in 2010.

Finally, spending with staff rose by 4.4% in real terms between January and October 2010 as compared to the same period in 2009. Although this growth rate is the lowest among the main primary spending items, it is worth remembering that it has been increasing since the beginning of the second half, when wage increases were granted. In addition, the comparison basis is high, as spending with staff grew, in real terms, by 10.5% in 2009.

After the effects of the economic crisis, spending of states and municipalities is once again on the rise

Spending by all regional governments is estimated to grow by 10.9% in real terms between January and October in relation to the same period the year before. While the Federal Government maintained the 2009 expansionary fiscal policy in 2010, states and municipalities increased their spending rate in relation to the previous year, when expenditures rose by only 0.6%.

For this reason, although the Federal Government's spending is significantly up, the behavior of states and municipalities also contributed decisively toward greater fiscal expansion in 2010.

Economic growth and end of tax exemptions boost public sector's revenues

The Federal Government's net revenue rose by 26.2% in real terms from January to October 2010 as compared to the same period in 2009. However, this growth rate was largely determined by the inflow of R$ 74.8 billion from the onerous assignment of 5 billion petroleum barrels to Petrobras. Without this huge amount of extraordinary revenues, net revenue would have increased by 11.5% in real terms on the same comparison basis.

This 11.5% growth in net revenue can be explained by the effects of the economic growth recovery on the collection of taxes and contributions, whose real growth rates amounted to 9.4% and 12.2%, respectively. In addition, the end of several tax exemptions that were granted 2009 contributed to these results. The 11.8% real increase in INSS collection, which continues to be driven by the formal labor market expansion, also deserves special mention.

Economic growth recovery and the end of tax exemptions granted by the Federal Government also contributed to the increase in states' and municipalities' available revenues. For all regional governments, we estimate a real growth of 10.2% in available revenues in the first eight months of 2010 in relation to the same period in 2009.

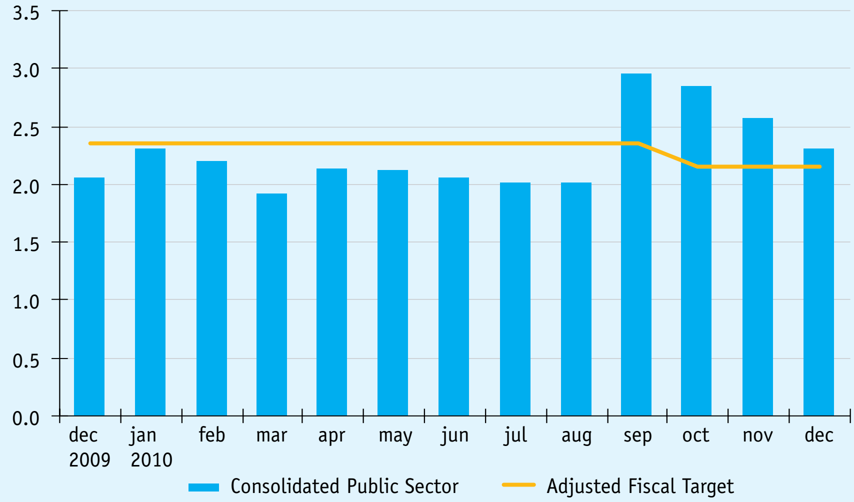
The increased pace of economic activity contributed to a 13.4% real increase in revenues from the Tax on Circulation of Goods (ICMS) and to a growth of 4.4% in transfers from the Federal Government. The latter was also influenced by the end of different exemptions on the Tax on Industrial Products (IPI), which is shared between the Federal Government and states and municipalities.

Petrobras capitalization process and accounting changes allow primary surplus to exceed the target

Evolution of public sector's primary surplus

Accumulated in 12 months in relation to GDP (%)

Only in September, with extraordinary revenues, the primary surplus achieved the adjusted fiscal target



Source: Central Bank - Note: Primary surpluses for November and December 2010 were estimated by CNI. Eletrobras is included between December 2009 and September 2010. Eletrobras is not considered after October 2010.

Because of the positive net balance of the Petrobras capitalization process (R$ 31.9 billion) and of a reduction in the adjusted fiscal target (from 2.35% to 2.15% of GDP) resulting from the removal of Eletrobras from public accounts, the public sector's primary surplus is above the target set for 2010, notwithstanding a significant increase in spending.

