BRAZILIAN ECONOMY

Special Edition of the Economic Report

ISSN 1676-5486
Year 27 • Number 04 • December 2011 • www.cni.org.br

Change is needed for Brazil to sustain growth

The last strong growth period experienced by the Brazilian economy – the 2004-2008 period, when economic growth in the country exceeded that of the global economy – was led by industry. In the wake of the international economic crisis, this scenario has changed. In 2011, once again Brazil grew less than the world and industry grew less than Brazil: GDP increased by 2.8% and industry by only 1.8%.

The slowdown in advanced economies and the shift in the dynamic axis of the global economy toward Asia reflected negatively on Brazilian industry. This shift caused net demand for Brazilian manufactured products to drop, as Asia is a direct competitor of Brazil in this market. Apart from reducing the share of Brazilian industrial exports in the foreign market, it also increased the entry of foreign products in the Brazilian market.

In this scenario, the prevalence of a macroeconomic equation marked by high interest rates and an overvalued exchange rate, coupled with little progress in removing barriers to enhance competitiveness, is fatal: manufacturing industry grew by only 1.1% in 2011.

For industry to resume its role as dynamic drive of the Brazilian economy and for Brazil to sustain growth rates in excess of the world average, it is of fundamental importance to change our growth strategy and face two challenges. On one hand, measures must be taken to enhance Brazil's competitiveness, so that our industrial products can compete on an equal footing with those produced in Asia. On the other, it is also necessary to change domestic growth patterns and give priority to investments – and not consumption – as the lever of economic growth. In a sustainable growth model, consumption should not be allowed to grow more than GDP.

From the macroeconomic viewpoint, higher investment rates need to be financed by a greater availability of savings. If domestic savings are insufficient, this investment effort will lead to an increasing current-account gap.

Because about 60% of GDP is made up nontradables (goods not traded internationally, such as services) and the natural resource-intensive industry is very competitive, the savings deficit translates into a growing deficit in manufactured goods. An appreciated exchange rate makes this strategy feasible.

Industry needs to grow more than GDP and GDP should grow more than consumption. If the current model is not changed, the Brazilian manufacturing industry will grow little – less than GDP – and its relative share in the economy will continue to decrease. Without having completed its development cycle, Brazil should not run the risk of becoming an early post-industrial economy.

CNI

2011 analysis

Less intense industrial activity slows down GDP growth in 2011

The Brazilian economy experienced a marked slowdown in 2011, closing the year at a growth rate of only 2.8%, much less than the 7.5% rate registered in 2010.

This poor GDP performance was caused by different economic dynamics in the first and second half of the year. In the first six months of the year, monetary policy measures based on higher interest rates and credit restrictions were preponderant factors. These measures led consumer spending to slow down moderately and, as a result, GDP to grow less as compared to the previous year: 3.8% in 2011 against 9.0% in 2010.

In the second half, the decline in consumer spending and the worsening of the crisis abroad further reduced the economic growth pace. The deterioration of business confidence has affected investments, which are now expected to grow by only 4.8% in 2011, against 21.3% in 2010.

This drop in activity was also caused by a decline in exports of manufactured goods throughout the year.

There is no doubt that industry was particularly affected by the adverse external and domestic scenario. A weaker foreign and domestic demand and the increasing penetration of imports in the domestic market due to the currency appreciation led to a sharp slowdown in industrial activity, which is expected to grow by only 1.8% in 2011.

It's important to mention that industrial production and revenues have been following different paths. Due to a reduction in undesired stocks and to a more intense use of imported inputs in production processes as a result of the exchange rate appreciation, industry's revenues have been increasing more than production.

The accumulation of undesired stocks is also reflected in greater idle capacity in the industrial park. Actual-usual capacity utilization shows that industry has been operating with idle capacity since December 2010.

The first half of the year was marked by an exchange rate appreciation trend. This movement was reversed by measures to control the inflow of funds and by a new cycle of interest rate reductions since August. The exchange rate is still highly volatile, reflecting the effects of uncertainties prevailing in the global scenario. The Real-US dollar exchange rate is likely to close 2011 at around R$ 1.79 / US$ 1, according to CNI estimates.

An appreciated Brazilian currency against the US dollar in 2011 in relation to 2010 led to a substantial increase in imports of industrial products, with a heavy impact on purchases abroad: imports are estimated to total US$ 225.1 billion in 2011.

Exports of Brazilian commodities remained on an upward path, exceeding those of manufactured products once again and reducing the share of the latter in exports even more.

Prices played a determinant role in pushing exports up in 2011, which are predicted to end the year at a growth rate of 25% – lower than the one recorded in 2010. As a result, the trade balance in 2011 - US$ 28.8 billion – was higher than the one registered the year before.

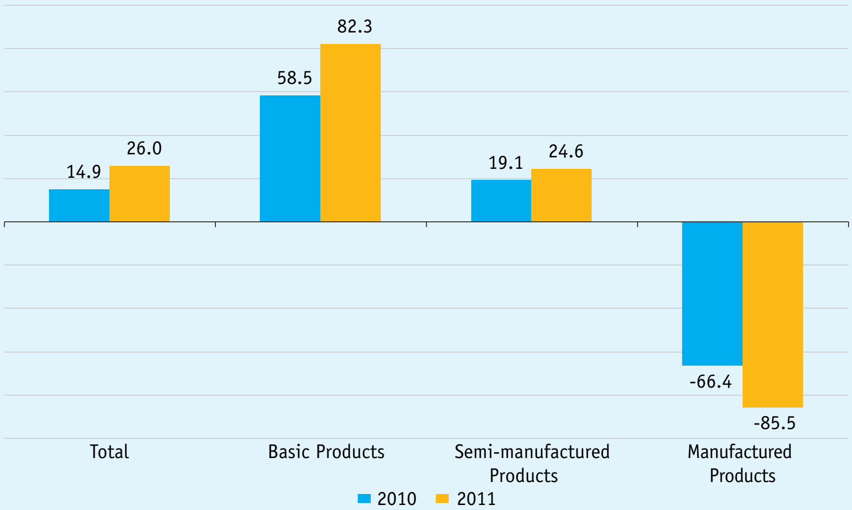
Despite this positive trade balance result, higher service and income deficits had a negative impact on current transactions, which closed the year with a deficit of 2.1% of GDP in the 12-month period ending in October.

Drop in interest rates follows inflation slowdown

Unlike its approach during the 2008 crisis, the Central Bank of Brazil decided to act ahead of the likely effects of its new developments and took expansionary monetary policy measures in the second half of the year. Cuts in interest rates since August led the Selic rate to end the year at 11.00%. Still, this rate is higher than the one registered in December 2010 (10.75%).

Inflation remained above its central target (4.5% p.a.) throughout 2011, but signs of a slowing down were observed in the last months of the year. Food prices kept the inflation rate at a high level once again, causing the IPCA to close 2011 at 6.5%, the target ceiling. This time, however, price hikes were more widespread and were not restricted to food products. Service prices, regulated prices and, to a lesser extent, industrial product prices also contributed to pushing the inflation rate up.

Trade balance by product category (January - November)
In US$ billion
Manufactured products' trade deficit continues to grow



Source: Secex

Fiscal policy contributed to keeping demand under control

The fiscal policy was an important factor in keeping inflation under control and achieving its target in 2011. Unlike the situation in previous years, governments managed to reduce their spending growth rate this year (especially the Federal Government).

On the other hand, a marked increase in revenues was recorded as a function of the economy's lagged effects on tax collection in 2010 and of an increase in consumption and revenue windfalls. The 12.4% real growth in revenues was higher than the one observed in the previous year and much higher than GDP growth.

As a result, the primary surplus target is likely to be exceeded. The primary result of the Federal Government and its state-owned enterprises is projected to more than offset the failure of states and municipalities to achieve the target.

This scenario is very different from the one observed in the previous year, when the target could only be achieved thanks to the inflow of funds resulting from Petrobras' capitalization process.

Notwithstanding this higher primary surplus, the increase in interest spending will push the nominal deficit up. On the other hand, a higher inflation in 2011 will lead the nominal GDP to grow, bringing the debt/GDP ratio down to 39.1%.

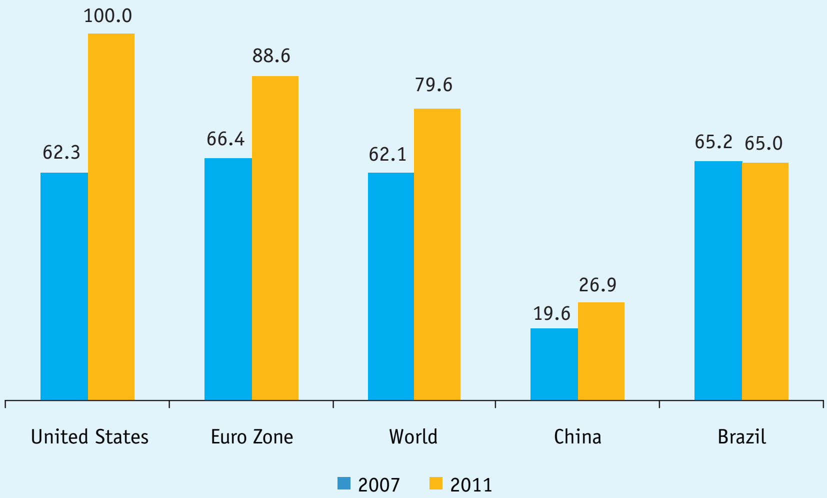
Special topic: new developments of the crisis

Impacts of the global economic slowdown on Brazil

Fears of new effects of the financial crisis are back in 2011. When the crisis first broke out, in 2008, three scenarios were considered. The first one was that its effects in the financial system would have an impact on the real economy for a long time, causing an economic depression similar to that seen in 1930s.

The second one was that these effects would be quickly overcome as a result of an aggressive economic policy response from advanced countries, followed by a period of rapid recovery that would put the economy back on the growth path seen before the crisis ("V" recovery). The third one was that recovery would be possible, but other effects could lead to a new economic slowdown ("W" recovery).

Gross debt to GDP ratio
In (%)
Developed countries' debt has grown substantially with the crisis



Source: World Economic Outlook – IMF (Sept. 2011)
Prepared by: CNI

Three years after the crisis broke out in 2008 (with the bankruptcy of Lehmann Brothers in September 2008), the first scenario, of a prolonged depression, was discarded. The crisis reached its peak in 2009, when the GDP of developed economies shrunk and the growth pace in emerging countries slowed down.

Recovery followed in 2010. Brazil, whose growth rate had decreased by 0.3% in 2009, grew by 7.5% in the following year. The Euro Zone went from a 4.3% retraction in 2009 to a 1.8% growth in 2010. The US also experienced a positive recovery from a 3.5% drop in its GDP to a 3% increase. The economies of India and China slowed down in 2009, but not to the point of bringing about a recession, and resumed growth more intensely in 2010.

