Economic Report

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Appreciated exchange rate prevents production from increasing more

Domestic demand continues to be the main factor leading GDP growth

The Brazilian economy is still growing at robust rates. Brazil's GDP will grow by 7.5% in 2010, leveraged by domestic demand for consumption and investments. This new CNI forecast is 0.3 percentage points higher than the previous one, published in June. The projected industrial GDP growth remained the same, at 12.3%.

The increase observed in domestic demand would be sufficient to boost an even more significant GDP and industrial growth. GDP calculations indicate that the contribution of foreign trade to growth will be negative by 2.6 percentage points, owing to a more intense increase in imports than in exports. This situation is mainly attributed to a marked exchange rate appreciation, which diverts part of domestic demand to other economies and limits production growth domestically. Another factor contributing to this scenario is the difference observed between the growth pace of demand in Brazil and in the world.

Industry is the sector that has been most affected by this two-fold process. The data reveal intense growth in manufacturing production in 2010, but prospects for the future are less promising. A downward trend was detected in installed capacity use indicators in recent months, showing that growth in this sector is not limited by productive capacity, but rather by other reasons.

The negative effects of the exchange rate appreciation on the competitiveness of industrial products can be clearly perceived in foreign trade statistics. Imports – mostly of industrial goods – have been rising at an extraordinary rate, leading to a marked increase in the coefficient of penetration in the domestic market. Exports of manufactured products have in turn been losing momentum. The value of total exports has been increasing only as a result of the prices of certain commodities. The expected trade balance in 2010 – US$ 12 billion – is the lowest one since 2001; while the current account gap is expected to hit a record high.

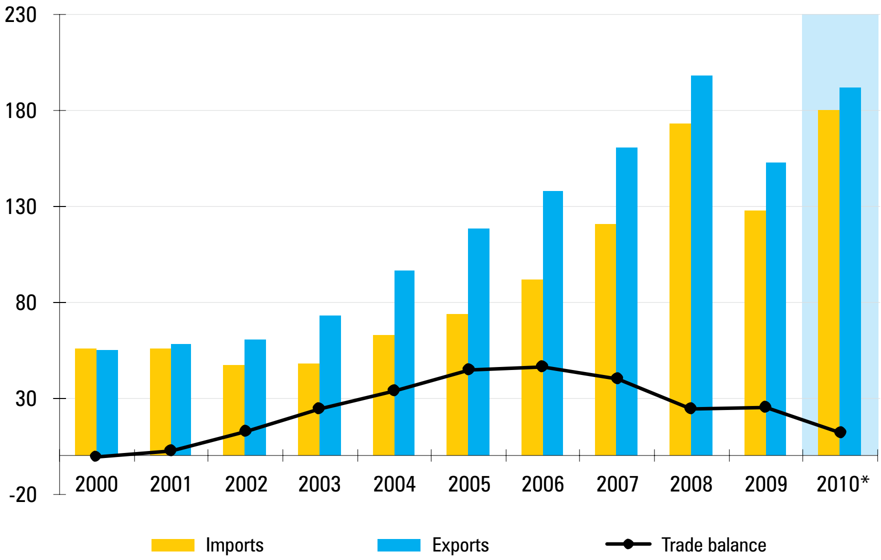
The real tends to appreciate even more. This appreciation trend is partly explained by global factors, such as a weakening dollar and the artificial depreciation of the Chinese currency. But there are domestic components pushing the Brazilian currency up. The fact that interest rates in Brazil remain excessively high in relation to those prevailing on the global market, in a scenario of heated domestic demand, attracts capitals to sustain public and private consumption at high levels.

This scenario requires short-term actions to avoid an excessive supply of foreign currencies, such a higher taxation on capital. In the long term, however, improved competitiveness conditions and permanent changes in the fiscal-monetary relationship are required to enhance the domestic saving capacity and ensure the feasibility of a less appreciated currency that will not undermine the growing capacity of domestic production.

Exports, imports and trade balance

In US$ billion

Imports grow at much more intense rates than exports



Source: SECEX   *Projection 2010: CNI

The Brazilian economy in the third quarter of 2010

economic activity

Domestic demand is the pillar of GDP growth

Investments boost demand

CNI revised its economic growth estimate in 2010 from 7.2% to 7.5%. This change was determined, on the demand side, by a higher-than-expected increase in household consumption and government spending and, on the supply side, by a sharp rise in the supply of services and in the agriculture/livestock sector. In addition, the dragging effect – as measured by the year's accumulated average divided by the 12-month average the year before – increased from 6.0% to 6.7% between the first and the second quarter.

The economic growth pace has been consolidating itself and the slowdown observed in the second quarter was not widespread: CNI expected to see a 1.0% growth, 0.2 percentage points below the one that was actually observed.

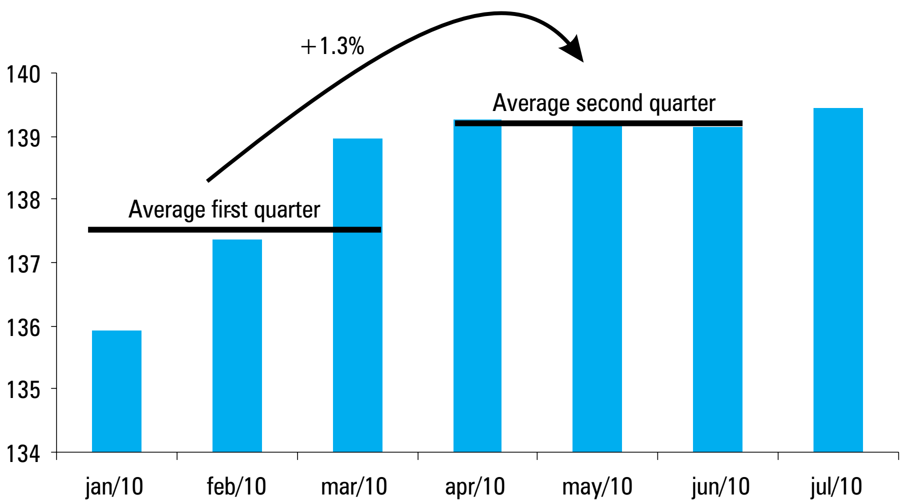
As compared to the previous quarter, the GDP growth pace slowdown from 2.7% to 1.2% between the first and the second quarter indicates that GDP is converging to its growth potential.