In the last 12-month period ending in October, the public sector's primary surplus hit the mark of 2.85% of GDP. In the Federal Government and its state--owned enterprises, the primary result amounted to 2.13% of GDP, against a goal of 1.2% 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 enterprises, the primary surplus for the last 12 months was calculated at 0.72% of GDP, very far from the target of 0.95% of GDP.

Despite a reduction in the growth rate of Federal Government's spending as a result of the inclusion of the last two months of the year, the 12-month accumulated figure for primary surplus is expected to drop significantly. This will happen because the R$ 10 billion in extraordinary revenues collected in November and December 2009 will not be seen this year. The primary surplus of regional governments is likely to grow slightly by the end of the year.

The Federal Government's growth rates of spending and net revenue are expected to keep falling in the last months of 2010. Spending, which had grown by 11.4% until October, is expected to close the year with a 10.5% real growth. Net revenue, which had increased by 26.2% until October if the operation with Petrobras is taken into account, is expected to rise by 19.1% at the end of 2010.

In this scenario, the primary surplus estimated for the Federal Government and its state-owned enterprises stands at 1.55% of GDP, against an adjusted target of 1.2% of GDP. On the other hand, we expect the primary surplus for regional governments and its enterprises to hit the mark of 0.75% of GDP, very far from the target of 0.95% of GDP. Therefore, the public sector primary surplus is likely to amount to 2.3% of GDP in 2010, above the adjusted target of 2.15% of GDP and the 2009 result (2.06% of GDP).

It should be emphasized that, in the absence of extraordinary revenues, the public sector primary surplus in 2010 would amount to 1.4% of GDP, well below the adjusted fiscal target.

For broader fiscal results, the increase in the primary surplus in relation to 2009 and a decrease in the amount of interests paid in relation to GDP will cause the nominal deficit of 3.26% of GDP in 2009 to fall to 2.9% of GDP in 2010. As a result, the public sector's net indebtedness is also expected to drop, with the debt/GDP ratio declining from 43.4% in 2009 to 40.8% in 2010.

Budget bill for 2011 suggests adoption of expansionary fiscal policy

Fiscal policy is once again expected to be expansionary in 2011, overburdening the monetary policy – at least at the federal level, where the Annual Budget Bill (PLOA) contemplates a significant increase in both compulsory and discretionary spending.

Furthermore, the increase in expenditures provided for in the PLOA threatens the achievement of the adjusted fiscal target, which in 2011 will no longer be in relation to GDP and will be expressed in nominal values – R$ 85.9 billion for the public sector.

The risk that the adjusted target will not be achieved arises from the very optimistic estimate of a 5.5% real growth in GDP contained in the PLOA. CNI estimates that real GDP will grow by 4.5% in 2011 and is projecting that the nominal growth in net revenue will be R$ 21.3 billion lower than the one estimated in the PLOA.

With respect to spending, CNI projects a real growth of 6.9% in relation to 2010 – without considering expenditures involved in the Petrobras capitalization process. For this reason, if a significant financial programming is not made for the expenses expected for 2011, Federal Government spending will once again grow above GDP, characterizing a new fiscal expansion next year.

We estimate that a financial programming for expenses in the amount of R$ 19.0 billion needs to be made for the adjusted target to be achieved, as this would reduce the rate of spending growth to a level close to that of real GDP growth and, therefore, the expansionary nature of the fiscal policy.

Considering that the programmable base in the 2011 PLOA stands at about R$ 90.0 billion, we believe that it is feasible to cut expenses by R$ 19.0 billion, thus ensuring the achievement of the adjusted target. For this reason, we expect the primary surplus to amount to at least 2.2% of GDP in 2011.

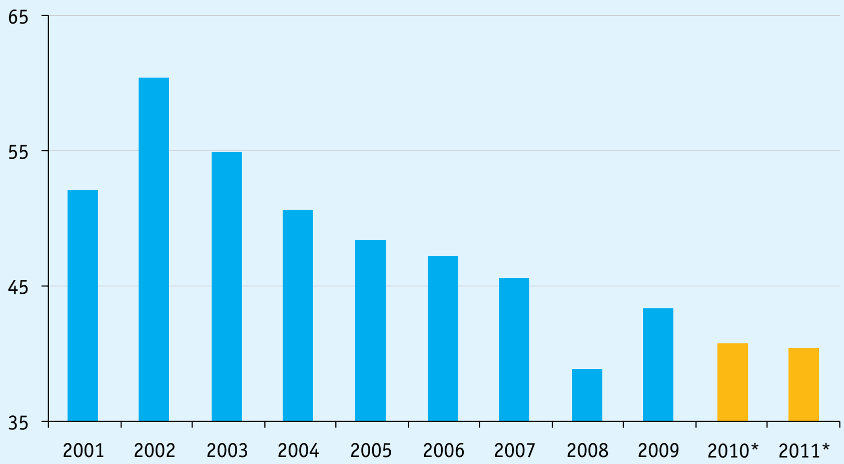
Under this scenario, the nominal deficit is expected to rise to 3.2% of GDP owing to a lower primary surplus in relation to that observed in 2010 and to increased interest expenses. Public debt, in turn, would decrease slightly, with the debt/GDP ratio hitting the mark of 40.4% of GDP.