The second scenario can be discarded as well. Despite the strong recovery observed in different countries in 2010, the risk of new effects of the crisis on economic activity is no longer a possibility, but rather a fact. The IMF's forecasts for Brazil and the US are that their economies will grow by 50% of the rate registered in 2010. The Euro Zone and China will also grow less, especially in 2012. The world GDP increased by 5.1% in 2010 and will slow down to 4% in 2011.

Thus, growth is not likely to be resumed, making the third scenario the most plausible one. Discussions are now centered on the intensity of this new phase of the crisis (in terms of economic slowdown and of how long it will last) and on measures to be taken to mitigate its effects.

Rising debt hinders fiscal policy in developed countries

The problems faced in global financial markets and in the world economy in 2011 should not be seen as a new fact unrelated to the 2008 crisis. Actually, most of these effects resulted from policies adopted worldwide to mitigate the effects of the crisis and the impact of the ensuing economic downturn on government revenue.

Since the crisis emerged in 2008 due to a liquidity crisis, the measures adopted to deal with it largely consisted in expansionary fiscal and monetary policies. The US and the Euro Zone issued currency to lend liquidity to the market and sustain the population's purchasing power. In addition, they further reduced their interest rates, cutting them down to near zero.

These measures made credit available in these countries once again, but led to a new problem, which began to materialize in 2011: their incapacity to pay off a rising public debt. So the crisis today is one a fiscal nature entailing sovereign risks. The US gross debt amounted to 62.3% of GDP in 2007. Four years later, this percentage is predicted to exceed 100% in 2011. According to IMF forecasts, this percentage will continue to increase steadily, rising to 115.4% in 2016.

The Euro Zone debt totaled 66.4% of GDP in 2007 and rose to 88.6% in 2011. The IMF predicts the debt/GDP ratio to increase until 2013 (exceeding 90% of GDP) and then decrease soon after that year.

Doubts about the capacity of countries to repay such a high debt are evident, particularly in Europe. High debt rates and the unfeasibility of reducing interest rates any further jeopardized the fiscal and monetary policies of the Euro Zone. For this reason, some of these countries were forced to resort to the IMF to continue to repay their debts.

The financial market quickly reflected the loss of confidence in sustained growth. The volatility of stock markets worldwide has increased considerably since September, mainly as a result of actions taken by European financial institutions holding government bonds of countries facing more serious difficulties (such as Greece).

This situation has two negative effects on economic activity. The first one is related to credibility. A likely default situation has been inhibiting foreign investment in debtor countries, restricting the availability of credit, shortening repayment periods, reducing private consumption, and forcing enterprises to review their production plans. The slowdown in GDP growth is a mere reflection of this scenario.

The second one relates to the requirements imposed on countries for having access to IMF funds. The Fund imposes many restrictions on public spending to make sure borrowing countries will be able to repay their loans. Specific targets are set for each borrowing country, and these usually require a huge fiscal effort and restrict even more the power of their governments to adopt their own fiscal and monetary policies. This change has direct impacts on public and private consumption and contributes to economic slowdown.

Recent actions to restore stability in the Euro Zone are positive. They contribute to fiscal consolidation and redefine parameters for the indebtedness of different countries. They are also likely to grant more powers to the European Central Bank to make funds available to countries facing greater difficulties to roll their debt over.

Still, the outlook for the next few years is bleak, as economic recovery depends on the ability of these countries to make the required fiscal adjustments. It is highly unlikely that this will be a quick process. Measures of this kind usually involve long-term austerity plans with year-on-year restrictive targets which dilute negative effects on GDP in the short term, but prolong economic stagnation. What happened to the Japanese economy in the 1990s may happen in the Euro Zone, which could experience a decade of close-to-zero growth.

Special topic: new developments of the crisis

Entrepreneurs see uncertain economic scenario in 2012

In Brazil, industrialists believe that new developments of the crisis will also impact the Brazilian economy. According to CNI's Special Survey - Global Economic Scenario, carried out in October 2011, most entrepreneurs believe that the global scenario is uncertain and risky for their companies right now.

Among the entrepreneurs who see the current economic scenario as uncertain, 45% believe that this negative scenario will prevail at least until the end of 2012. In addition, almost one-third of the respondents believe that this scenario will get worse over the next few months.

Clearly, Brazil is not free from the effects of the deterioration observed in Europe. The very perception of entrepreneurs of an economic scenario in turmoil affects their expectations, which may lead them to revise their consumption and investment plans.

In fact, evidence of the impacts of the crisis on Brazil can be observed already. Brazilian exports slowed down as a result of a downturn in international demand. These effects are being more strongly felt in manufacturing industry, which experienced a decline in production in the last three months.

This situation will make it more difficult for Brazil to resume growth. The impact of the first effects of the 2008 crisis on GDP changed the growth dynamics experienced by Brazil earlier in the decade. From 2004 to 2008, the country grew at an average 4.8% per annum, above the global average of 4.6%. For comparison purposes, it should be mentioned that advanced countries grew by only 2.3% a year over the same period.

This 0.3% drop in 2009 distanced Brazil's GDP from its trend, i.e. from the GDP that the country would have if it had continued to grow at pre-2008 rates. After growing by 7.5% in 2010, GDP virtually resumed its high-growth trend. However, as the crisis unfolds and considering CNI's new estimates for economic growth in 2011 and 2012, GDP will once again move away from its previous path. The Brazilian economy will grow less than the world average in 2012.

The positive aspect is that, overall, Brazil seems to be better prepared to mitigate the effects of the crisis now than back in 2008. There's clearly room for economic policy actions, such as further reductions in the Selic rate. In addition, the country's public debt has been decreasing (as a proportion of GDP).

However, the problem of a high inflation must be taken into account. The situation requires a countercyclical combination of fiscal and monetary policies, but with the necessary austerity and in line with the inflation target regime. The example of a protracted fiscal crisis in Europe reveals a risk we cannot take.

GDP Growth

Yearly percentage

Slower pace of growth in Brazil in the post-crisis

	2004/2008	2009/2011*	2012*
China	11.6%	9.7%	9.0%
Emerging Countries	7.6%	5.5%	6.1%
World	4.6%	2.8%	4.0%
Brazil	**4.8%**	**3.2%**	**3.0%**
United States	2.1%	0.3%	1.8%
Euro Zone	2.1%	-0.3%	1.1%

Source: World Economic Outlook – IMF (Sept. 2011) - * Forecasts for 2011 and 2012: CNI (Brazil) and IMF (other countries)
Prepared by: CNI

OUTLOOK FOR 2012

Modest growth scenario expected to continue in 2012

New guidelines set for monetary policy, in combination with a more expansionary fiscal policy as of next year, are expected to sustain economic growth in Brazil in 2012 in an international crisis scenario that is unlikely to worsen any further.

GDP will grow by only 3.0% in 2012. Industry will grow less once again: CNI projects industrial GDP to grow from 1.8% in 2011 to 2.3% in 2012.

Domestic consumption will be the main driver of economic growth, as it is expected to increase by 4% and contribute 2.6 percentage points to GDP growth. This is the result of the combination between a minimum wage increase, less stringent currency controls, and higher public spending.

Conversely, however, the international credit market is expected to retract and the labor market to lose momentum. Investments will also increase rather moderately next year, by only 5%, contributing little to GDP growth.

Industry will recover slightly in 2012. The measures to boost industry implemented in late 2011 will produce some effects, but these will be insufficient to leverage growth at a higher rate. We will continue to have an overvalued exchange rate and to face competitiveness problems, leading domestic demand to leak to imports.

Since the external environment will remain favorable to Brazilian exports of manufactured goods, the contribution of external demand will be negative by 0.6 percentage points, a similar figure to that seen in 2011.

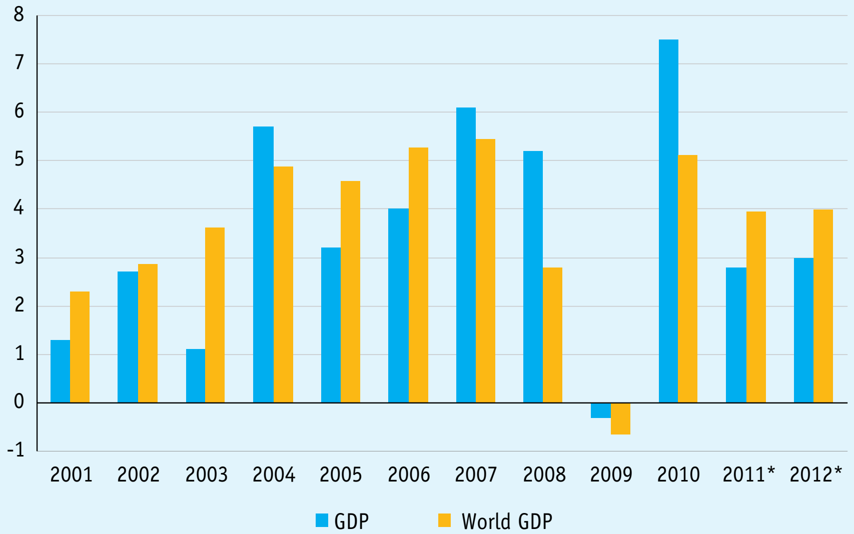
We expect to see two additional cuts in the benchmark interest rate early next year. As a result, CNI predicts the Selic rate to close 2012 at 10.00% p.a., with an average real interest rate of 4.4%.

This drop will reduce the difference between domestic and foreign interest rates, creating a disincentive to foreign capital inflow. We therefore estimate the exchange rate to end 2012 at an annual average of R$ 1.80 / US$ 1, but with variations throughout the year.

GDP and World GDP

Variation against the previous year

Brazilian GDP will grow less that world GDP for two years in a row



Source: IBGE and IMF
* CNI (Brazil) and IMF (world) estimates

perspectivas 2012

Exports will continue to consist mainly of basic commodities, closing 2012 at a lower growth pace and hitting the mark of US$ 275.4 billion.

Imports are also expected to slow down in 2012, due to the weak economic activity. But foreign purchases are likely to increase at a faster pace than exports, ending the year at US$ 254.6 billion. CNI estimates the trade balance to close 2012 at US$ 20.8 billion.

Finally, the current account gap will be close to that observed in 2011, despite an expected reduction in foreign direct investment in Brazil next year due to the turbulent environment abroad. We expect a deficit of US$ 56 billion, or 2.1% of GDP, in 2012.

Inflation closer to the center of the target

Inflation will slow down in 2012. Due to the economic slowdown – and changes in the IPCA index weighting structure – we expect to see a 5.2% inflation in 2012.

Food and service prices will remain above the upper band of the target, pressing the index up once again. Despite the inertial character of regulated prices, they are expected to exert less pressure on the IPCA index than in 2011, because of the General Price Index downturn this year.

As in 2011, industrial product prices will continue to contribute to a lower inflation in 2012. This result is also partly due to the new IPCA weighting structure, as a result of which more weight will be given to these products than to those of other groups.

Expansionary fiscal policy will be adopted

Fiscal policy is likely to be strongly expansionary in 2012. Apart from the fact that the Annual Budget Bill (PLOA) provides for a significant increase in mandatory government spending, the federal administration will be less strict in its discretionary spending in order to stimulate economic activity.