After the intense economic growth registered in February and March, the economic activity index (IBC-BR) calculated by the Central Bank – an indicator that has been efficiently measuring GDP variation – remained stagnant in the three months that followed. Although indicators between April and June were very similar to the ones calculated in March, the average indicator for the second quarter was 1.3% above the average observed in the previous quarter, pointing to a growth scenario that failed to materialize.

Economic activity index

2002 index = 100

Despite the economic stagnation observed in the three months of the second quarter, the indicator increased, in average, by 1.3%



Source: Central Bank

The manufacturing activity slowdown observed in the second quarter can be largely attributed to the end of anti-crisis measures to boost consumption. March was the last month in which consumers were exempted from the Tax on Industrial Products for automotive vehicles and household appliances, which led them to move up their plans to buy such products.

After the second quarter, economic activity resumed a growth path in July in relation to the previous month. The Central Bank's IBC-BR index increased by 0.24%. During this period, manufacturing production (PIM-PF/IBGE) increased by 0.6% and turnover and jobs in manufacturing industry (CNI) grew by 3.6% and 0.5%, respectively, also in relation to the month before.

In August, a slowdown was observed in economic activity in relative terms. While manufacturing production (IBGE) and real turnover in industry (CNI) dropped by 0.1% and 0.3%, respectively, jobs kept growing (0.5% in relation to the previous month). According to CNI's Industrial Survey - Manufacturing and Mining, stocks in August remained above planned levels, which can explain why production remained stable in the period.

Despite this performance in August, CNI has not revised its estimate for industrial GDP growth. Industry continues to be the engine of economic growth, having increased by 12.3% in 2010. This estimate, as well as those for GDP in the construction (14.0%), manufacturing (13.0%), extractive (7.0%), and public utility services (8.5%) industries, was maintained.

It should be emphasized that GDP growth in manufacturing was accompanied by higher investments. Capacity utilization in industry decreased for four months in a row, hitting the mark of 82.3% in August, reflecting an increase in the industrial complex.

The agriculture/livestock industry surprised with a record 149-million-ton harvest of grains, leguminous plants, and oil seeds in 2010. This volume represents an increase of 10.3% in relation to the 2009 harvest (National Food Supply Company - Conab). This result led CNI to recalculate its growth estimates for the agriculture/livestock industry from 6.0% to 8.0% in 2010.

Domestic demand will grow at robust rates

Despite the slowdown observed in household consumption over the past quarters, the labor market continues to grow at an increasingly fast pace – mainly the formal labor market. The effects of this dynamic labor market translate into real gains in total earnings. This scenario suggests that household consumption will resume a more intense growth path over the next two quarters of this year and will grow by 7.6% in 2010, and not by 7.3% anymore, as had been projected before.

GDP growth is not concentrated in household consumption only, but also – and mainly – in higher investments in production.

Gross Fixed Capital Formation (GFCF) resumed a growth path early in 2009 and kept growing at a fast pace, at rates in excess of 7.0% over the previous quarter. Despite the economic slowdown in the second quarter of 2010, this GDP component increased by 26.5% over the same quarter the year before.

CNI believes that the loss of momentum observed in investment growth in the second quarter was a direct effect of the economic slowdown registered in the period. For this reason, this GDP component is expected to resume a more robust growth path in the third and fourth quarters – in relation to the previous quarter – and to experience a 24.5% average variation in 2010. This estimate was not revised, as it contemplates a scenario of less intense manufacturing activity in the second quarter.

Government spending rates have increased between the first and second quarters (over the previous quarter). Therefore, CNI revised its growth estimate for this GDP component upward from 4.1% to 5.0% in 2010. In the wake of higher domestic demand, the service GDP is expected to grow a little more intensely than expected, by 5.3% in 2010 and not by 5.1% as had been projected before.

Domestic demand on the rise and appreciation of the Brazilian currency will increase the negative contribution of the foreign trade sector to GDP

The higher absorption of domestic demand with an appreciated real will increase the negative contribution of the foreign trade sector to GDP from 2.3 to 2.6 percentage points. An appreciated real will boost imports and affect the competitiveness of Brazilian exporters as a result of a relative hike in prices on the international market.

Imports are projected to increase by 33.0% in 2010, exceeding the 30.7% annual variation observed in 1995. On the other hand, exports will grow less than expected (by 10.0%, and not by 10.9% as had been projected before).

GDP Estimate - Percentage variation and contribution of GDP components

	GDP components	2010 Growth rate (%)	2010 Contribution (p.p.)
Demand side	Household consumption	7.6	4.8
	Government consumption	5.0	1.0
	Gross formation of fixed capital	24.5	4.1
	Exports	10.0	1.1
	(-) imports	33.0	3.7
Supply side	Agriculture/livestock	8.0	0.5
	Industry	12.3	3.1
	Mining and quarrying	7.0	0.1
	Manufacturing	13.0	2.0
	Construction	14.0	0.7
	Public administration, health, and public education	8.5	0.3
	Services	5.3	3.6
	GDP mp	**7.5**	

jobs and income

Labor market resumes pre-crisis dynamism

Formal jobs grow on an intense and continued basis

The labor market has been growing steadily, and this growth will keep domestic demand at high levels. Jobs are being created at the same pace registered before the crisis broke out, particularly in the formal sector. Despite the slowdown in economic activity in the second quarter, the labor market remained heated, resulting in the lowest unemployment rate in the past eight years.

Considering the six largest metropolitan regions in Brazil, jobs grew by 3.2% both in July and August in relation to the same month the year before (IBGE). This growth pace is more intense than the annual average observed since 2002 (2.7%). The quality of the job growth rate composition has also improved. Of the 691,000 jobs created in the last 12 months, 685,000 were formal jobs in the private sector. As compared to the same month in the previous year, formal jobs increased at a rate of 7.2% in August. At the same time, no variation was observed in informal jobs in the private sector in the period and self-employment grew by only 0.8% on the same comparison basis.