An alternative scenario could emerge if the Federal Government decided to make the fiscal policy consistent with the monetary policy for the purpose of ensuring an economic growth close to its potential and reducing inflationary pressures. In this case, the Federal Government would promote a financial programming of more than R$ 19.0 billion in the 2011 budget, which would allow spending to grow at a rate below that of GDP.

Path of the public sector net debt

In relation to GDP (%)

After growing by 4.5 p.p. of GDP in 2009, public debt is expected to drop by 2.6 p.p of GDP in 2010



Source: Central Bank

Note: The figures for 2010 and 2011 were estimated by CNI. Eletrobras is not included.

foreign trade sector and exchange rate

Brazilian foreign trade is back to pre-crisis levels

Exchange rate remains appreciated

In 2010, the Brazilian currency experienced an appreciating trend against the dollar – albeit less intensely than in recent years – leading the real to appreciate highly. The R$ / US$ exchange rate appreciated by 2.9% between December 2009 and December 2010 and accumulates a 28% appreciation in comparison with December 2008. The real exchange rate in relation to the currency baskets of Brazil's 13 main trade partners accumulates an appreciation of 25% on the same comparison basis.

Short-term measures were taken to prevent the real from appreciating even more in 2010. These include, mainly, the acquisition by the Central Bank of US$ 46.8 billion in reserves between January and November 2010, totaling US$ 286.4 billion early in December. Government also reinstituted the Tax on Financial Operations (IOF) to foreign investments in fixed-income and increased tax rates.

The measures limited the appreciation of the real, but did little to shift the exchange rate away from its current appreciated level, as the reasons for exchange rate appreciation are still present.

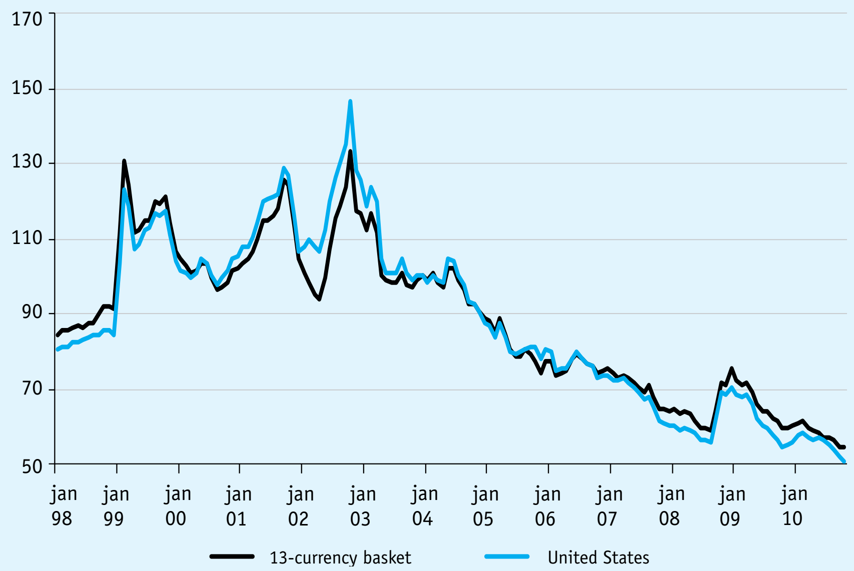
The slow recovery in economic activity in developed countries led to a significant increase in the use of expansionary monetary policies in these countries with a view to curbing the effects of the economic crisis. This practice, however, generates imbalances for different currencies. The United States, in particular, keeps its interest rates down and injects billions of dollars into its economy, leading to an appreciation trend in the US currency.

The significant difference between domestic and international interest rates intensifies the appreciation of the Brazilian currency, which continues to strongly stimulate the inflow of short-term capital into the country. In addition, economic recovery in emerging countries – particularly in Brazil – over the year was more intense than in more developed economies, thus stimulating foreign investments and inflows of foreign currency.