If it decides to achieve its primary surplus target without deducting investments contemplated in the Growth Acceleration Plan (PAC), the federal government will make provision for a R$ 40.0-billion financial programming in the PLOA.

Less spending with interest payments will lower the nominal deficit to 2.6% of GDP. A lower nominal deficit and GDP growth in 2012 will result in a decline in the debt/GDP ratio to 38.6% of GDP, against 39.1% in 2011.

Implications of the European crisis getting worse

The government has tried to stay ahead of the effects of the crisis in the Euro Zone. Clear efforts are being made to deal with the economic downturn through measures to stimulate activity in specific areas. However, the ones taken so far don't consider the possibility of a rupture in the European Union, which would lead to a much more serious fiscal crisis in the bloc. On the contrary, fiscal consolidation and specific actions by the European Central Bank are expected to avoid such a scenario.

However, such rupture cannot be entirely ruled out. Should it occur, the possible default of a country could cause a new systemic banking crisis. Brazil would be deeply affected by such a scenario. Its effects, particularly on international liquidity and credit flows, would cause a sharp currency devaluation and economic instability. The result would be a similar situation to that observed in 2008, with a downturn in exports, consumption, production, and employment.

In this scenario, GDP would grow much less. It would require more aggressive economic policy responses to sustain demand, preferably involving strict actions in the monetary policy arena.

economic activity

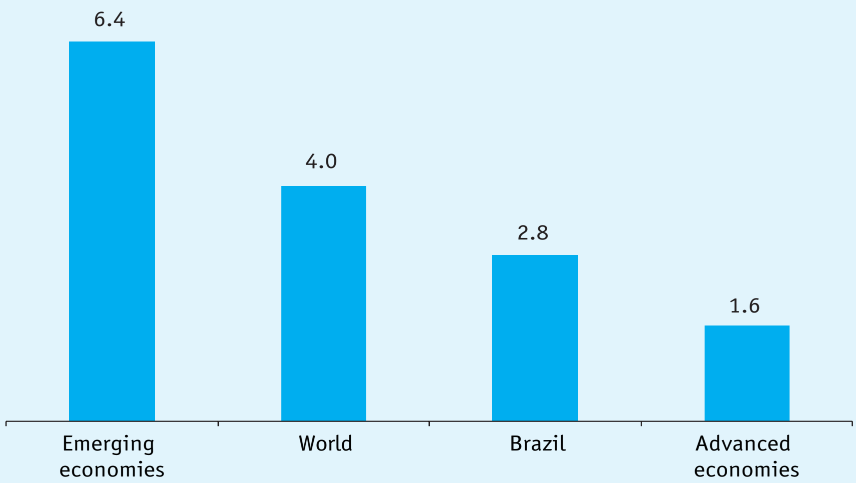
GDP growing below global average once again

After growing by 7.5% in 2010, the Brazilian economy is likely to grow by only 2.8% in 2011. This performance is below the average observed in the global economy, which is predicted to grow by 4.0% according to IMF estimates. With this performance, Brazil is far from the average GDP growth recorded in emerging economies in 2011 (6.4%).

Estimated GDP growth in 2011

Percentage variation against the year before

Brazilian GDP grows less than emerging economies



Source: IMF and CNI

The GDP growth pace lost momentum over the year and declined to its lowest level in the third quarter, with zero growth in relation to the previous quarter. During the first three quarters of 2011, GDP grew at a rate of 3.2% as compared to the same period the year before.

Two factors led to this result: difficulties faced in the global economy and domestic demand slowdown.

As the economic situation abroad got worse, especially in the second half of the year, the Brazilian economy suffered negative impacts, affecting business confidence. The recession experienced by some economies in Europe and the difficulties faced by the US economy led to a decrease in Brazilian exports to those markets.

Restrictive monetary policy measures taken in the first half of the year – such as higher interest rates and credit restrictions – have led to a slowdown in domestic demand (both for consumption and investment) intense enough to interrupt its growth in the third quarter.

Household consumption, which had been increasing for 10 consecutive quarters in relation to the previous quarter, dropped by 0.1% in the third quarter of 2011 in relation to the previous one; investments, as measured by gross fixed capital formation, which had been on the rise for nine quarters in a row, decreased by 0.2%; government consumption also decreased by 0.7% over the same period. As a result of the less intense effects of domestic demand as a growth pillar, the contribution of the foreign sector to GDP growth was positive between July and September 2011. This was an unusual result in relation to what had been observed in previous quarters.

Considering four-quarter accumulated figures, all demand components slowed down during 2011, consolidating a low-growth scenario.

On the supply side, the decline in activity affected manufacturing industry more intensely – it decreased by 1.4% in the third quarter as compared to the previous one. All other industry

economic activity

categories posted growth on the same comparison basis, but the service GDP also declined, suggesting a scenario of economic stagnation.

The cumulative expansion rate of the service industry in four quarters as compared to the previous four-quarter period dropped from 5.7% in the third quarter of 2010 to 3.6% in the third quarter of 2011. Agriculture/livestock growth dropped from 6.3% to 2.7%, while industry experienced a decline in its growth rate from 10.5% to 2.9%.

The slowdown in economic activity led to a shift in the monetary policy path in Brazil. The Central Bank reversed the path of interest rates (which had been on the rise until then) in August of this year and reduced the Selic rate by 0.5 percentage points thrice. Credit constraints have been eased and the government also took measures to stimulate demand and cut down taxes. However, the effects of these measures have not been felt in the real economy so far, so their positive impacts will only become more apparent in 2012.

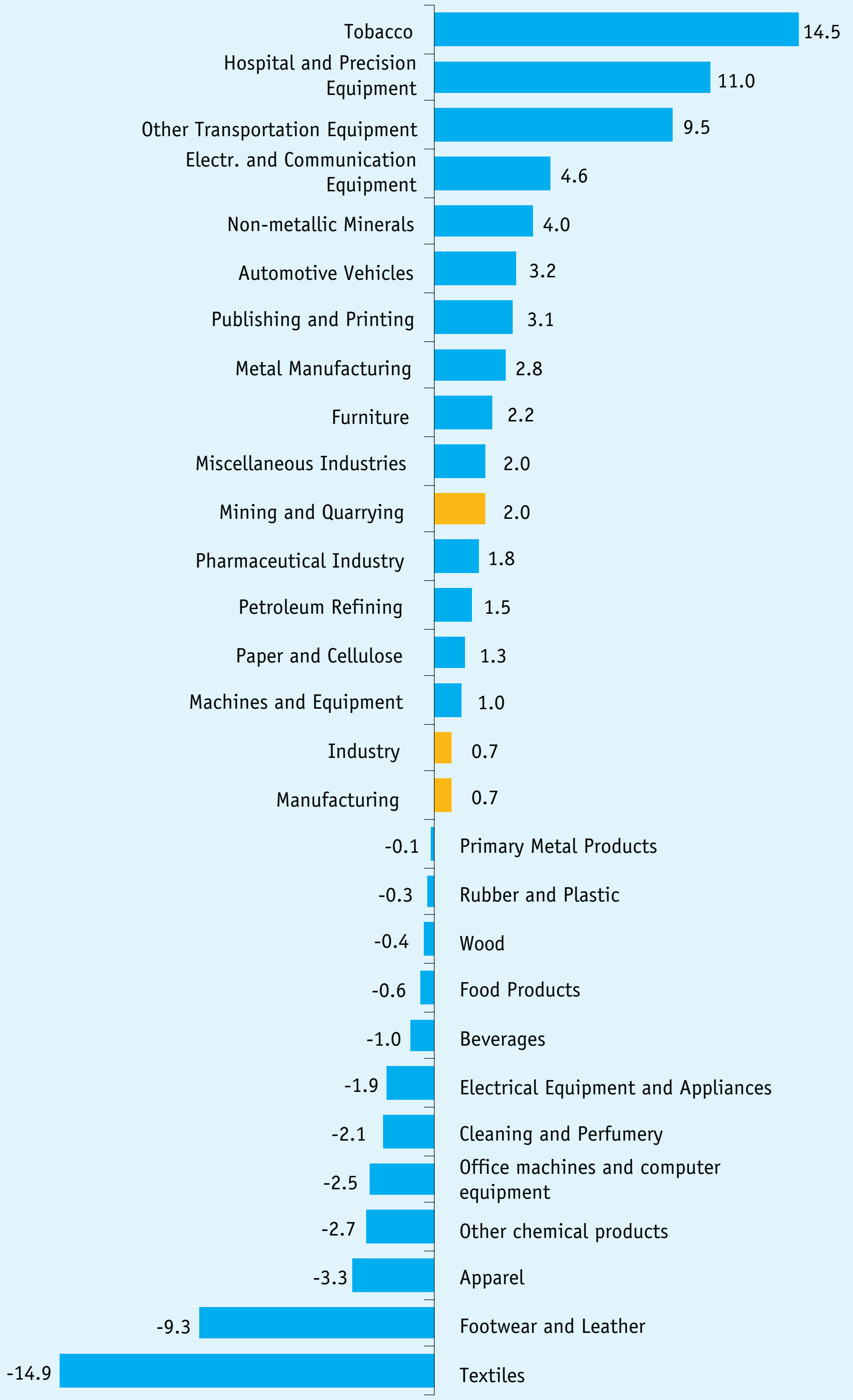
Industry finds it difficult to react

Industry was the most affected sector by the unfolding of the crisis. The continued appreciation of the domestic currency is forcing it to face a double challenge. In the foreign market – affected by a weak global demand

Industry's sectoral production

Variation in the January-October 2011 accumulated average against the same period in the previous year

16 sectors grow at a slower pace than that of industrial GDP



Source: IBGE

– industry faces strong competition due to the relatively expensive price of its products. In the domestic market, it faces an invasion of imported products, which has led domestic demand to shift an increasing share of its purchases to imports.

The industrial sector's loss of competitiveness is the result of a country burdened by high production costs for years. Industry uses much more expensive labor as compared to that of other countries. The wages of Brazilian industrial workers in US dollars increased by 16.2% from January to October 2011 as compared to the same period the year before, while industrial wages rose by only 1.9% in the US over the same period. A high tax load puts a heavy financial burden on enterprises, high electricity costs make production more expensive, rising interest rates discourage investments, and too much red tape affects the business environment.

In the first ten months of 2011, industrial production grew by only 0.7% (PIM-PF/IBGE) in relation to the same period in the previous year.

Brazilian industry grew less this year than that of the US (2.3% on the same comparison basis), a country facing greater difficulties to tackle the negative impacts of the crisis.

In October 2011, industrial production in Brazil was 3.5% below pre-crisis levels (September 2008). What this means is that even after 37 months, industry has failed to keep production above its previous peak. In the United States, industrial production has already surpassed the levels observed in September 2008 by 2.9%.

Other industrial activity indicators confirm a scenario of stagnation. Stocks remained above planned levels in almost every month this year (CNI Industrial Survey). In October, the indicator for actual-planned stocks rose to 53.4 points (figures above 50 indicate stocks at higher-than-desired levels).