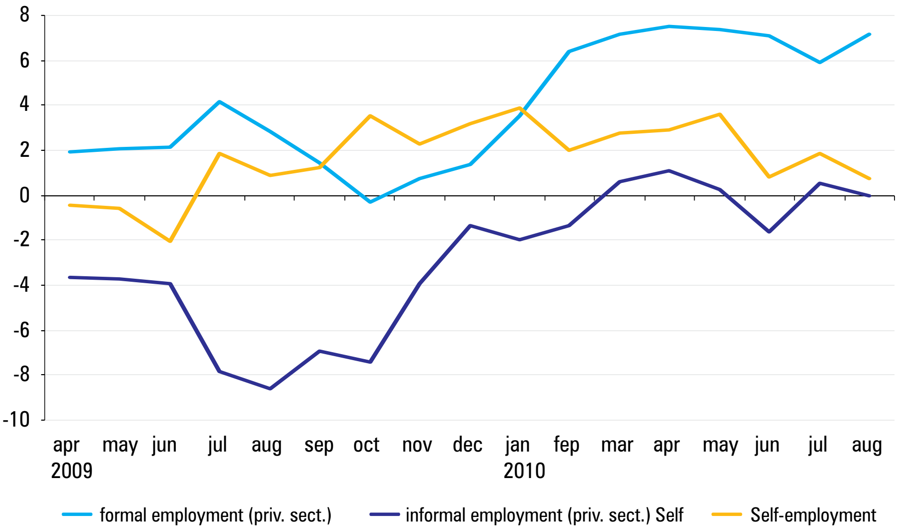
Approximately 25% of all jobs created in metropolitan areas over the last 12 months were in the manufacturing and construction industries (IBGE). As a matter of fact, jobs in the manufacturing industry have been growing steadily, even during the second quarter, when a downturn in manufacturing activity was registered. Jobs have been continually on the rise since the second half of 2009. In August, the seasonally adjusted indicator for industrial jobs (CNI) increased by 0.8% in relation to the previous month.

The General Registry of Employed and Unemployed Persons (Caged) of the Ministry of Labor and Employment also indicates that formal jobs are being created at a fast pace, with a flow of about 2 million new jobs in the 12-month accumulated figure up till August. Considering only the first eight months of the year, 1.7 million new jobs were created. As reported in the Monthly Job Survey, the Caged suggests a steady growth in industrial jobs. The combined flow of new formal jobs in the manufacturing and construction industries in Brazil amounts to almost half (46.3%) of all formal jobs created in the past 12 months.

Jobs by occupation category

Percentage variation in relation to the same month in the previous year

Formal jobs grow at a fast pace



Source: IBGE

Slow labor force growth reduces pressure on the unemployment rate

The number of unemployed persons decreased by 290,000 over the past 12 months, to 1.7 million. This drop is explained not only by the fact that more jobs were created during this period, but also by a lower demand for jobs. The economically active population (EAP) has been growing less than jobs since June 2007 – both at the peak of the crisis and after it.

The unemployment rate in metropolitan areas, which had hit the mark of 9.3% in March 2009, took a downward turn and decreased to 6.7% in August 2010.

This is the lowest indicator in IBGE's historical series, initiated in 2002. This lower labor force growth is projected to continue, putting less pressure on the unemployment rate in the future. The continuation of this process will lead the unemployment rate to fall to less than 6.0% in December, resulting in an average annual rate of 7.0% in 2010 – the same estimate published in the previous Economic Report.

Labor market dynamism increases the population's purchasing power and its confidence to consume

The lower search for jobs as compared to new jobs being generated enhances the value of labor, increasing the bargaining power of workers. This process facilitates better wage negotiations. According to the Interunion Department for Statistics and Socioeconomic Studies (Dieese), about 97% of the 290 wage negotiations held in the first half of 2010 ensured salary raises equal to or above past inflation as measured by IBGE's INPC (National Consumer Price Index). This result was better than the ones achieved in wage negotiations held in 2008 and 2009.

The real average income of metropolitan workers (IBGE) hit the mark of R$ 1,472.10 in August, 5.5% higher than in the same month the year before. As a result of the increase in jobs, total earnings rose by 8.8% over the same period.

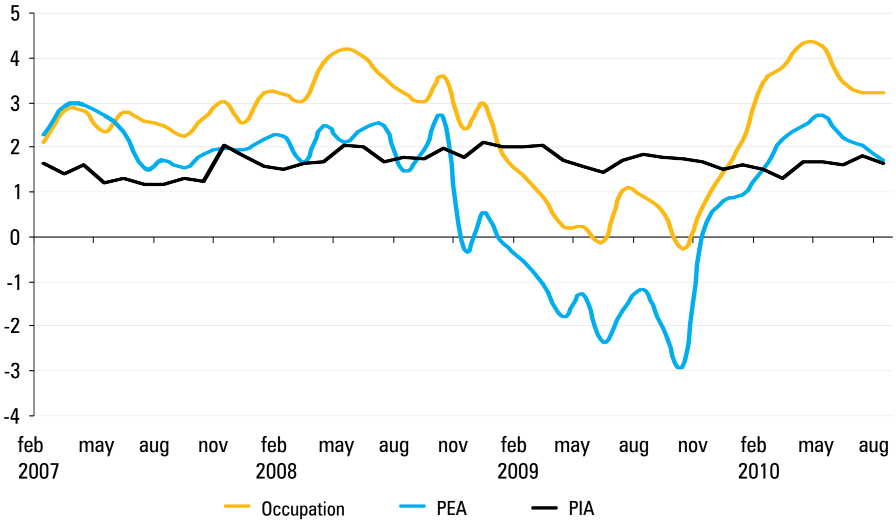
The labor market will continue to grow at similar rates over the next quarters, continuing to ensure real gains to total earnings. The fear of unemployment index (CNI) was calculated at 82.3 points in June 2010, suggesting that interviewees felt very secure in their jobs, since the index remained very close to the historical floor, registered in March.