Effective real exchange rate

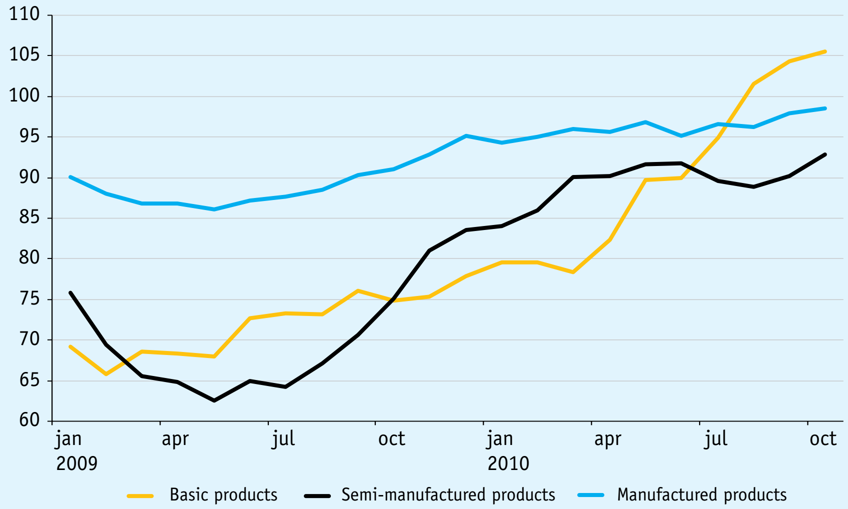
Base-index number Dec/2003 = 100 (Deflator: IPA)

Real is at the most appreciated level since the adoption of floating exchange rates



Source: Funcex

Price indexes for Brazilian exports
Base-index number Sep/2008 = 100
Prices of basic products are above pre-crisis levels



Source: Funcex

Manufactured products lose share in the value of exports

Brazilian exports, which stood at 2007 levels in late 2009, grew by 31% from January to November 2010, totaling US$ 181 billion. The growth rate of sales abroad has been above 30% since August and, for this reason, exports are expected to close the year at about US$ 198 billion.

Due to the growth observed in 2010, the value of exports will return to 2008 levels. However, there are significant differences in the composition of exports, destination countries, prices, and quantities.

Prices were the main driver of the recovery in exported values in 2010. According to Funcex, export prices increased by 20% and exported volumes rose by 8% from January to October 2010.

Export prices are back to 2008 levels. Price indices for total exports have grown steadily since May 2009, when they hit their lowest level after the crisis. Since then, they have accumulated a 35% growth and returned to pre-crisis levels. In October, prices hit their second highest figure in the historical series, falling behind only the figure registered in August 2008.

The prices of basic products deserve special mention. These rose by 28% from January to October 2010 and by 55% between May 2009 and October 2010, when they hit a record high. The prices of semi-manufactured and manufactured products are also close to pre-crisis levels, but still lower.

Exported volumes, in turn, have been on an upward trend since late 2009. It should be stressed, however, that they are still 7% below the average figure for the last 12-month period ending in September 2008, shortly before the outbreak of the crisis. Basic products are the ones that contributed most to this recovery, and are already up by 9% on the same comparison basis. Industrialized products experienced negative growth: drop of 5% in semi-manufactured products and of 19% in manufactured products.

The composition of sales also changed significantly. Basic products, which accounted for 37.1% of Brazilian exports in 2008, represent 44.4% of all exports in 2010. Industrialized products, in turn, are down from 60.3% to 53.6% on the same comparison basis. For the first time in over 30 years, exports of basic products will exceed those of manufactured products in 2010.

Seven of the ten main products exported by Brazil in 2010 consist of basic products, which account for 37.2% of all Brazilian exports. Iron ore alone accounts for 14%. Two of the ten main products are semi-manufactured products and only one (passenger cars, with 2.2%) consists of a manufactured product.

foreign trade sector and exchange rate

There was also a change in destination markets. The United States' share decreased from 14.1% in 2008 to 9.5% in 2010. The share of China, main destination of basic products (29%), rose from 8.5% to 15.6%.

Different factors explain this change in the composition of Brazilian exports. In general, developed countries, major destinations of Brazilian industrialized products, have been recovering at a slow pace. Commodity prices, in turn, remain high as a result of a higher demand. In addition, investors are seeking more profitable assets on account of low international interest rates, which also increases commodity prices.

