CNI Newsletter
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ECONOMIC REPORT

Brazilian National Confederation of Industry
THE FUTURE OF INDUSTRY

Real economy failing to keep up with expectations

Perception of slower progress on necessary reforms slows down economic activity

Through the first quarter of the year, economic growth prospects for Brazil in 2019 are lower than at the end of last year. CNI estimates that GDP will grow by 2.0% in 2019, rather than by 2.7% as projected in December. This downward revision of estimates clearly reveals a mismatch between the weak productive activity recorded in the first months of this year and the significantly improved expectations observed in the immediate period following the elections.

This lower growth can be explained by two basic factors. The first one is the growing feeling among economic agents that the process involved in approving necessary reforms for promoting structural changes in the Brazilian economy will be more time-consuming and complex than initially perceived. This fact can be clearly perceived in the pace at which the pension reform bill is being processed by the House of Representatives, as it is still in the initial phase of checking its constitutionality.

The delay in processing the pension reform bill has been hindering substantive progress on processing the tax reform bill. Rationalizing the tax system is necessary to eliminate distortions, reduce costs, and increase Brazil's competitiveness, especially of Brazilian manufactured products facing intense international competition. This means that it is a fundamental reform to increase the growth pace of the Brazilian economy.

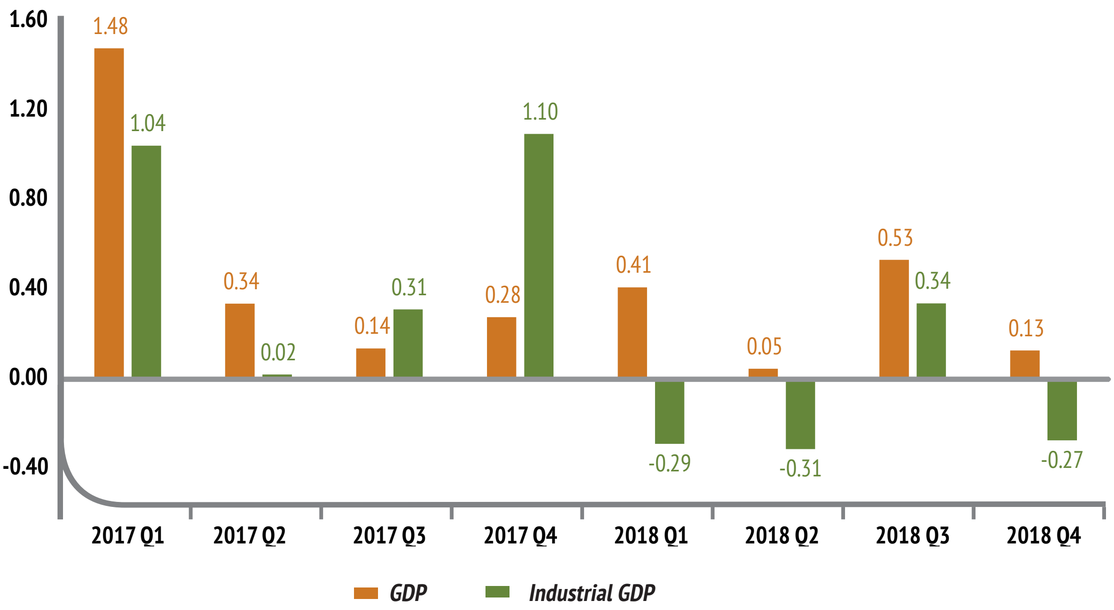
The second factor explaining the weak economic growth observed in the first months of 2019 is that little progress has been made on reducing structural gaps that hinder the daily operations of Brazilian companies and reduce our ability to compete

(continued on the next page)

The Brazilian economy in the first quarter 2019

Industrial GDP fell in the last quarter of 2018

GDP and industrial GDP
Variation (%)



Source: National Accounts/IBGE

with foreign products. These difficulties inhibit private investment decisions and, given the fiscal incapacity of the Brazilian State, reduce the country's investment rate.

Without resuming investment, growth - both potential and actual growth - is compromised. The way the labor market has been evolving clearly confirms this fact: jobs are being created at an insufficient rate to meet the actual demand for jobs, and as a result the unemployment rate remains at a very high level.

On the consumption side, the fact that a large number of people remain unemployed reduces the purchasing power of households, hindering production growth. This insufficient growth is directly reflected in the performance of industrial GDP, which has remained stagnant since the second half of last year and dropped by 14% in relation to 2014.