The National Consumer Confidence Index (INEC/CNI) in September 2010 continues to reflect the optimism of Brazilian consumers. As a result of this greater confidence to consume – resulting from the creation of more formal jobs and from a higher income –, domestic demand will remain on a solid growth path in the next quarters, ensuring an important base for economic growth.

Labor force, population and occupation

Percentage variation in relation to the same month in the previous year

Rise on employment is superior than labor force expansion

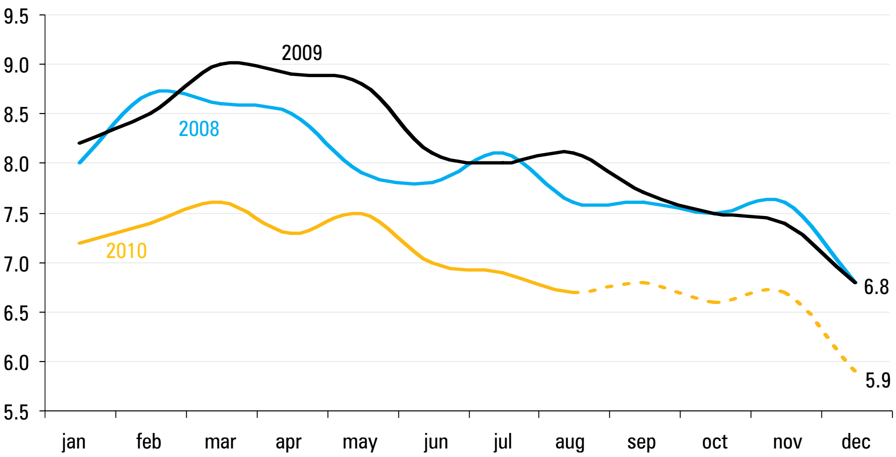


Source: PME/IBGE.

Metropolitan unemployment rate

In (%)

Unemployment rate reaches the lowest historical point



Source: IBGE Projection : CNI

inflation, interest rates and credit

Deflation in food products forestalls hikes in the *Selic* rate

Inflation will not be a problem in 2010

The scenario for inflation has changed significantly as compared to three months ago. The expectations that the prices of food products would continue to rise were not confirmed. Therefore, the 12-month Extended Consumer Price Index (IPCA), the official inflation index, is once again in tune with the core target of 4.5% per annum, having hit the mark of 4.49% in August.

The Extended Consumer Price Index (IPCA) has been fluctuating directly in tune with the movement observed in food prices. When the index is broken down into government-managed prices and prices for industrial products, food and services, only service prices remain above 4.5% in the 12-month accumulated figure. However, this group has historically remained above 6.0%. In the past twelve months, it has remained within the range of 6.6%. No short-term hike trend has been detected for these prices, meaning that their contribution to the Extended Consumer Price Index (IPCA) will not vary much until the end of the year.

Adjustments in government-managed prices are not seen as a problem in 2010. Since they are strongly based on price indices for which deflation was detected in 2009 (such as the General Market Price Index - IGP-M), increases in 2010 are expected to remain below 4% in the 12-month accumulated figure. Some prices are still expected to be adjusted until the end of the year (such as those for public transportation and telephone services), but not to the extent of changing this scenario.

The prices of industrial products have been fluctuating around 3.5% per annum since January. Increases in the Selic rate throughout the year contributed to this situation, since these products are the most affected by higher interest rates on credit. Over the next few months, despite expectations of a strong demand, industry is prepared to meet this higher demand. This is a process resulting from a continued increase in investments, which increased industry's productive capacity, as evinced by the fourth drop in a row in the capacity utilization rate for industry (CNI). Combined with a marked increase in imports, domestic demand is expected to be fully met without putting too much pressure on the prices of industrial products.

For food products, however, the scenario is different. Food prices are rather volatile, as they depend on harvested volumes, weather conditions, and international commodity prices. Up till April, these prices were seen to be on an upward path, from 3.2% per annum in December 2009 to 7% p.a. in April 2010.

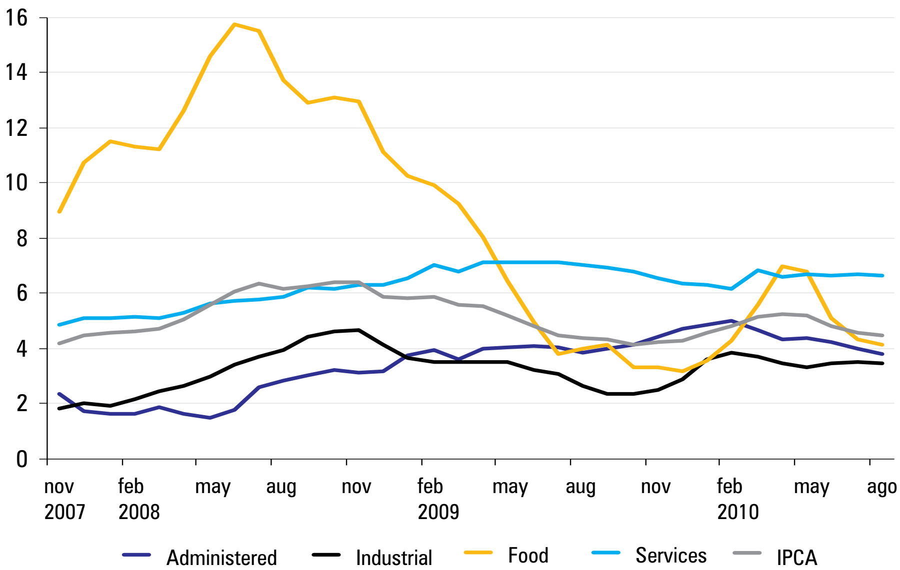
However, as opposed to market expectations, food and beverages experienced deflation in June, July and August, leading the Extended Consumer Price Index (IPCA) to remain at virtually zero in these months and back to the core target in the 12-month accumulated figure. In the remaining months of 2010, prices in general will be pressured by those of food products, as suggested by the Extended Consumer Price Index (IPCA) on September 15.