Brazilian imports grow driven by consumer goods

Brazilian imports kept growing sharply throughout the year. In November, Brazilian imports had totaled US$ 166 billion, a growth of 44% as compared to the same period in 2009. Should this growth rate continue, imports will hit the mark of US$ 183 billion at the end of 2010, up by 6.1% in relation to the figure registered in 2008.

As opposed to exports, the value of Brazilian imports increased almost exclusively due to imported volumes. According to Funcex, while import prices increased by 2% from January to October 2010, imported volumes rose by 40% over the same period.

Import prices are still much below those seen in September 2008, before the international crisis hit for many products: fuels (-33%), intermediate products (-12%), and non-durable consumer goods (-9%). Capital goods increased by only 0.1%, while prices of durables rose by 3%.

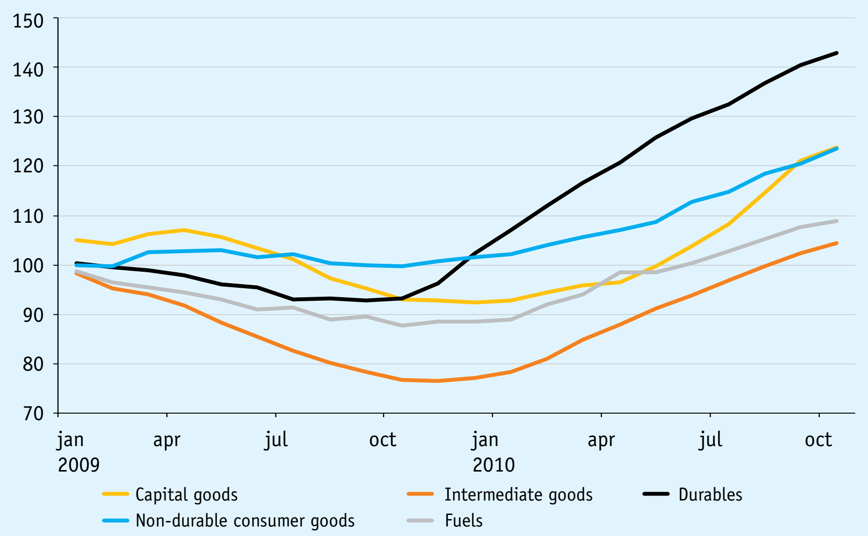
Imported volumes have grown in a widespread and strong fashion since late 2009. Taking into account the 12-month moving average figure, all categories grew from October 2008 to October 2010: durable goods (40%), non-durable consumer goods (23%), capital goods (20%) and, less strongly, fuels (7%) and intermediate products (3%).

The increase in imports is explained by the appreciation of the real, coupled with a strong growth in household consumption. The share of consumer goods in total Brazilian imports rose from 12.9% in 2008 to 17.1% in 2010.

Quantum indices of Brazilian imports

Base-index number Sep/2008 = 100

Imports of all product categories are above pre-crisis volum



Fonte : Funcex

Current account deficit rapidly on the rise

The trade balance accumulated until November 2010 amounted to US$ 14.9 billion, down by 35% in relation to the figure calculated in 2009. The current account deficit is significantly up: deficit of US$ 38.8 billion from January to October 2010 and of US$ 48 billion in

12 months – about 2.4% of GDP. The deficit in services and income also increased rapidly, accounting for 64% of the increase in current account deficits. In the January-October period this year, the negative balance stood at US$ 55.7 billion, a growth of 38% when compared to the same period in 2009. The deficit in international trips and equipment rental rose, respectively, by 92% and 40%.

Foreign trade to consolidate a new profile in 2011

The monetary policies adopted by countries like the United States to stimulate their economies will continue in place in 2011, which will generate an imbalance in exchanges rates. It is very unlikely that the necessary depreciation to reverse exchange-rate pressures on exports and reduce stimulus to imports will occur. If the gap between domestic and international interest rates is not reduced – a very likely scenario –, the exchange rate will not change significantly. CNI believes that the exchange rate will not fluctuate without experiencing a trend of sharp depreciation or appreciation, ending 2011 at about R$ 1.70.