The undesired accumulation of stocks increases idle capacity in industry. There were clear signs of a downward trend in capacity utilization over the year, especially in the second half. In October, the seasonally adjusted indicator hit the mark of 81.4% (CNI Industrial Indicators) as a result of its fifth consecutive drop. In fact, the actual-usual capacity utilization index for the month (CNI Industrial Survey) shows that industry has been operating below usual capacity since December 2010.

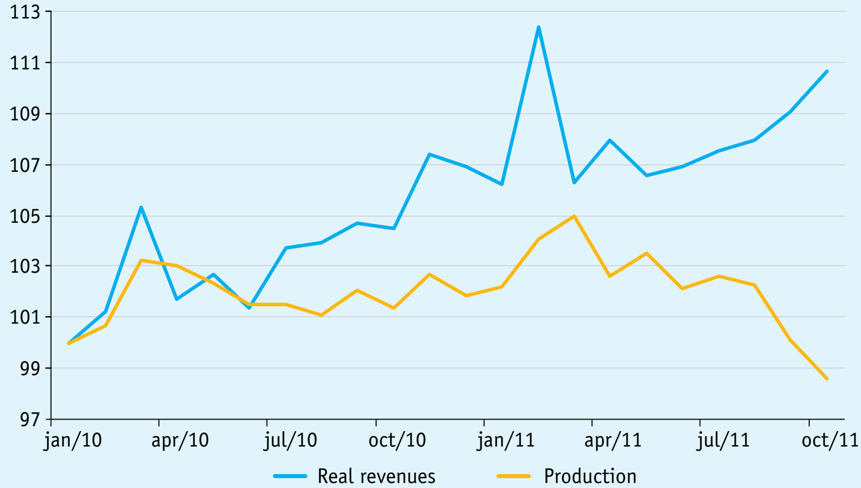
While industry has stagnated in average, industrial production broken down by sectors has been heterogeneous.

In the year's accumulated figure up to October, the performance of 16 of the 26 sectors surveyed by the Brazilian Institute for Geography and Statistics (PIM-PF) was below the performance of the industrial GDP over the same period. Production is down in some sectors. Among the 12 sectors with a decline in production, two had the worst performance: the Textiles (down by 14.9%) and the Footwear and leather (-9.3%) sectors. On the opposite extreme, three sectors had a remarkable performance: the

Manufacturing industry's real revenues and production

January 2010 index figure = seasonally adjusted

Curves getting further apart as a result of a reduction in undesired stocks and a higher share of imported goods per production unit



Source: CNI and IBGE

economic activity

GDP estimate for 2011

Percentage variation and contribution of GDP components

	GDP components	2011 Growth Rate (%)	2011 Contribution (p.p.)
Demand side	Household consumption	4.2	2.5
	Government consumption	2.0	0.4
	Gross fixed capital formation	4.8	0.9
	Exports	4.5	0.5
	(-) Imports	8.5	-1.0
Supply side	Agriculture/livestock	3.5	0.2
	Industry	1.8	0.5
	Mining and quarrying	2.2	0.1
	Manufacturing	1.1	0.2
	Construction industry	3.0	0.2
	Public industrial services	2.9	0.1
	Services	3.0	2.0
	GDP	**2.8**	

Prepared by: CNI

Tobacco (growth of 14.5%), Hospital and Precision Equipment (11.0%), and Other Transportation Equipment (9.5%) sectors.

Real revenues on a different path than that of manufacturing activity

Despite a scenario of moderate industrial activity, the real revenues of manufacturing industry have been on a path of its own. An increase in revenues led this indicator to follow a different path than that of industrial production. Lower undesired stocks and a higher share of imported products per production unit explain this phenomenon.

With stocks on the rise, industry needs to sell stock surpluses before stepping up production once again. An appreciated real has been boosting purchases of imported raw materials in the industrial production process. As a result, intermediate-good industries have been losing market share to international competitors, pushing industrial production down.

GDP expected to grow little in the last quarter of 2011

After remaining stagnant in the third quarter, GDP is expected to resume its growth process in the last quarter of 2011. Its slow growth pace, of around 0.4% as compared to the previous quarter, will result in an annual growth rate of 2.8%. It will grow much less than expected earlier this year (4.5%).

The service industry, affected by a slowdown in the third quarter, will resume growth, providing a positive contribution to GDP growth. Because a tax exemption granted to white goods has made it possible to reduce the prices of these products already, there will be a surge in retail sales.

The difficulties faced by industry to grow will still be present in the fourth quarter. In October, industrial production dropped by 0.5% against the previous month and sectoral indicators suggest that industry's performance in November will be weak.

Outlook

In 2012, GDP is predicted to grow at a similar pace to that seen in 2011

In the wake of a slow economic upturn, GDP will be on the rise early next year. A minimum wage increase coupled with measures to boost consumption will drive household consumption up – a trend that will gain momentum over the year. However, there are limitations to the greater dynamism of domestic consumption: the positive contribution of the labor market is no longer the same. Employment will increase at a slower pace, as well as the availability of credit, leading household consumption to grow by 4.0%.

Investments will also respond to this scenario. The expected 5.0% growth was based on a scenario of falling interest rates and still high inflation, resulting in very low real interest rates for Brazilian standards. Government will adopt an expansionary fiscal policy, in line with the monetary policy, increasing its spending by 2.2%, which will also boost the economy somewhat.

On the supply side, industry will face the same challenges as in 2011. The Brazilian currency is predicted to devaluate against the dollar, but not much. It will remain appreciated, keeping the import penetration coefficient on the rise. Stock levels are expected to be adjusted over the year, starting in the first half, and industrial production is thus predicted to become more dynamic in the second half of the year and to increase by 2.3% in 2012.

The unfavorable external environment will continue next year. It is more likely to get worse than better. At best, the Euro Zone will remain stagnant, but recession in the region is still likely. The effects of the unwinding of the fiscal crisis will be felt for some time in that zone, making it difficult for growth to be resumed in it.

The US economy will continue to grow little, so progress in the global economy will depend on emerging economies primarily.

In this scenario, CNI expects exports to grow little (2.5%) and imports to increase at a higher pace (6.9%), with the foreign sector contributing -0.6 percentage points to GDP. As in 2011, the service industry will be the engine of economic growth in 2012, accounting for nearly 75% of the 3.0% GDP growth predicted to occur in that year.

GDP estimate for 2012

Percentage variation and contribution of GDP components

		2012	
	GDP components	Growth Rate (%)	Contribution (p.p.)
Demand side	Household consumption	4.0	2.4
	Government consumption	2.2	0.5
	Gross fixed capital formation	5.0	0.9
	Exports	2.5	0.3
	(-) Imports	6.9	-0.9
Supply side	Agriculture/livestock	3.0	0.2
	Industry	2.3	0.6
	Mining and quarrying	2.5	0.1
	Manufacturing	1.8	0.3
	Construction industry	3.0	0.2
	Public industrial services	3.0	0.1
	Services	3.3	2.2
	GDP	**3.0**	

Prepared by: CNI

employment and wages

Less jobs available in the labor market

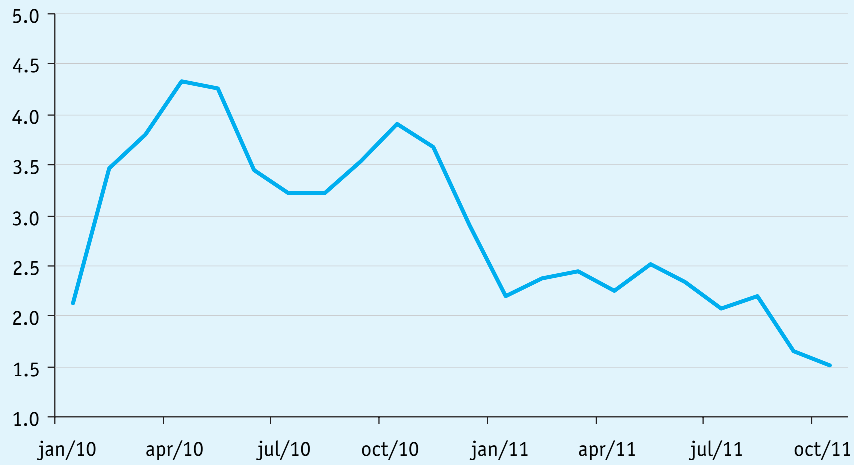
The year 2011 was marked by a loss of momentum in the labor market. The real income of workers in metropolitan areas, however, continued to increase significantly, which coupled with an increase in formal employment boosted household consumption.

The effects of the economic slowdown are being felt in the labor market already. Metropolitan employment (PME/IBGE) grew by 2.2% on average from January to October 2011 in relation to the same period the year before. This rate is well below that recorded in 2010 (3.5%). Job creation in the six largest metropolitan areas in Brazil lost momentum during the year. In October, employment grew by only 1.5% as compared with the same month in the previous year.

Employment in metropolitan areas

Variation against the same month the year before

Occupation growth rate has been slowing down since the second quarter of 2010



Source: IBGE

Employment in industry slows down in a heterogeneous fashion

Employment in industry (CNI Industrial Indicators) has also been following the same trend, with marked variations in dynamics across activity sectors. Comparing the average in the first 10 months of 2011 to that in the same period last year, growth was observed in most sectors.

While on the one hand sectors such as Automotive vehicles (7.3%), Machinery and equipment (5.6%) and Other transportation equipment (5.3%) stood out for a marked increase in employment, on the other hand the pace of hiring in some sectors was much less intense. An exception was observed in the Wood sector, in which employment decreased by 5.3% over the same period.

Formal employment in metropolitan areas is still on the rise at a pace above that of total occupation, as informal employment has been dropping steadily in the annual comparison since September 2010. Formality in the metropolitan labor market – as measured by the sum of registered workers, military and civil servants divided by total occupation – continued on the rise. In October, this indicator hit its highest mark (61.2%) in the PME/IBGE series initiated in March 2002.

employment and wages

CAGED/MTE data point to the same loss of momentum: lower growth in formal employment rates. In October, formal employment increased by 1.5 million in the 12-month accumulated figure. This figure is well below the more than 2 million formal jobs registered almost throughout 2010.

However, certain phenomena are still present in the labor market. Albeit less intensely, employment continues to grow at a faster pace than that of the economically active population (EAP). The labor force grew by 1.2% in October as compared to the same month the year before, while the occupation rate increased by 1.5%. It should be noted that the difference between the employment and labor force growth rates has been decreasing.

Unemployment rate drops less intensely

The unemployment rate has been dropping not only as a result of rising employment, but also due to the fact that less people are looking for a job. This trend, which has been observed since August 2007, is becoming less intense. As the difference between the labor force and occupation growth rates decreases, unemployment will drop less. This is a natural trend, since the unemployment rate has hit historically low levels.

Higher consumer income keeps consumption up

The average real income measured in Brazil's six largest metropolitan areas continued to increase in the first ten months of 2011. In the average between January and October 2011, the average real income grew by 2.9% against the same period the year before.