The competitiveness problems faced by manufacturing industry are greater and different from those faced by other productive segments, as the industrial sector faces competition from foreign products that are not affected by the same difficulties Brazilian producers are forced to deal with - inefficient taxation, high interest rates, and logistical difficulties. As evidence of this fact, it should be noted that the growth rate of domestic demand, as reflected in the performance of retail trade, has not been accompanied by the growth rate of industrial production.

The macroeconomic scenario remains positive and should have paved the way for a higher growth rate than the one being observed now. Inflation remains stable and without significant pressures, with expectations pointing to a below-target annual rate, and external accounts remain favorable despite the intensification of disputes in the international scenario.

Despite a high primary deficit for the fifth year in a row, fiscal accounts have been evolving positively in the short term. However, addressing this imbalance on a permanent basis is a must for eliminating the sources of the mismatches that led to the recession experienced in the country in recent years.

This environment shows that there is even room for reducing the basic interest rate of the economy. However, political turbulence and uncertainties about the robustness of the pension reform bring volatility to asset markets and make it difficult for the Monetary Policy Committee (Copom) to lower the Selic rate in its next meetings.

Therefore, for leveraging the current growth pace, promoting substantive changes is crucial - both in structuring reforms and in actions affecting the business environment - to generate both a "confidence shock" and a "reality shock" (i.e. in day-to-day business) at a sufficient level to improve the propensity to invest in the economy.

Less robust reforms - or reforms excessively spaced in time - and only incremental competitiveness gains may reinforce the current climate of accommodation of economic agents in a business-hostile environment, and will not change the pace of investment in any substantial way. As a result, there is a risk of consolidating a situation of low growth - with stagnation of the per capita income - similar to the one observed over the last two years.

In short, the Brazilian economy remains stuck in low gear and lacking the capacity to gain speed quickly. Economic agents still have favorable expectations, but conditioned to the actual implementation of structural reforms - such as the pension and tax reforms - capable of ensuring long-term fiscal balance and of improving the business environment. Success in such a scenario depends on concerted actions between the Executive and Legislative branches with a view to passing these bills. If no progress is made in these areas, the current low-growth environment will likely crystallize itself.

ECONOMIC ACTIVITY

Frustration with low growth

Weak late 2018 and turbulent early 2019 cast doubt on the possibility of more robust economic growth

GDP data for the fourth quarter of 2018, combined with the first figures announced for 2019, suggest that the Brazilian economy has been recovering at a slower-than-expected rate. At the very least, uncertainties have risen, increasing the number of possible scenarios in the year. GDP closed 2018 at a growth rate of only 1.1%, with industry recording the worst result among the main sectors of economic activity (industry, agriculture/livestock, and services).

The disappointing result recorded at the end of 2018 - GDP growth of 0.13% in the fourth quarter - has reduced the so-called "statistical carryover" to 2019. In other words, if GDP remains constant in 2019 at the same level recorded in late 2018, a growth rate of only 0.4% this year would be guaranteed[1]. Our previous forecast for GDP growth in the last quarter of the previous year was 1%, and as a result the expected carryover effect was greater, namely, of 1.2%.

The Brumadinho tragedy took place in January 2019 and its effects on the production of the mining and quarrying industry could already be felt in February. In addition, the forecast for crops, especially for the soybean crop, has been revised downward. Finally, employment data and indicators for the manufacturing industry suggest moderate consumption and activity.

Data on confidence and expectations, which had been showing a positive trend, have stalled in March.

The first steps in processing the Pension Reform Bill showed that it will be more difficult to overcome resistance to it in Congress than was initially assumed, and this fact, combined with weaker economic activity, has contributed to reducing the optimism of economic agents.

Despite the difficulties involved in predicting how discussions on the bill will evolve, we believe it is more likely to be passed, although probably in a less robust version than the one initially proposed. What is certain is that the longer it takes to process it, the longer uncertainties will linger and the longer it will take for the positive effects of its passage to be felt.

All of these factors led GDP growth projections for 2019 to be revised downward from 2.7%, as forecast in December 2018 in this Economic Report, to 2%. Industrial GDP growth projections were also revised downward from 3% to 1.1%. This estimate has a downward bias, that is, considering all risks involved, we now believe that this figure is more likely to be revised downward than the other way around.