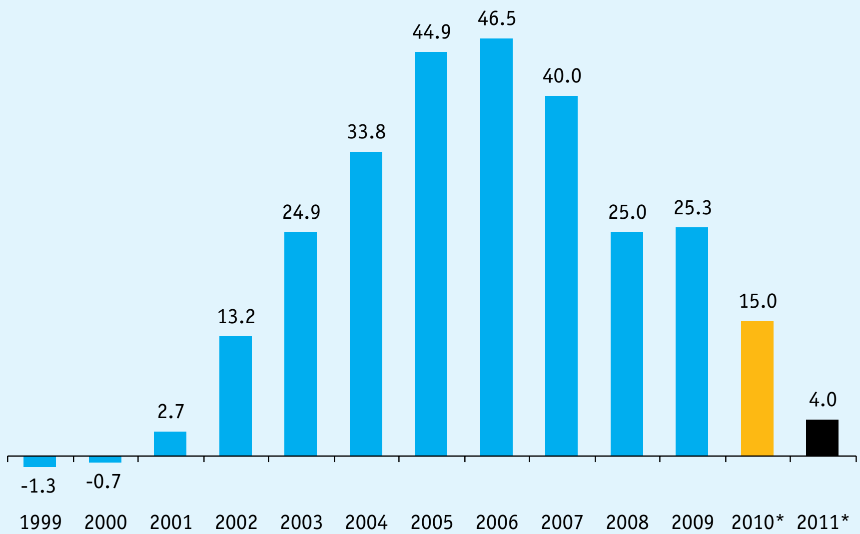
In 2011, the Brazilian economy is once again expected to grow at a rate in excess of that of major developed economies. The fact that the real remains at an appreciated level and household consumption is up will continue to strongly boost imports of consumer goods. Foreign purchases of intermediate and capital goods will also continue to grow, but to a lesser extent. As a result, imports are likely to grow sharply in 2011, totaling US$ 224 billion, an increase of about 22%.

The increase in domestic consumption will probably exceed foreign demand as the main stimulus to economic growth. Despite growing pressures on currencies and the risk of protectionism, the recovery of emerging economies is expected to stimulate Brazilian exports.

It should be emphasized, however, that this stimulus will be more strongly reflected in sales of basic products. For this reason, exports are expected to total US$ 228 billion at the end of 2011, a 15% growth.

Finally, under this scenario, we are expecting to see an increase in the deficit in services and income, which will be only partially made up for by an increase in direct investments. As a result, we estimate that the current account deficit will increase and hit the mark of US$ 70 billion, equivalent to 3% of GDP.

Brazilian trade balance
US$ billion
Trade balance in 2011 will be the lowest in 10 years



* Forecast
Source: Secex

BRAZILIAN ECONOMY OUTLOOK FOR 2010 - 2011

	2008	2009	2010 *estimate*	2011 *projection*
Economic activity				
GDP (annual variation)	5.2%	-0.6%	**7.6%**	**4.5%**
Industrial GDP (annual variation)	4.1%	-6.4%	**10.9%**	**4.5%**
Household consumption (annual variation)	5.7%	4.2%	**7.9%**	**5.1%**
Gross fixed capital formation (annual variation)	13.6%	-10.3%	**24.5%**	**13.5%**
Unemployment rate (annual average - % of the labor force)	9.3%	7.9%	**6.8%**	**6.0%**
Inflation				
Inflation (IPCA - annual variation)	5.9%	4.3%	**5.8%**	**5.0%**
Interest rates				
Nominal interest rates				
(average rate in the year)	12.45%	10.13%	**9.90%**	**11.84%**
(end of year)	13.75%	8.75%	**10.75%**	**12.00%**
Real interest rate (average annual rate and defl: IPCA)	6.4%	5.0%	**4.6%**	**6.3%**
Public accounts*				
Nominal public deficit (% of GDP)	2.06%	3.38%	**2.90%**	**3.20%**
Public primary surplus (% of GDP)	3.45%	2.06%	**2.30%**	**2.20%**
Net public debt (% of GDP)	38.9%	43.4%	**40.8%**	**40.4%**
Exchange rate				
Nominal exchange rate - R$/US$				
(average in December)	2.39	1.75	**1.70**	**1.70**
(average in the year)	1.83	1.99	**1.76**	**1.70**
Foreign trade sector				
Exports (US$ billion)	197.9	153.0	**198.0**	**228.0**
Imports (US$ billion)	173.0	127.6	**183.0**	**224.0**
Trade balance (US$ billion)	25.0	25.3	**15.0**	**4.0**
Current account balance (US$ billion)	-28.2	-24.3	**-50.0**	**-70.0**

* Does not includes enterprises of the Petrobras Group and Eletrobras

BRAZILIAN ECONOMY | Special edition of the 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, Isabel Mendes de Faria Marques, José Luis Gordon, 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, DF - ZIP CODE: 70040-903 www.cni.org.br. | This publication may be copied, provided that the source is mentioned.
Document prepared on December 13, 2010