Wage negotiations in the first half of 2011 (Dieese) continued to be very positive. Of the 353 wage negotiations held in the first six months of 2011, 84% resulted in salary increases above inflation as measured by the INPC/IBGE index.

Outlook

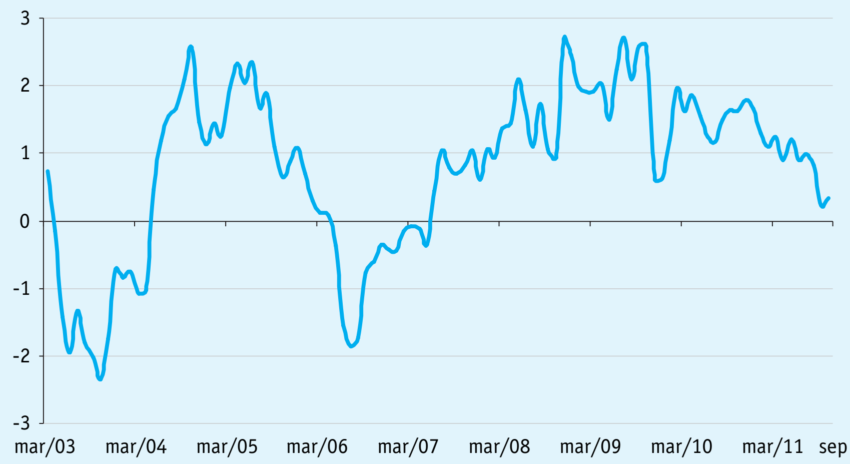
Lower unemployment rate, but with less jobs being created

In 2012, CNI believes that the unemployment rate will drop to 5.8% and that real income will remain on the rise, as a result of which domestic consumption will continue to be the main engine of economic growth. Employment will continue to increase, albeit less intensely, due to the weak economic activity. The service sector will be the one that will contribute most to a rising occupation rate, as it will grow faster than other economic sectors.

Occupation-labor force annual growth rate differential

In (%)

Employment rate decreases as a result of a less intense labor force growth



Source: IBGE - Prepared by: CNI

inflation, interest rates and credit

Inflation is once again a problem in 2011

In 2011, inflation took an upturn and hit the upper limit of its target (6.5%). The official inflation index (IPCA) started 2011 on an upward path and remained above its central target (4.5%) throughout the year, as well as above its target ceiling (6.5%) since April. The 12-month accumulated IPCA reached its peak in September, when it rose to 7.31%. Since then, it has been falling, hitting the mark of 6.64% in November.

Inflation on the rise was observed in all four IPCA groups. This situation differs from other periods of increased pressure on prices, such as the one recorded in 2008, when food price hikes were the only factor pushing inflation up.

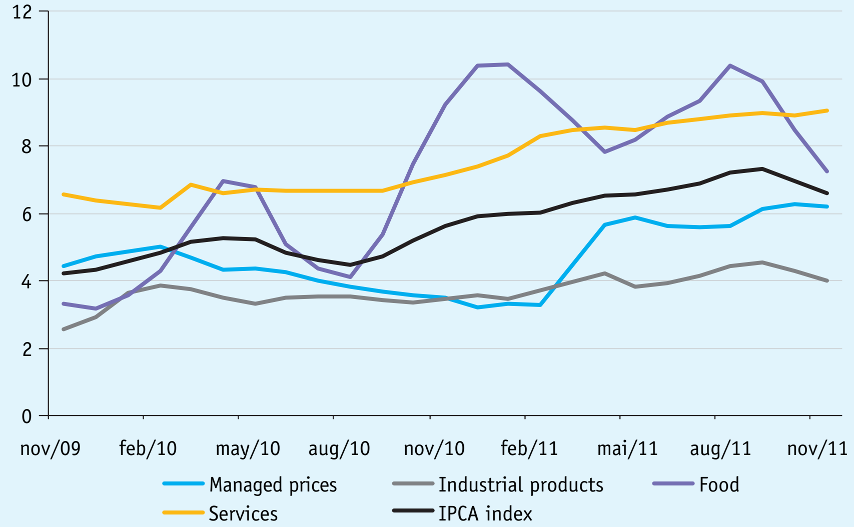
As noted in recent years, prices were highly volatile in 2011. In the 12-month accumulated figure, the rate for this group began the year at 10.4% (January) and was the main source of pressure on the IPCA index. As a comparison, the rate was only 3.6% in January 2010. The rising inflation for this group did not hold, although food prices remained high throughout the year (12-month accumulated rate ranging from 8% to 10%).

In the last months of 2011, especially since October, food price hikes slowed down mainly due to more pronounced problems in the international arena, which pushed commodity prices down somewhat. Thus, because the high monthly hikes recorded for the group (upwards of 2%) late in 2010 were replaced by milder ones in 2011, the 12-month accumulated rate is likely to close December at the lowest percentage in the year, namely, at 6-7%.

IPCA per groups

12-month accumulated figures (%)

Food prices increase less intensely at year's end



Source: IBGE - Prepared by: CNI

Industrial product prices are the ones that contributed least to pushing the IPCA index up. Prices for this group also increased in 2011, from a 12-month accumulated percentage of 3.5% in January to 4.5% in September. Nevertheless, the more pressing problems observed in the international scenario affected demand for industrial products and, as a result, their prices will close the year on a downward path, with a 12-month accumulated rate below 4%.

Managed prices, to which high indexation rates were applied, increased above average throughout the year. Price indices reached a 12-month record high (above 10%, as observed in the IGP-M) in 2010 and played a major role in pushing managed prices up. The 12-month accumulated figure for this group, which was only 3.3% in January, peaked to more than 6% in October.

Inflation in services showed an upward trend, reflecting a strong domestic demand throughout 2011. The 12-month index for service prices began 2011 at more than 7% and continued to rise throughout the year at a faster pace (peaking to 9% in November, the main factor that kept the IPCA index above its central target).

Despite the high levels of monitored and service prices, the IPCA index is predicted to remain at the upper limit of its target in 2011. The price hikes observed in these two groups will be offset by a slowdown in food prices and by industrial product prices remaining at low levels.

This means that the scenario at the end of year will be different than that seen in 2010. The fact that the sharply rising inflation rates observed late last year were replaced by milder ones late in 2011 will lead the IPCA index to end the year on the upper band of the target (6.5%), contradicting the prevailing projection of 5.0% early in the year.

Copom takes early measures to deal with the effects of the crisis

The measures taken by Copom in 2011 revealed two distinct approaches. The first one consisted in a cycle of interest rate hikes ending in July, from 10.75% p.a. in January to 12.50% p.a. The second one, from August onwards, resumed a downward cycle, reducing the rate to 11.00% p.a.

Inflation on the rise earlier this year raised concerns that the target would not be achieved. As domestic inflation took a sharp upturn, Copom considered it necessary to raise the benchmark rate in order to curb demand and reduce money supply in the economy. This decision guided the first five Copom meetings in 2011.

However, the worsening situation in the international scenario led the committee to set a new direction to the monetary policy. Unlike what happened during the 2008 crisis, when the committee was late to adjust the monetary policy to deal with the negative effects of the crisis in Brazil, in 2011 the Central Bank decided to take early measures to address these effects. In August (at the meeting following the last decision to raise interest rates), it began to lower the Selic rate until it reached its current level of 11.00% p.a.

From the standpoint of inflation, the reductions in the Selic rate did not prevent the target from being achieved in 2011. As in 2008, the current crisis has deflationary effects. Food prices are the main factor pushing inflation down, as they have been rising at substantially lower rates. In addition, the adoption of macro-prudential measures until the first half of the year also contributed to removing the excessive weight of the monetary policy, paving the way for reductions in the Selic rate.

As a result, it will close 2011 at 11.00% p.a., still above the level registered at the end of 2010. With inflation at 6.5%, CNI estimates that the real interest rate will average 4.8% in 2011.

Loans to individuals slow down during the year

Credit began the year on the rise, as a result of a set of measures adopted during the 2008-2009 crisis that were still effective. Later, it went through a downturn, when those measures were discontinued.

Earlier this year, there were signs of recovery of loans to corporations, which had been the most affected by liquidity restrictions brought about by the 2008 crisis. Loans to individuals rose more sharply, hitting the mark of a 22% increase in February (average in the last 12-month period against the previous 12 months). On the same comparison basis, corporate credit rose by 9.6% in the same month.

A worsening inflation outlook in the first months of the year led the Government to adopt macro-prudential measures to prevent credit from being granted without adequate controls. The main measure was to increase the IOF (tax on financial operations) for individuals, which had been reduced to 1.5% a year during the crisis and raised to 3% p.a. in April.

Such measures were intended to increase credit costs for borrowers

inflation, interest rates and credit

(and reduce the profits of investors in the financial market) without raising the Selic rate. This was an effective measure to restrict credit to individuals, which dropped to 13.9% in October (average in the last 12-month period against the previous 12 months). Loans to corporations, which were not affected by a higher IOF, continued to increase at rates ranging from 8% to 9%.

The rate of interest on credit charged by financial institutions kept pace with the macro-prudential measures. The average interest rate for loans to individuals peaked to 47% in October (against 43.8% p.a. in January) as a result of the increase in the IOF tax. Interest rates for loans to corporations, in turn, varied little throughout the year, from 29.3% p.a. in January to 29.8% p.a. in October.

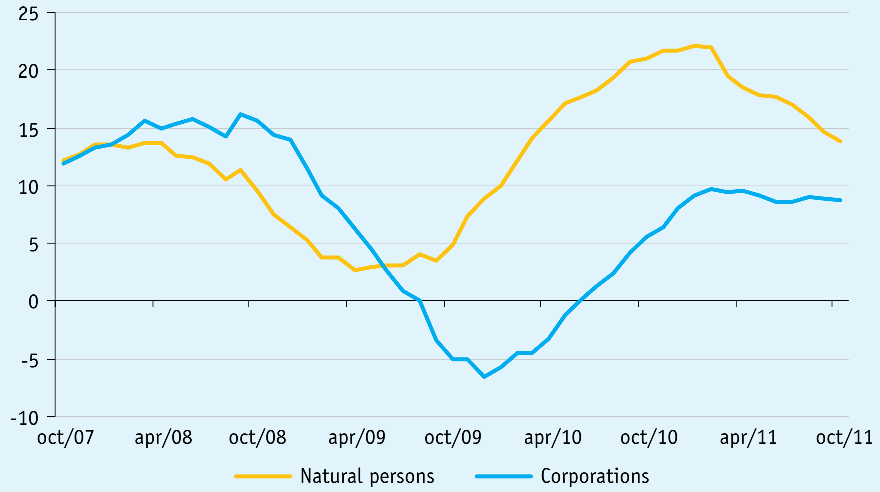
However, the fact that the Government took early measures to deal with the negative effects of new developments of the crisis, coupled with a slowdown in inflationary pressures late in the year, paved the way for a new set of measures that were taken in November and December. The main one was reducing the IOF tax on loans to individuals from 3% to 2.5% p.a. (a level still above the one registered at the peak of the 2008-2009 crisis).