For this reason, CNI revised its expectations for the Extended Consumer Price Index (IPCA) in 2010 downward from 5.4% per annum in the last Economic Report to 5.0% per annum, and expects to see less intense monthly variations in this index until December. In this regard, the inflation target set by the National Monetary Council (CMN) will be achieved.

Extended Consumer Price Index (IPCA) by groups

12-month accumulated figure

Upward food price trend has reverted in recent months



Source: IBGE Calculation: CNI

The prices of controlled food products brought stability to the *Selic* rate

A strong decrease observed in food prices brought about a favorable scenario for inflation in recent months, making it possible for the Copom to move up the end of a cycle of increases in the Selic rate. The Selic rate, which began the year at 8.75% p.a., began to increase in April and rose to 10.75% p.a. in July after being increased three times in a row, remaining stable since then.

These increases were determined by the Copom in response to the volatility of the Extended Consumer Price Index (IPCA). Since variations in this index have been directly determined by variations in food prices lately, the upward trend observed in these prices between January and April led the Copom to increase the Selic rate.

However, it should be observed that these prices (which determine the IPCA calculation) are not very influenced by movements in interest rates, since food products are essential goods. Therefore, the increases in the Over-Selic interest rate mainly affected manufacturing production, which was not generating inflationary pressures.

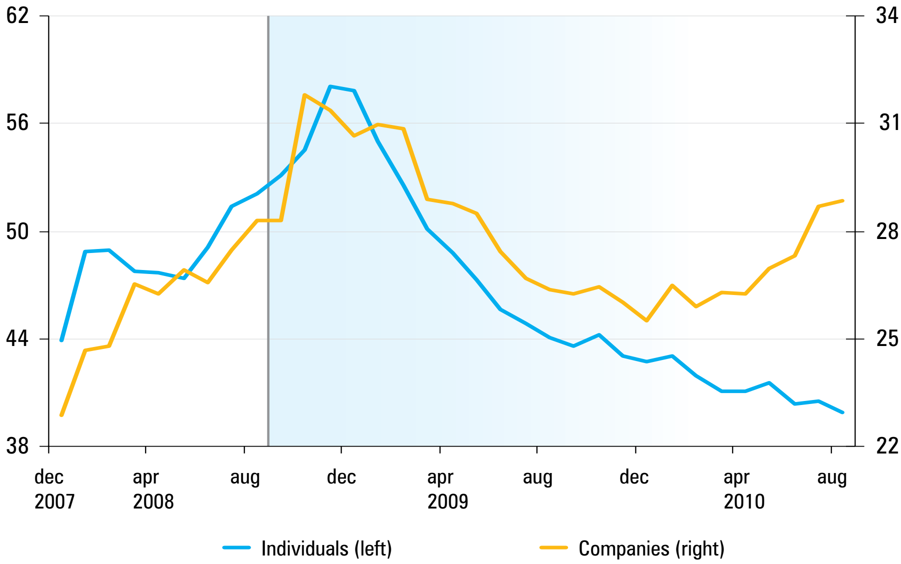
The deflation in food products in recent months, albeit temporary, ended up bringing about a positive direct effect: the cycle of interest rate increases was halted before it was expected to. CNI believes that keeping the Selic rate at its current level is a decision to be made at the Copom meetings to be held in the remainder of the year.

For this reason, CNI revised its Selic rate projection for 2010 downward, believing that it will close the year at its current level of 10.75% p.a., with real interest rates at 4.8% per annum.

Interest rates on loans for free disposal during pre-and post-crisis

Annual percentage

Interest rates to companies turn to rise in 2010



Source: Central Bank

Interest rates for companies on the rise

The Selic rate increases throughout the year and a high default rate resulted in higher interest rates on corporate loans with non-earmarked resources. The rates for individual borrowers, in turn, have been dropping since the first negative effects of the crisis began to dissipate.

Interest rates on corporate loans resumed the upward trend observed before the crisis. The larger supply of funds for loans since the credit market returned to normal conditions after the crisis contributed to pushing interest rates down. Interest rates for companies followed this trend initially. But between December 2009 and August 2010 they increased from 25.5% to 28.8% per annum, close to the level observed at the crisis' peak (31.8% per annum in October 2008).

This scenario is not expected to change over the next few months. Other components that define the interest rate charged by banks, such as client delinquency, behaved in different ways. While loan repayment delays in excess of 90 days for individual borrowers have been decreasing since the crisis was at its peak, repayments in arrears for enterprises are still substantially higher than before the crisis.

This situation creates a vicious circle by itself. Repayments in arrears suggest that companies are having a hard time to repay their loans, forcing them to borrow more short-term funds for working capital and discounting of trade bills. However, the high interest rates charged on their loans inhibit greater indebtedness in this kind of credit line.

Apart from this, the current level of the Selic rate also contributes to this scenario. Despite the end of the cycle of increases in the rate, the level it was raised to caused strong and lasting damages to credit for companies. The upward trend observed for interest rates and the expectation that the Selic rate will be kept at the same level for an undetermined period push production costs up and contribute to reduce demand for corporate credit, particularly credit for investment.

fiscal policy

Public spending drops, but is still significantly high

Extraordinary revenues ensure that fiscal target will be achieved

The pace of federal public spending decreased in recent months and reduced its contribution to boosting economic activity. On the other hand, the spending pace of regional governments increased.

In such a scenario, the fiscal effort of the consolidated public sector is only expected to ensure that the adjusted fiscal target will be achieved. Achieving the fiscal target without deducting investment spending will only be possible due to extraordinary revenues derived from Petrobras stock offer.

The Federal Government primary spending growth pace decreased in recent months. This spending, which grew at a real rate of 12.8% up till April, increased by 11.8% in real terms between January and August of this year in relation to the same period the year before.

Once again, spending with defrayal and capital was the one that pushed overall spending up most, and despite the decrease observed in its real growth pace, it hit the mark of 22.6% between January and August 2010 as compared to the same period in 2009.