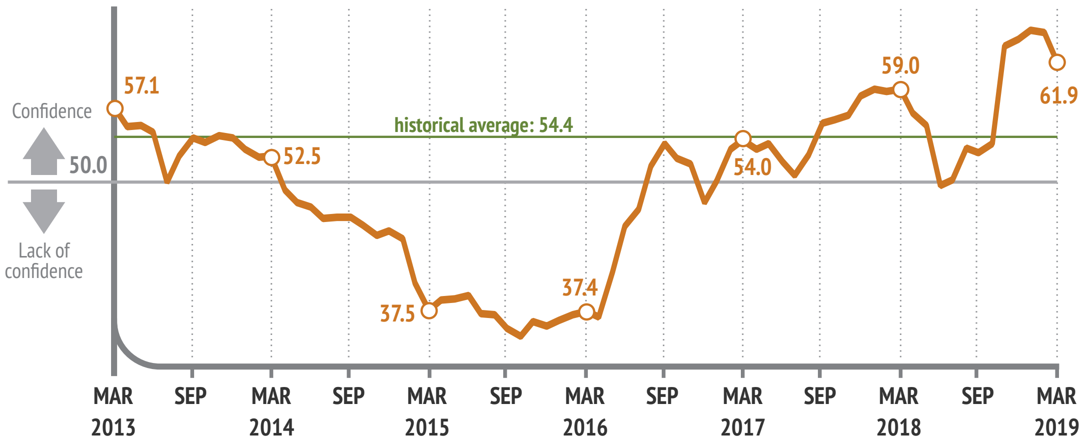
TREND TOWARD INCREASED CONFIDENCE WAS INTERRUPTED

Industrial business confidence as measured by the Industrial Business Confidence Index (ICEI-CNI), which was on the rise early this year, stabilized in February and fell 2.6 points to 61.9

[1] In the particular case of industry, this carryover effect is negative: 2019 starts from a lower point than the average recorded in the previous year. Thus, industry needs to grow - by 0.11% in this case - to record in 2019 the same result observed in 2018.

Confidence on the decline in recent months

Industrial Business Confidence Index - ICEI
*Diffusion index (0-100 points)**



**Figures above 50 points indicate confidence on the part of entrepreneurs. The higher the figures are above 50 points, the greater and more widespread the confidence.*

points in March. Despite this fall, the index is 2.9 points above the one recorded in March 2018, 7.5 points above its historical average, and 11.9 points above the 50-point dividing line, which separates confidence from lack of confidence. That is, confidence can still be regarded as high, but recent developments suggest that entrepreneurs should adopt a more cautious posture.

Besides political uncertainties and data indicating economic underperformance, the first employment data for 2019 and new events in the scenario abroad have also played a role in reducing business confidence (see the sections "Employment and Income" and "Foreign Trade Sector" for more details). The expectation indices reported in CNI's Industrial Survey (expectations about demand, raw material purchases, number of employees, and exported quantity) fell in March, but they still show optimism.

INDUSTRY WILL GROW LESS THAN EXPECTED

CNI's projection for industrial GDP growth in 2019 has been revised downward from 3% to 1.1%. This drop is explained by downward revisions for the manufacturing and mining and quarrying industries.

With regard to the manufacturing industry, six months with production on the decline after July (the month following the end of the truck drivers' strike) led the sector's GDP to fall for two quarters in a row. As a result, the carryover effect of the manufacturing industry was negative: -0.62%.

That is, the manufacturing industry needs to grow by 0.62% for the result recorded in 2019 to be identical to that observed in 2018.

In addition, its activity in the first months of the year was weak: industrial production (PIM-PF/IBGE) remained stable in January. In February, it grew by 1%; however, this growth can be partly attributed to the higher-than-average number of working days in February, as in 2019 Carnival was held in March. For the same reason, the March result will likely be low, especially because CNI's Industrial Survey showed that industry had excess inventories in February. As a result, the sector's GDP tends to stabilize in the first quarter.

In the coming months, the sector will likely resume growth, albeit at a modest rate, as its growth will be limited by the difficulties it has been facing abroad and in the domestic market. With regard to exports, continued recession in Argentina is one of the main factors hindering sales of manufactured goods abroad. In the domestic market, despite optimistic expectations, entrepreneurs are still facing a weak financial situation: the indices for financial conditions disseminated in CNI's Industrial Survey-Manufacturing and Mining - are low in relation to their historical average. As a result, these agents remain cautious about increasing their production substantially or hiring new workers due to the prevailing uncertainties, which took a new upturn in early 2019.