These measures were intended to stimulate the granting of credit by reducing its costs to borrowers, so as to keep domestic demand for goods at the same level. Under this scenario, credit to individuals is projected to take an upturn in 2012 and credit to corporations to be little affected. Their impact on interest rates is uncertain, as it will depend on liquidity conditions in the banking system both in the domestic financial market and abroad.

Credit with non-earmarked resources granted to individuals and corporations

Average in the last 12-month period against the preceding 12 months (%)

Clear credit downturn in loans to individuals



Source: Central Bank of Brazil
Prepared by: CNI

Outlook

New weights applied to the IPCA index are projected to contribute to reducing inflation in 2012

A new IPCA scenario is expected in 2012. Inflation in 2012 will be marked by three key aspects: (i) the impacts of new developments of the global crisis, (ii) the pass-on of adjustments already agreed upon, and (iii) the new IPCA weighting structure, based on the 2008-2009 Household Budget Survey (POF).

New developments of the 2008-2009 crisis tend to reduce inflationary pressures in Brazil. The downturn in international demand is expected to put less pressure on international commodity prices, apart from leading part of what Brazil would otherwise export to be absorbed by the domestic market.

On the other hand, wage and price increases scheduled for 2012 are predicted to push inflation up, especially minimum wage adjustments. The raise in the minimum wage (of about 14%) will increase the population's purchasing power, offsetting the effects of the crisis slowdown but also generating cost pressures, particularly in the service industry.

The new IPCA weighting, announced in November 2011, will begin to be applied in January 2012. The IPCA index used to be based on the 2002-2003 Household Budget Survey and its weighting structure was about 29% for managed prices, 25% for services, 23% for food items, and 23% for industrial products.

With the new Household Budget Survey, this weighting structure was significantly changed. The highest weighting increase was that applied to industrial products, which will now account for 29% of the IPCA. The item that contributed most to this increase was that of automotive vehicles (both new and used), whose share in the IPCA more than doubled (to 6.7% of the total).

The weight of all other groups decreased. Managed prices dropped to 27%, food prices to 22%, and service prices to just over 21%. Service prices were the ones that decreased most, mainly due to the education item (from 7.3% to 4.2%).

This change is expected to push the IPCA index down. Since the 2002-2003 Household Budget Survey was adopted as the base for calculating the index, industrial product prices were the ones with the lowest variation rates. The 12-month cumulative average for these products (June 2007 - November 2011) was 3.3%, against 3.7% for managed prices, 6.7% for services, and 8.6% for food products. Thus, the higher weight of industrial products tends to reduce the IPCA index as a whole.

Inflation in 2012 will be much lower than in the previous year. Managed prices will put less pressure on the IPCA index, mainly due to a slowdown in the IGP (General Price Index) in 2011. Industrial product prices will remain below the center of the target, contributing to a lower IPCA more than any other group. Food and service prices will remain above the upper band of the target, but not to the point of preventing it from being achieved at year's end.

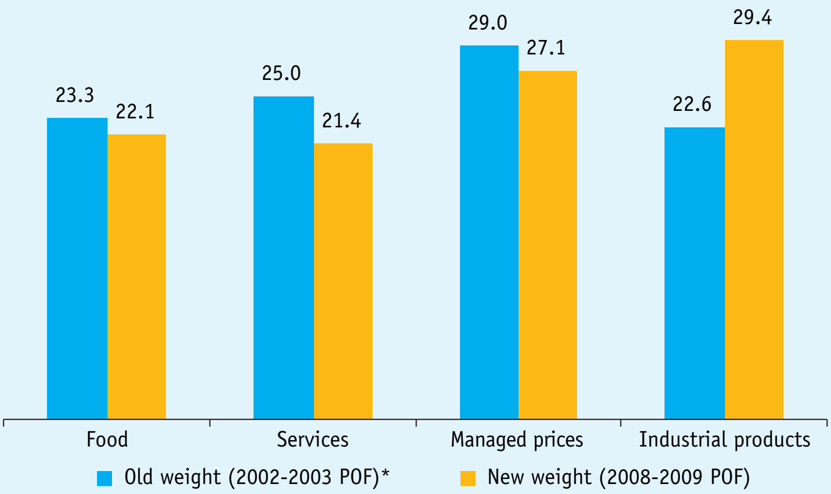
In this scenario, CNI estimates the IPCA index to close 2012 at 5.2%, a much lower percentage than the one recorded in 2011, but still above the central target of 4.5% per year.

This lower inflation scenario is in line with the slower economic growth pace expected for the year. It also takes into account reductions in the Selic rate at the end of 2011 and measures to stimulate credit. The downward trend of the Selic rate is expected to continue, ending 2012 at 10.00% p.a. As a result, the real interest will drop to 4.4% p.a., below the level observed in 2011.

Weight of IPCA groups

Share in the index composition (%)

More weight will be given to industrial products in the IPCA index in 2012



* Reference: November 2011 - Source: IBGE
Prepared by: CNI

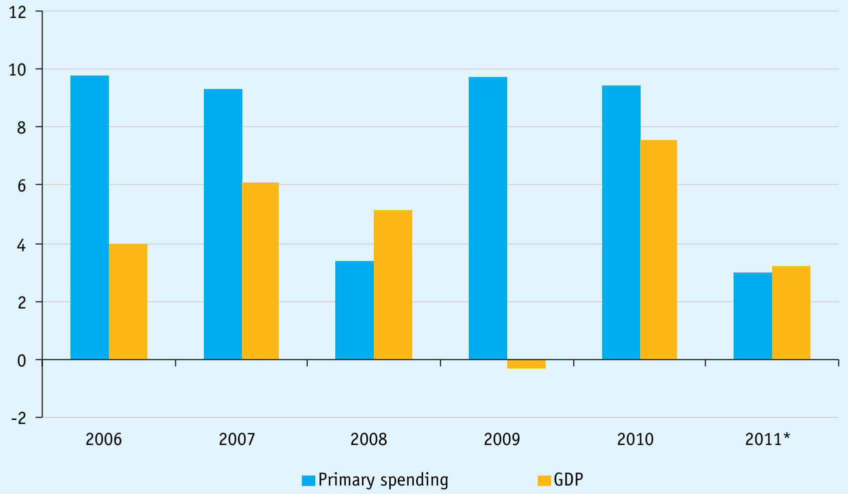
fiscal policy

Less intense increase in public spending contributes to keeping inflation under control

A significant change was made to the fiscal policy in 2011. The Federal Government reduced its spending growth rate significantly as a means to curb demand growth and strengthen monetary policy to control inflation. Spending by states and municipalities also increased at a slower pace than in 2010, and even though it largely exceeded the economic growth rate, it contributed to a more moderate increase in demand.

Federal Government primary spending and GDP growth
In (%)

Primary spending grows less than GDP until the third quarter of 2011



Sources: National Treasury Secretariat - STN/Ministry of Finance – MF - Prepared by: CNI
* Spending: January-October accumulated figure against the same period in 2010.
* GDP: January-September accumulated figure against the same period in 2010.

Apart from a smaller increase in spending, the public sector primary surplus target was more easily achieved as a result of a sharp increase in revenues. This increase was more pronounced in the Federal Government, which relied on substantial revenue windfalls to exceed its primary surplus target and more than offset the failure of regional governments to achieve it.

The fiscal policy scenario will be completely different in 2012, as the Federal Government is expected to resume a strongly expansionary fiscal policy to reduce the economic slowdown. States and municipalities are likely to do the same, as municipal elections will be held and the governors' first year in office will end, at which point spending usually starts to grows less.

Federal Government investments decrease in 2011 in real terms

Federal Government primary spending increased (IPCA deflator) by 3.0% in real terms between January and October 2011 against the same period the year before. It should be noted that this variation excludes extraordinary expenditures of R$ 42.9 billion related to Treasury contributions in the capitalization process of Petrobras in September 2010.

A high rigidity in public spending allows for spending to be curbed to assist in controlling demand growth with great emphasis on investment.

In the first ten months of 2011, Federal Government investments dropped by 9.5% in real terms in relation to the same period in 2010.

Current spending, in turn, had a real increase of 4.0% on the same comparison basis. Controlling such spending is more difficult, as it includes a high percentage of compulsory expenditures and expenses linked to certain revenues or governed by automatic increase rules.

Nevertheless, this real increase in current spending can be seen as a positive factor from the standpoint of using fiscal policy to control inflation. And two factors contributed decisively to this.

The first one was the Federal Government's decision not to grant further wage increases to public servants. As a result, spending with staff rose by only 2.5% between January and October 2011 against the same period in the previous year.

The second factor was that the minimum wage was not raised in real terms in 2011. In this scenario, the minimum wage adjustment rule, which uses real GDP growth in the two preceding years as the basis for real increases in the minimum wage, was instrumental in curbing spending. Because real GDP decreased by 0.3% in 2009, the minimum wage increased less in 2011. This helped to control increases in social security spending and also in some items of current and capital expenditures, such as unemployment insurance, salary bonuses and welfare benefits.

As a result, social security spending increased by 3.5% in real terms between January and October 2011 as compared to the same period in 2010. Current and capital expenses, in turn, had a real increase of 2.6% on the same comparison basis.

Spending of states and municipalities grows less than in 2010

We estimate the spending of all states and municipalities to have increased by 5.9% in real terms between January and September 2011 against the same period the year before. This is a significant reduction as compared to the real growth of 10.5% observed in 2010.

The reasons of this trend observed for regional governments are different than those mentioned for the Federal Government. Without major concerns with macroeconomic control, state and local governments controlled their spending via lower revenue increases and, in the case of the states, through the effect of the electoral calendar. In years of state elections, like 2010, the spending rate tends to increase and then slow down in the following year.

Increase in Federal Government revenues exceeds GDP growth by far

The Federal Government's net revenue increased by 12.4% in real terms between January and October 2011 against the same period in 2010. This increase largely exceeded the economic growth rate in the first three quarters (3.2%) and even the revenue growth recorded in 2010 (9.6%), a year in which GDP grew by 7.5%.

This sharp increase in net revenue can be explained by lagged effects of the economy's performance in 2010 on tax collection, by a higher consumption and total earnings, and by revenue windfalls.

The positive economic moment experienced in 2010 translated into higher corporate profits and a higher collection of income tax and of the Social Contribution on Net Income (CSLL) in the first two quarters of 2011. The higher consumption rate observed in 2011, in turn, led to a significant increase in revenues from the PIS (Social Integration Program benefits)/ COFINS (Contribution to Social Security Financing) and the Tax on Industrial Products (IPI). The increase in total earnings had a positive impact on social security contributions and on the Personal Income Tax.

Finally, special mention should be made of revenue windfalls of R$ 5.8 billion resulting from the waiver of legal disputes around the collection of CSLL contributions and of R$ 14.4 billion from instalment payments of debts in arrears under Law 11,941/09 (crisis REFIS - Tax Recovery Program).