The social security element also had a significant bearing on spending. Up till August of this year, spending with social security increased by 8.4% in real terms, a little less than in the first four months of 2010, when it grew by 9.2% in relation to the same period in the previous year.

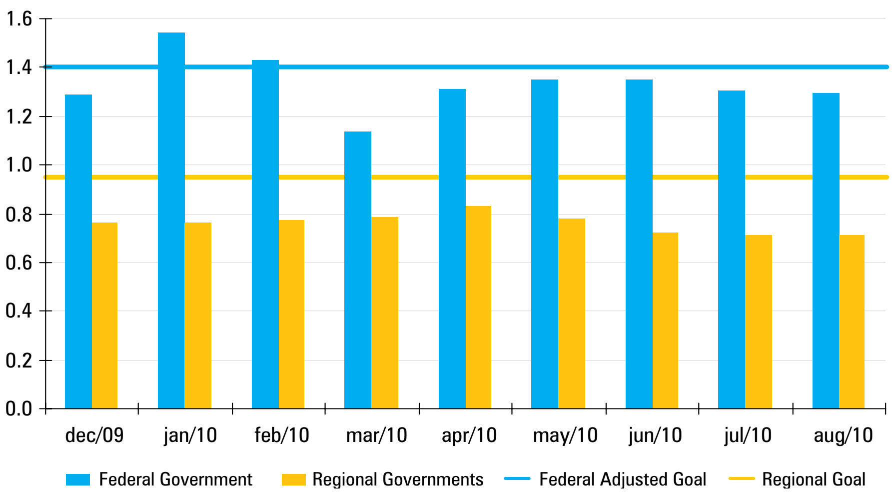
Spending with personnel, which increased by 2.0% between January and April 2010, began to grow at a faster pace and hit the mark of 4.0% in August as compared to the same period in 2009. This result is mainly explained by salary adjustments granted in the beginning of the second half of this year.

For regional governments, we estimate a real increase of 10.4% in spending between January and July in relation to the same period the year before. As opposed to the trend observed for the Federal Government, the spending of states and municipalities resumed an upward path, given that they grew by 9.4% in the first four months of 2010.

Evolution of the Primary Surplus of regional governments and of the federal administration

Percentage of GDP

Primary surplus of regional governments was 0.25 percentage points below the target in the last 12-month period ending in August



Source: Central Bank

Rising revenues lose momentum in the third quarter

The gross revenue of the Federal Government increased by 10.8% in real terms in the first eight months of 2010 in relation to the same period in 2009. This same analysis for the first four months of the year revealed a real growth of 12.7%, suggesting a slowdown in revenues.

There was also a slowdown in the net revenue increase rate, but less intense, suggesting that transfers from the Federal Government to states and municipalities have also increased less. The net tax revenue, which had increased by 13.6% up till April, grew by 12.4% between January and August as compared to the same period in 2009. This slowdown is largely attributed to the fact that the tax revenue grew more for taxes that are not shared by the Federal Government, such as value-added taxes (PIS (Social Integration Program contribution) and Confins (Contribution to social security financing)).

For states and municipalities, the net revenue increased by 10.8% in real terms in the first four months of 2010 in relation to the same period in 2009. The increase observed in this revenue also lost momentum, hitting the mark of 9.6% in the first seven months of 2010 as compared to the previous year. This movement can be explained by the lower rate of increase of the ICMS (value-added tax), which declined from 13.2% up till April to 11.5% up till July.

Fiscal results still below their targets for 2010

The decrease observed in the spending growth pace was not sufficient to enable the primary surplus of the Federal Government and its state enterprises in the last 12 months to achieve the primary surplus target set for 2010. In the case of regional governments, a higher spending growth pace pushed the result away from the target.

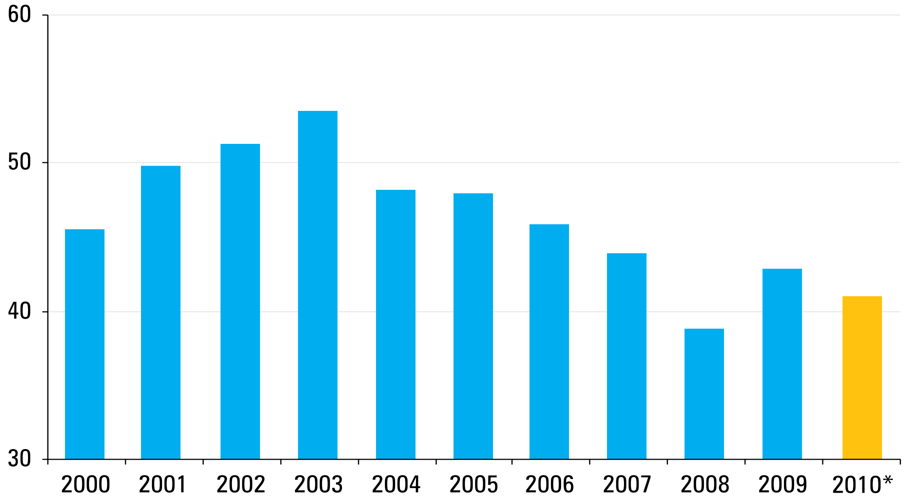
For the Federal Government and its state enterprises, the 12-month primary result until August 2010 amounted to 1.3% of GDP, against a target of 1.4% of GDP – after expenses with the Growth Acceleration Program (PAC) and Cash Remainders Due of extraordinary credit lines granted in previous years are deducted. For regional governments and their enterprises, the 12-month primary surplus was 0.7% of GDP, much less than the 0.95% target.

The growth pace of spending and net revenues of the Federal Government is expected to continue on a downward path in the four last months of the year. However, this slowdown will be less intense than expected at the end of the second quarter. In the case of spending, for which we had projected a real growth of 6.6%, our new projections suggest that it will increase by 8.7%. As for the net revenue, the previous projection of a real growth of 8.8% was revised upward to 10.0%.