Considering all the factors involved, we decided to revise our growth forecast for the manufacturing industry downward from 4.8% to 1.3%.

In relation to the mining and quarrying industry, that revision was due to the collapse of the Brumadinho dam and its consequences, such as the shutdown of other mining operations in Minas Gerais state. As early as February production had been heavily affected already: industrial production dropped by 14.8% as compared to January, according to IBGE data. As observed when the Mariana dam collapsed in 2015, the effects on this sector's production will likely linger during at least the first half of 2019. The performance of the mining and quarrying industry was therefore revised downward from a growth of 2.2% to a decline of 0.2%.

The forecast for the construction industry remains the same: it is likely to grow slightly, by 0.3%, in relation to 2018. This is a small but important growth, because it will be the first time the sector will grow after decreasing for five years in a row, during which it decreased by 28% altogether. The improved performance of this industry will be brought about by the building construction industry. The serious fiscal situation faced by the federal administration, states, and municipalities is still limiting their possibilities for implementing infrastructure projects.

The favorable carryout effect (higher than 2%) of the Public Utility Industrial Services (SIUP) sector has in turn led us to revise our growth projections for the sector upward from 1.8% to 2.4%.

Projections for the agricultural sector in 2019 were revised downward from 2% to 1% due to lower forecasts for the 2019 harvest, especially for the soybean harvest, due to droughts in major agricultural regions.

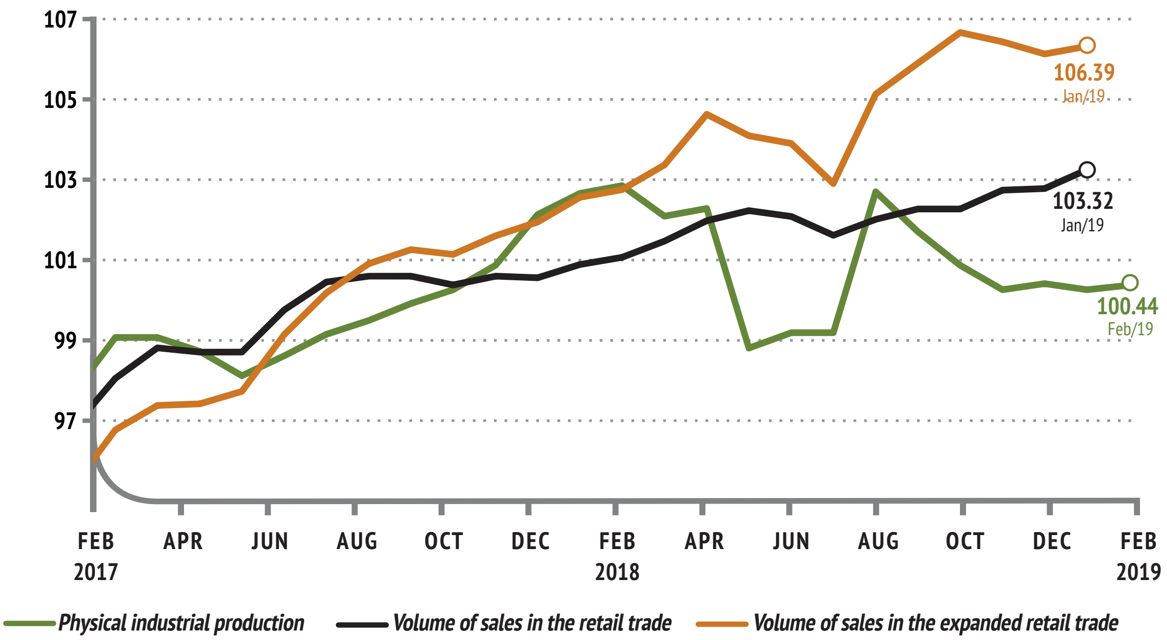
Growth in the service industry was also revised downward from 2.5% to 2.2%, mainly due to forecasts for services related to productive activities. As a result of the lower forecast for the manufacturing industry, demand for correlated services, such as for logistics services, will decline. On the other hand, services related to higher household consumption, such as those involved in retail trade, will sustain the growth of the service industry. Activities related to selling and renting real estate are also likely to grow more intensely as a result of the positive - albeit timid - performance of the construction industry expected for 2019.