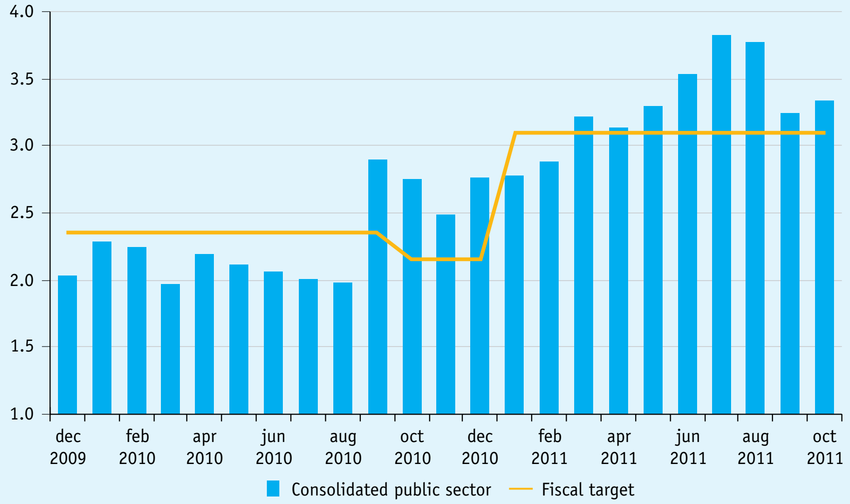
A significant increase in federal tax revenues shared with states and municipalities was the main factor leading to an estimated real growth of fiscal policy

7.8% in regional government revenues. Federal government transfers to these governments increased by 15.7% between January and September 2011 in relation to the same period in 2010. On the other hand, the revenue from the ICMS (turnover tax) rose by only 4.2% on the same comparison basis.

Evolution of the public sector primary surplus

12-month accumulated figures (% of GDP)

Revenue windfalls and control on spending made it possible for primary surplus to exceed its target



Source: Central Bank

Public sector primary surplus above its target

With growth in spending under control and revenue windfalls for the Federal Government, the public sector primary surplus will exceed the target set for 2011. For this purpose, the Federal Government will have to make up for the failure of regional governments and their enterprises to achieve their target.

In the 12-month period up till October, the public sector primary surplus amounted to R$ 133.6 billion (3.3% of GDP). The Federal Government primary result was R$ 102.4 billion, while the surplus of regional governments amounted to R$ 31.2 billion.

The primary surplus is predicted to decrease slightly until the end of 2011, as the expenditures of the Federal Government will increase at a faster pace. After increasing by only 3.0% until October, federal spending will close the year with a net increase of 4.1%. In addition, the increase in net revenues is expected to continue to lose momentum and to drop from the current 12.4% to 11.7% at the end of the year.

We therefore estimate the primary surplus of the federal government and its state-owned enterprises to hit the mark of R$ 99.7 billion against a target of R$ 91.8 billion. The surplus of regional governments and their enterprises is in turn expected to end the year at a level close to that seen in the 12-month period ending in October, at R$ 32.4 billion, below the R$ 36.1 billion target.

In this scenario, the public sector primary surplus is predicted to amount to R$ 132.1 billion (3.25% of the CNI-estimated GDP), against a target that was increased by R$ 10.0 billion during the year to R$ 127.9 billion (3.1% of GDP).

As a result, the primary surplus in 2011 is projected to exceed that recorded in 2010 (2.8% of GDP). However, the increase observed in interest spending – from 5.3% to 6.0% of GDP – will cause the nominal deficit to grow from 2.55% of GDP in 2010 to 2.75% of GDP in 2011. Despite a higher nominal deficit, the rising inflation will cause the nominal GDP to grow more and the public sector net debt to decrease, leading the debt/GDP ratio to decrease from 40.2% in 2010 to 39.1% in 2011.

Outlook

Budget and economic slowdown suggest fiscal expansion

The strongly expansionary stance of fiscal policy that was interrupted in 2011 will likely be seen again in 2012. Besides the fact that the Annual Budget Bill (PLOA) contemplates significant growth in mandatory spending, the Federal Government will probably be less rigorous in the execution of discretionary expenditures in order to boost economic activity, which is showing signs of slowdown.

With respect to mandatory spending, the greatest pressure for increasing expenditures will come from the 7.5% real increase in the minimum wage in 2012. As a result, social security expenditures are expected to grow by 6.1% in real terms, compared to only 3.7% in 2011. Other expenditure components, such as unemployment insurance, special salary raises, and social security benefits, will likely behave in a similar fashion.

As regards discretionary spending, the PLOA provides for a marked 8.4% real growth in 2012. Nevertheless, if the Federal Government is to achieve the primary surplus target without discounting investment expenditures, it will need to create a R$ 40.0-billion financial programming, which would reduce this expansionary trend.

The need for creating such a significant financial programming derives from the real GDP growth forecast of 5.0% contained in the PLOA. CNI estimates that real GDP will grow by only 3.0% in real terms in 2012 and that net revenue will fall R$ 29.0 billion below that estimated by the PLOA, with a real increase of only 2.4% as compared to 2011. In addition, some expenses will be probably higher than the ones estimated in the PLOA, such as those related to minimum wage, whose expected value has already been changed by the Executive Branch.

We believe the Federal Government will make provision for a financial programming of about R$ 40.0 billion, which would allow for the fiscal target to be achieved without adjustments, since the budget programmable base is expected to remain at about R$ 100.0 billion and the figure is close to the initial financial programming made in 2011. For this reason, CNI expects expenditures to rise by 10.2% in real terms in 2012 in relation to 2011 and the Federal Government's primary surplus to stand at 2.2% of GDP.

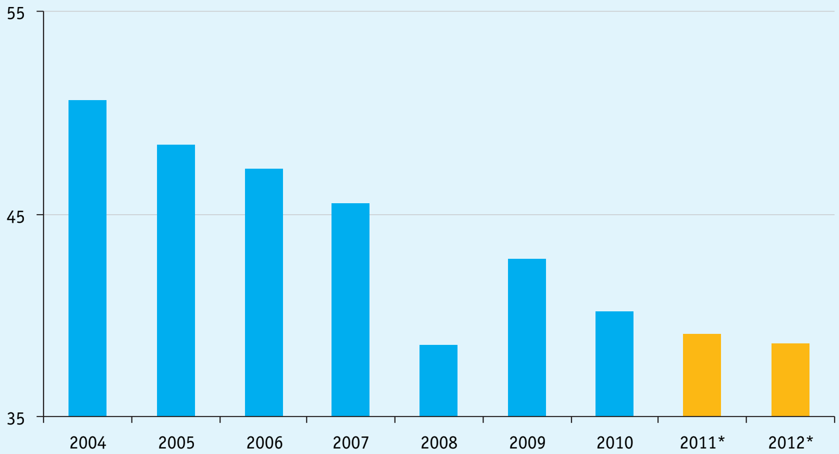
Again, states and municipalities are not likely to achieve their primary surplus target of 0.9% of GDP. Apart from not having achieved this level in recent years, regional governments are expected to speed up their spending growth rate on account of the upcoming municipal elections. As we expect to see a primary surplus of 0.8% for these entities, we project that the positive primary result will amount to 3.0% of GDP for the public sector in 2012.

Under this scenario, the nominal deficit would shrink to 2.6% of GDP, particularly owing to the drop of 0.4 percentage points of GDP in interest expenses. With a lower nominal deficit, the public debt would fall slightly, with the debt-GDP ratio hitting the mark of 38.6% of GDP.

Trajectory of the Public Sector Net Debt in relation to GDP

In relation to GDP (%)

Public debt is predicted to decrease for the second year in a row and accumulate a reduction of 3.7 p.p. of GDP



Source: Central Bank

Note: The figures for 2011 and 2012 were estimated by CNI.

foreign trade sector and exchange rate

Prices of basic products set the pace for the evolution of exports

Exchange rate remains volatile on a slight downward trend

The Brazilian currency had been on an appreciating trend until September 2011, hitting its lowest rate in more than a decade in July. To prevent the exchange rate from appreciating further, some measures were taken by the Federal Government. However, the first actions proved incapable of reversing or interrupting the appreciation. All they did was reduce the currency's momentum.

In September, the worsening in the foreign scenario and shifts in the Brazilian monetary policy brought about a rapid change in the exchange rate scenario. Cuts to the Selic interest rate reduced the difference between domestic and foreign interest rates, thereby reducing incentives for the inflow of foreign currencies and, consequently, interrupting the upward trend in the Brazilian currency.

Since then, the Real/dollar exchange rate has been volatile, but with a tendency to depreciate. Between late September and the first week of December, the Real/dollar exchange rate depreciated by 2.1%. This scenario will not change significantly by the end of the year, meaning that the average rate for December will stand at about R$ 1.79/US$ and the annual average at R$ 1.67/US$.

Prices of basic products account for increased exports

By November, exports had totaled US$ 233.9 billion, up by 29% in relation to November 2010. The growth rate is expected to remain at about 25%, and thus exports will likely close 2011 at US$ 253.9 billion.

Exports of basic products are still the most dynamic ones: up by 39% in the January-November period on a year-on-year basis. Sales of semi-manufactured products rose by 30%, while those of manufactured goods grew by only 17%.

As a result, manufactured goods continue to lose share in the list of exported products. From January to November, manufactured goods accounted for only 35.8% of all exported products, compared to 39.5% in 2010 and 60.7% in 2000. The share of basic goods, in turn, hit the mark

Evolution of the Real/US Dollar exchange rate

PTAX closing rates

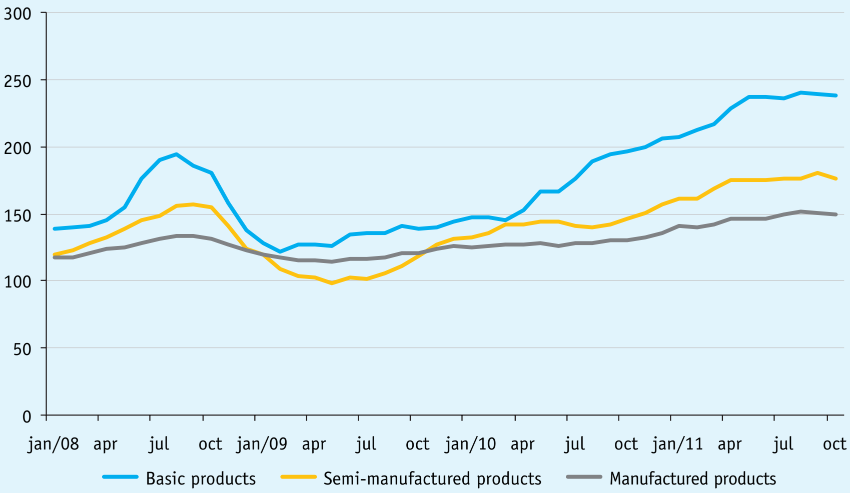
Real depreciates again

Source: Central Bank

Price indices for Brazilian exports per product category

September 2008 = 100

Prices of basic products recorded strong increase in 2011 and stability in recent months



Source: Funcex

of 47.9% in 2011, against 44.4% in 2010 and 23.4% in 2000.