Evolution of the Public Sector Net Debt/GDP ratio

Percentage of GDP

Lower nominal deficit and solid GDP growth are expected to reduce the debt/GDP ratio by 1.8 percentage points



Source: Central Bank *Preparation and projection for 2010: CNI

In this scenario, the primary surplus estimated for the Federal Government would drop from 1.7% to 1.4% of GDP. However, funds derived from Petrobras stock offer that will be deposited in the National Treasury will lead this surplus to rise considerably. Because the amount of this revenue is not known, we will stick to the primary surplus forecast that comprises only the fiscal effort that will be actually made in the year, without taking into account this huge volume of extraordinary revenues.

This fiscal effort will therefore be sufficient to enable the Federal Government to exceed its fiscal target (1.2% of GDP) and make up for the primary result below the expected target registered for federal state enterprises. For these companies, we expect to see a maximum primary surplus of 0.1% of GDP, below the 0.2% fiscal target. Therefore, the Federal Government and state enterprises will close 2010 with a primary surplus of 1.5% of GDP, exceeding the 1.4% of GDP target.

The significant growth pace observed in the spending of regional governments will not allow them to achieve the fiscal surplus target of 0.95% of GDP. We expect to see a primary surplus of 0.85% of GDP at most for all regional governments and their enterprises. Therefore, in the absence of extraordinary revenues, the fiscal effort projected for the consolidated public sector in 2010 is 2.35% of GDP, identical to the fiscal target.

For broader fiscal results, we are projecting a nominal deficit of 3.1% of GDP and a 41.0% debt/GDP ratio in December 2010. This estimate points to less favorable results that those described in the previous Economic Report both in relation to the nominal deficit (increase of 0.15 p.p.) and to the debt/GDP ratio (0.1-p.p. increase).

foreign trade sector and exchange rate

Appreciated real boosts imports to a record high in 2010

Brazilian currency tends to appreciate again

As opposed to early in 2010, when the exchange rate between the real and other currencies was relatively stable, the Brazilian currency appreciated in the third quarter of 2010. In this period, the real appreciated 6.6% against the US dollar.

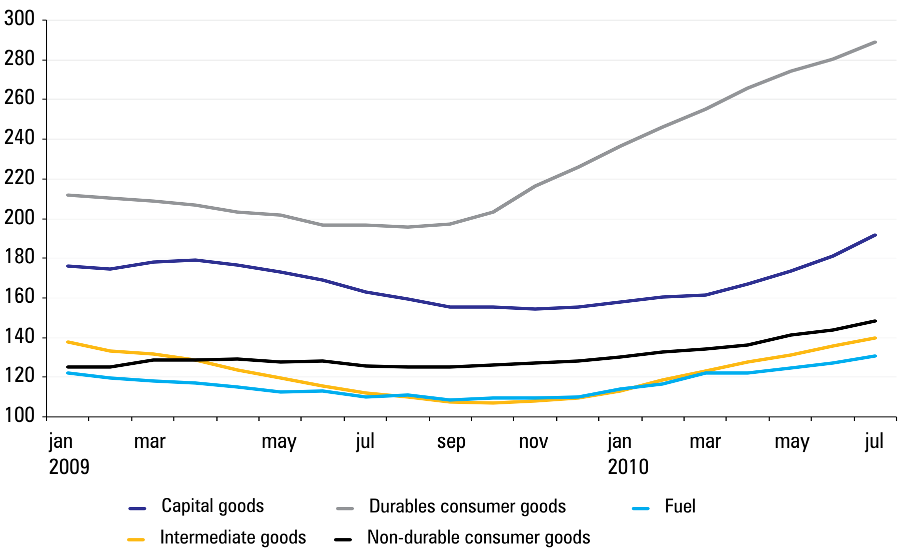
It would have appreciated more were it not for a strong intervention from the Central Bank. The Bank bought over US$ 10 billion in September alone, leading Brazil's international reserves to hit the record figure of US$ 275 billion. In addition, the Tax on Financial Operations (IOF) was raised (on October 5) from 2% to 4% for foreign deposit-based investments. The government also said that it will use the Brazilian Sovereign Fund to buy US dollars. These (short-term) measures are intended to curb or slow down this exchange rate appreciation process.

In the last weeks of September, the Petrobras stock offer played a major role in creating this movement in the foreign exchange market. According to data provided by the Central Bank, almost US$ 9 billion entered Brazil through the financial market between September 13 and 17. For comparison purposes, the volume observed in five days is 15.6% higher than all the volume registered from January up till September 10. During this period, the real-US dollar exchange rate decreased from R$ 1.77-US$ 1 to R$ 1.72-US$ 1. Early in October, the exchange rate decreased to levels below R$ 1.70-US$ 1.

Quantum of Brazilian imports

12-month Average – 2006 Index = 100

Imports of durables are the ones that grew most in volume



Source: Secex

Growth pace of Brazilian imports is one of the highest in the world

Brazilian imports keep growing at quite a fast pace. In the figure accumulated up till September, imports totaled US$ 132 billion, meaning that they grew by 45.1% as compared to the same period in 2009. According to data from the World Trade Organization (WTO), Brazilian imports have grown by 121% since the peak of the crisis, second only to China.

Brazilian imports grew almost exclusively as a result of an increase in the imported volume. The imported quantum increased by 43% in the figure accumulated between January and August 2010, while prices rose by only 2%.

The fast increase observed in imports is leading their participation in the Brazilian apparent consumption to grow. Imports of industry at large grew and hit a record 20.7% of Brazil' apparent consumption. The share of durables in total imports increased from 8.6% in 2009 to 9.9% in 2010.

The fact that the year's end festivities are drawing near and that no changes are expected in domestic demand or in the exchange rate (the effects of the tax on financial operations tend to be marginal and short-term) suggest that Brazilian imports will grow more in 2010 than in 2008, before the crisis, and hit a new historical record. At the end of 2010, we estimate that imports will total US$ 180 billion, a growth of 41% as compared to 2009 and of 4% in relation to 2008.

Growth in exports is increasingly dependent on basic products and price gains

Exports also keep growing, but at a much slower pace than imports. Up till September, exports totaled US$ 144.9 billion, 28.9% above the figure registered over the same period in 2009. The difference observed between the growth rate of exports and imports is attributed to a marked increase in domestic demand, which exceeded the growth pace of foreign demand – many of Brazil's partner countries still feel the effects of the international crisis. On top of this, the high appreciation of the domestic currency reduced the profitability of exports and the competitiveness of Brazilian industry.