CONSUMPTION HAS ONCE AGAIN BECOME THE MAIN ENGINE OF ECONOMIC GROWTH

In 2019, household consumption will once again be the main driver of GDP growth in Brazil. The last months of 2018 were marked by greatly improved consumer expectations, which began to reverse the more cautious posture adopted by those agents after the truck drivers' strike (back in May 2018) and the uncertainties that prevailed during the pre-election period.

Production does not keep pace with consumption growth

Physical industrial production, volume of sales in the retail trade, and volume of sales in the expanded retail trade
Quarterly moving average, seasonally adjusted (Base: 2017 average = 100)



Source: PMC/IBGE and PIM-PF/IBGE

This reversal could be even stronger were it not for the problems faced in the labor market. The unemployment rate remains high and, as a result, fear of unemployment is also high. In addition to repressing income growth, this also causes households to hesitate to commit a greater share of their income, preventing consumption from increasing, especially of higher-value goods.

For the remainder of the year, the unemployment rate will likely continue to decline slowly (see the “Employment and Income” section). As a result, we are projecting a 2.2% increase in household consumption, a higher percentage than the one recorded in 2018 (1.9%) and close to that observed in the last year in which it grew before the recent crisis, back in 2014, when it increased by 2,3%.

Government consumption, which is another potential driver of economic growth, remains low, as consumption not only of the federal administration, but also of states and municipalities, is limited by the need to promote fiscal adjustment. We are projecting a slight decrease in government consumption, of 0.2%, in relation to 2018.

Gross Fixed Capital Formation (GFCF), which is a measure of investments made by the country, could also boost growth. However, its performance is likely to be only slightly better than in 2018. According to our estimates, it will grow by 4.9%, against 4.1% in 2018. It will grow for the second consecutive year, but it should be stressed that this growth is, at least in part, explained by a change in the REPETRO regime designed to grant special tax treatment to investments in oil and gas. That change generates large, merely accounting flows of “imports” of oil rigs that inflated GFCF in 2018 and still affects GFCF in 2019. In January, Ipea’s indicator for GFCF rose after declining for two months due to these imports.

GFCF is also likely to increase on account of the construction industry, as we are projecting that it will grow, albeit modestly, in 2019. Finally, utilization of industry’s installed capacity is on the rise, albeit very slowly. Since in our base scenario we do not expect to see any strong reversal of expectations, investment intentions are also likely to remain at a moderate to high level.

Two factors have been preventing GFCF from expanding more intensely. Disbursements by public banks, especially by the BNDES (Brazil’s investment bank), which play a key role in financing investment plans, have been on the decline since last year. In addition, government consumption is being restricted by fiscal adjustment.

As for the external contribution to GDP, it is also being affected by the impact of the REPETRO regime on imports of capital goods. Purchases of consumer goods abroad are also likely to grow moderately as a result of increased household consumption. However, purchases of intermediate goods are not likely to increase at the same pace due to the modest growth of industrial activity.

Exports will also increase little in 2019. Although the peak of trade tensions between China and the US seems to have been left behind, the environment abroad is not favorable and is subject to risks (see the “Foreign Trade Sector” section).

In this scenario, we are projecting a 3% increase for exports and a 4.2% increase for imports of goods and services. Accordingly, the external contribution to GDP would be negative by 0.2 percentage point.

Estimate of GDP and its components for 2019

Projected percentage variation

	GDP COMPONENTS	Percentage change (%)
Demand side	Household consumption	2.2
	Government consumption	-0.2
	Gross fixed capital formation	4.9
	Exports	3.0
	(-) Imports	4.2
Supply side	Agriculture/livestock	1.0
	Industry	1.1
	Mining and quarrying	-0.2
	Manufacturing	1.3
	Construction	0.3
	Public utility industrial services	2.4
	Services	2.2
PIB		**2.0**

Projected by: CNI

EMPLOYMENT AND INCOME

Another year marked by a high unemployment rate

Economic uncertainties and lower economic growth have prevented more significant progress on the employment front

The slow labor market recovery observed in 2018 will likely repeat itself in 2019. This possibility is based on a downward revision of economic activity growth forecasts for this year and also on uncertainties about how reforms will actually evolve, especially the pension reform.