It is also worth noting that much of the growth in export values is determined by price gains and not by increases in shipped volumes. Between January and October, export prices grew by 25.5%, while export volumes rose by a mere 3.5%. Price increases accounted for 88% of the growth in export values in 2011 (until November).

The difference between price and volume gains can be seen for all use categories, particularly for basic goods: while prices are up by 36.2%, volumes grew by only 2.9%. Gains in commodity prices accounted for 42% of the growth in exports, i.e. US$ 22.2 billion.

One in five industrial products consumed in Brazil is imported

Imports totaled US$ 207.9 billion in November – up by 25.2% as compared to the same period in 2010. In recent months, the year-on-year increase has been more moderate, which will likely cause imports to total US$ 225.1 billion at the end of 2011.

Price gains and increases in import volumes are both responsible for a significant share of the growth in import values. While import prices rose by 15%, import volumes are up by 10%.

In November, fuel imports experienced the highest year-on-year growth rate in 2011: 41.7%. It should be stressed, however, that the rise in import prices was almost exclusively responsible for the increase in import value of this use category. Until October, FUNCEX (Foreign Trade Study Center Foundation) had registered an increase of 39.9% in prices and of only 1.3% in its import volume.

The fact that the exchange rate remains at an appreciated level and household consumption is growing continues to simulate imports of consumer goods. In the January-November period, the import value of consumer durables rose by 36.9% in comparison to 2010, while that of non-durables increased by 27.3% on the same comparison basis. The growth was observed mainly in import volumes of these goods: 27.8% for durables and 17.5% for non-durables in the figure accumulated up to October.

It can also be seen that a significant share of investments is being allocated to the purchase of imported capital goods. The value of imports rose by 19.0% by November; by October, prices recorded a 4.2% growth, while import volumes increased by 13.1%.

Since manufacturing activity has not kept up with this pace, imports of intermediate goods have also grown less. Import values increased by 20.6% until November, but prices account for over half of this growth (up by 13.2% until October).

foreign trade sector and exchange rate

A new study carried out jointly by CNI and FUNCEX shows that the share of imported products in domestic consumption of industrial goods (known as import penetration rate) stood at 21.5% in the third quarter of this year. This is to say that over one-fifth of total consumption has been met by imports. And this share is expected to increase by the end of 2011.

Surplus of basic products sustains trade balance

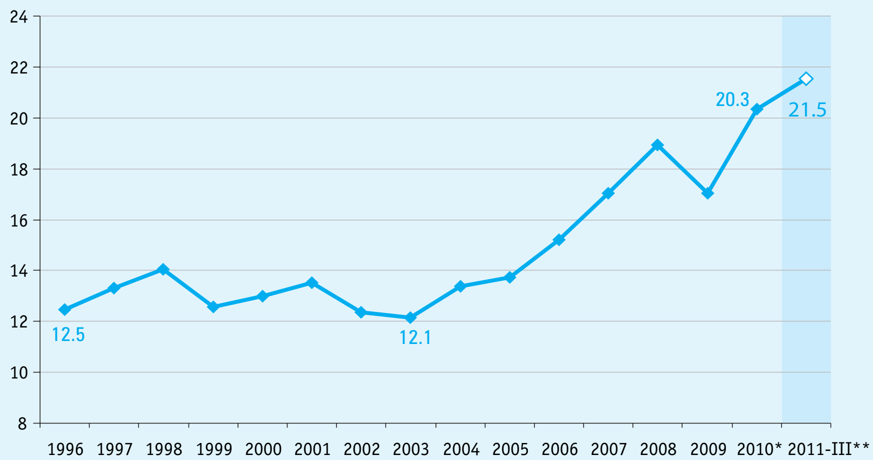
The trade balance totaled U$ 25.9 billion by November, a 74.3% increase in relation to the figure accumulated in the same period in 2010. Month after month, the Brazilian trade balance exceeded the figure registered in 2010, causing the 12-month accumulated figure to remain on an uptrend throughout 2011.

The increase in the trade surplus in 2011 was made possible mainly by the positive and growing foreign trade balances in basic products. The balance in basic goods totaled US$ 82.2 billion (a 40.7% increase in relation to 2010), while the one in semi-manufactured products stood at US$ 25.5 billion (up by 28.6%). On the other hand, manufactured products recorded a US$ 85.5 billion deficit in the January-November period, up by 28.9% as compared to 2010.

Import penetration ratio

2007 constant prices (%)

Share of imported goods in the Brazilian market is on the rise



Source: CNI
* Estimate
** Four-quarter accumulated figure until the third quarter of 2011

Current account deficit no longer on the rise

Throughout the year, the growing trade balance offset the increased deficit in services and income, which led the 12-month current account deficit to rise slowly in the first half and only reverse this trend at the end of the year. In the 12-month period ending in October, the current account deficit totaled US$ 47.3 billion, equivalent to 2.1% of GDP.

The deficit in service and income accounts rose by 19.7% in the first ten months of 2011 as compared to the same period in 2010. Expenditures on international travel, equipment rent, and transportation have pushed this deficit up for some time. Spending limits imposed on these accounts made it easier for them to be controlled at the end of 2011. By August, the deficit had grown by 24% on a year-on-year basis.

Outlook

Scenario to remain unfavorable for the export of manufactured products

So far, the effects of the European crisis and the slow recovery of the US economy in Brazil are less intense than those observed right after the collapse of Lehman Brothers in 2008.

Based on the assumption that the crisis will not worsen further, the exchange rate will not remain above R$ 1.85/US$ and R$ 1.75/US$ for a long time, meaning that the annual average would stand at about R$ 1.80/US$.

We believe there will be no new interventions in the foreign exchange market, that risk aversion will stabilize, and that the difference between domestic and foreign interest rates will fall. Furthermore, commodity supply and demand conditions will not allow prices to reverse the marked increases observed in recent years. Neither will they stimulate new increases.

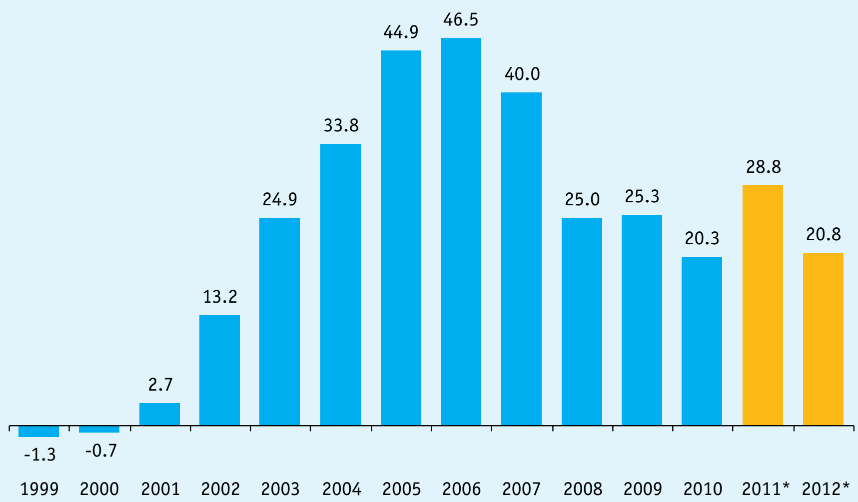
The main impacts of an unfavorable foreign scenario on the Brazilian economy will be felt in the trade sector. In 2012, the global economic growth will be lower than in 2011, particularly in the Euro Zone. Even emerging economies such as China will likely grow at a slower pace. As a result, both prices and demand for manufactured products will remain depressed in 2012.

As Brazilian sales abroad have been boosted by prices and basic products (and commodity prices are expected to remain stable), exports will probably grow at a slower pace in 2012, hitting the mark US$ 275.4 billion.

As for purchases, demand conditions in Brazil will continue to boost imports of consumer goods – albeit less intensely than in previous years. Purchases of inputs are also likely to decrease on account of weaker manufacturing activity, but will possibly improve in late 2012. Moreover, fuel prices will hardly grow at the same rate seen in 2011. As a result, both volumes and prices of imports are estimated to grow at a slower pace. Foreign purchases, however, will probably expand at a stronger rate than exports, amounting to about US$ 254.6 billion. Consequently, the trade balance will be lower than in 2011: US$ 20.8 billion.

The current account deficit is likely to remain under control, increasing slightly due to a decline in the trade balance. Balances for profits and dividends, travel and transportation are estimated to hold relatively steady, possibly trending upward, in response to the exchange rate and to a weaker domestic demand. Direct foreign investments will likely be lower than in 2011 owing to reduced growth in the Brazilian economy, but will remain high enough to finance the current account deficit. We estimate the current account deficit at US$ 56 billion, about 2.1% of GDP.

Brazilian trade balance
US$ billion
Trade balance in 2012 will be lower than in 2011



* Forecast
Source: Secex

BRAZILIAN ECONOMY OUTLOOK FOR 2011 - 2012

	2009	2010	2011 *estimate*	2012 *projection*
Economic activity				
GDP (annual variation)	-0.3%	7.5%	**2.8%**	**3.0%**
Industrial GDP (annual variation)	-5.6%	10.4%	**1.8%**	**2.3%**
Household consumption (annual variation)	4.4%	6.9%	**4.2%**	**4.0%**
Gross fixed capital formation (annual variation)	-6.7%	21.3%	**4.8%**	**5.0%**
Unemployment rate (annual average - % of the labor force)	7.9%	6.7%	**6.0%**	**5.8%**
Inflation				
Inflation (IPCA - annual variation)	4.3%	5.9%	**6.5%**	**5.2%**
Interest rates				
Nominal interest rates				
(average rate in the year)	10.13%	9.90%	**11.76%**	**10.12%**
(end of year)	8.75%	10.75%	**11.00%**	**10.00%**
Real interest rate (average annual rate and defl: IPCA)	5.0%	4.6%	**4.8%**	**4.4%**
Public accounts				
Nominal public deficit (% of GDP)	3.34%	2.55%	**2.75%**	**2.60%**
Public primary surplus (% of GDP)	2.03%	2.77%	**3.25%**	**3.00%**
Net public debt (% of GDP)	42.8%	40.2%	**39.1%**	**38.6%**
Exchange rate				
Nominal exchange rate - R$/US$				
(average in December)	1.75	1.69	**1.79**	**1.80**
(average in the year)	1.99	1.76	**1.67**	**1.80**
Foreign trade sector				
Exports (US$ billion)	153.0	201.9	**253.9**	**275.4**
Imports (US$ billion)	127.6	181.6	**225.1**	**254.6**
Trade balance (US$ billion)	25.4	20.3	**28.8**	**20.8**
Current account balance (US$ billion)	-24.3	-47.5	**-50.0**	**-56.0**

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, Marcelo de Ávila, Marcelo Souza Azevedo, Mário Sérgio Carraro Telles and Isabel Mendes de Faria Marques | Technical information: (61) 3317-9468 | Graphic Design Supervision: DIRCOM | Bibliographic Standardization: ASCORP/GEDIN | 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.

Document prepared on December 13, 2011