It should be stressed that Brazilian exports have been growing mainly as a result of price gains. The volume of exports grew by 8% in the figure accumulated up till August, while prices rose by 19%.

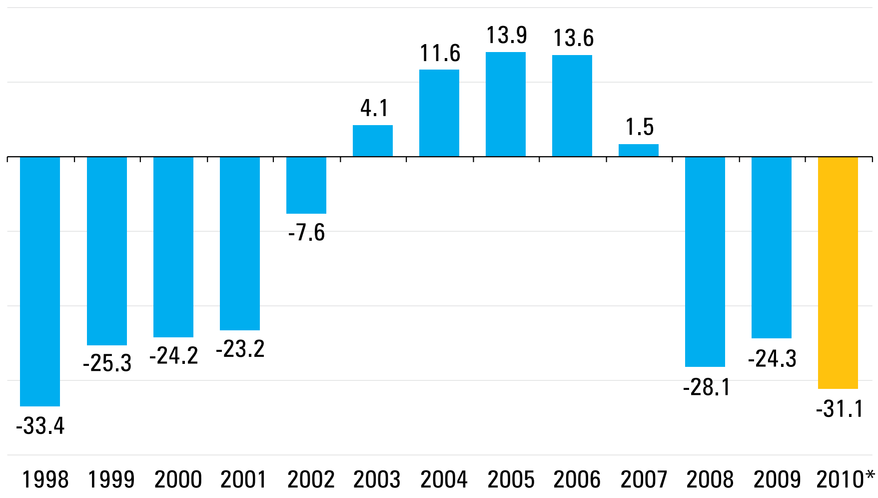
In addition, the increase in exports is concentrated in basic products, whose volume is expected to exceed that of exports of manufactured products. Exports of basic products grew by 61.9% in figure the accumulated up till September, while exports of manufactured products increased by 16.1%. As a result, the share of basic products in exports amounted to 47.3% in September, while that of manufactured products totaled 38.0%.

Just for one to have an idea of the increasing importance of basic products in exports, iron ore exports accounted for 13.3% of all Brazilian exports in the first nine months of this year, boosted by rising prices on the international market. Petroleum (7.8%) and soybeans (7.1%) were the second and third most exported items, respectively. The main manufactured product on the list, cars (2.2% of the total), ranked ninth in the list of Brazilian exports.

Current account surplus

Figure accumulated in the year (in US$ billion)

Deficit accumulated up until August is almost identical to the previous annual record, registered in 1998



Source: Central Bank *until August

With the end of the year, prices, particularly commodity prices, will continue to push exports up, while the appreciation of the real, should it persist, will continue to affect sales abroad negatively, particularly of manufactured products. Exports will continue to increase, but not enough to hit pre-crisis levels, and will close the year at US$ 192 billion. This figure is 26% higher than the one registered in 2009, but 3% lower than the one observed in 2008.

Current account deficit deterioration should be closely monitored

The difference between export and import growth rates is having a strong impact on the trade balance, which is expected to total only US$ 12 billion, the lowest result since 2001. In addition, a rising domestic demand, combined with the appreciation of the Brazilian currency, is leading to a deficit in services and incomes, which grew by 41% the year-accumulated figure as compared to the same period in the previous year, hitting the mark of US$ 44.8 billion. Direct foreign investments are lower than expected and likely to be exceeded by the flow of dollars into the country to buy bonds and stocks.

The current account deficit amounted to US$ 31 billion in the year (US$ 45.8 billion in 12 months) or to 2.39% of GDP. Although the deficit-GDP ratio is still lower than the one observed in the recent past in Brazil, the pace at which the deficit has been growing is a cause for concern. There are no prospects in the short run that there will be any abrupt change in the exchange rate or that the growth pace of domestic demand will slow down. Therefore, the deficit is likely to continue to increase and to amount to US$ 54 billion at the end of the year, or to about 2.5% of GDP. Should this happen, it will be the highest deficit in the historical series initiated in 1947, exceeding the previous record, registered in 1998, by 62%.

prospects for the Brazilian economy

	2008	2009	2010 *previous projection May/10*	2010 *projection*
Economic activity				
GDP (annual variation)	5.1%	-0.2%	7.2%	**7.5%**
industrial GDP (annual variation)	4.4%	-5.1%	12.3%	**12.3%**
Household consumption (annual variation)	7.0%	4.1%	7.3%	**7.6%**
Gross fixed capital formation (annual variation)	13.4%	-9.9%	24.5%	**24.5%**
unemployment Rate (annual average - % of the labor force)	7.9%	8.1%	7.0%	**7.0%**
Inflation				
Inflation (IPCA - annual variation)	5.9%	4.3%	5.4%	**5.0%**
Interest rates				
Nominal interest rates				
(average rate in the year)	12.45%	10.13%	10.22%	**9.90%**
(year end)	13.75%	8.75%	11.50%	**10.75%**
Real interest rate (annual average and deflated rate: IPCA)	6.4%	5.0%	4.8%	**4.8%**
Public accounts*				
Nominal public deficit (% of GDP)	2.00%	3.30%	2.95%	**3.10%**
Public primary surplus (% of GDP)	3.70%	2.05%	2.60%	**2.35%**
Net public debt (% of GDP)	38.8%	42.8%	40.9%	**41.0%**
Exchange rate				
Nominal exchange rate - R$/US$				
(average in December)	2.39	1.75	1.79	**1.70**
(average in the year)	1.83	1.99	1.81	**1.76**
Foreign trade sector				
Exports (US$ billion)	197.9	153.0	190.0	**192.0**
imports (US$ billion)	173.2	127.6	180.0	**180.0**
Trade balance (US$ billion)	24.7	25.4	10.0	**12.0**
Current account balance (US$ billion)	-28.3	-24.3	-54.0	**-54.0**

* Excludes Petrobras Group's companies

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