The unemployment rate calculated through the Continuous National Household Sample Survey (PNAD Continua/IBGE) increased by 0.85 percentage points altogether between the moving quarters ending in December and February.

The average real income increased more significantly during these first two months of the year as compared to the same period last year. On the other hand, employment increased by only half of the rate recorded in 2018 on the same comparison basis. Therefore, the main driver of the increase observe in real total payroll was the growth seen in real income.

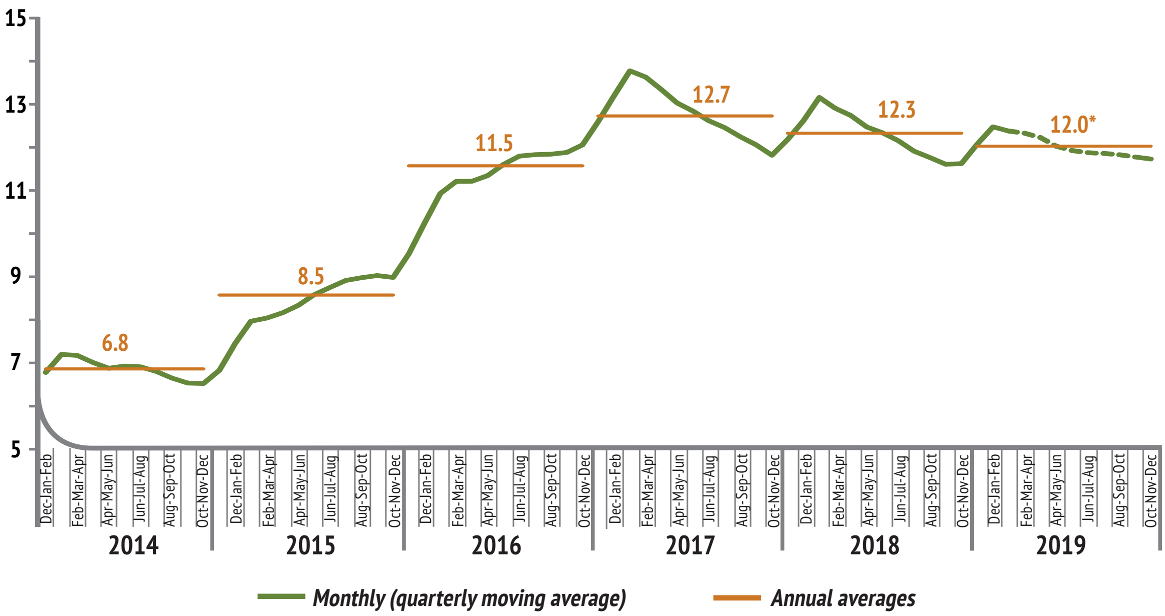
No further significant progress on the employment front is expected over the next few months. The downward revision of GDP growth forecasts (see the section "Economic Activity") and the influence of political turbulence on investment decisions will protract the slow process of improving the unemployment rate. The response from the labor market continues to depend on the robustness and consistency of economic growth, how long it takes for idle resources of the productive sector to settle, and contingencies related to the how reforms are processed. Considering that such prospects have worsened recently, CNI revised its forecast for the average unemployment rate in 2019 upward from 11.4%, as indicated in the Economic Report of December 2018, to 12.0% of the labor force.

UNEMPLOYMENT RATE WILL LIKELY AMOUNT TO 12% IN 2019

The year 2019 began with two consecutive increases in the unemployment rate that pushed the indicator up from 11.6% in the quarter ended in December to 12.4% in February, according to data from the Continuous Pnad/IBGE survey.

Unemployment rate will remain high

Unemployment rate as a percentage of the labor force
As a percentage (%)



Source: Continuous Monthly Pnad/IBGE survey
Projected by: CNI

The indicator increased last month due a drop in employment (875,000 fewer jobs in February compared to December 2018), despite the positive influence of the calendar, as this year Carnival was held in March and not in February, when it is usually held. In addition, the labor force remained virtually stable during the same period.

The behavior of the unemployment rate reflected seasonality in the indicator, which usually drops in the last months of each year, when more employees are usually hired to meet year-end demands, which are boosted by Christmas and Black Friday. On the other hand, the unemployment rate usually rises more rapidly in the first quarter of each year as these temporary workers are laid off.

In addition to this high unemployment rate, the degree of informality in the economy is also noteworthy. Despite the improvements observed since the last quarter of 2018, the percentage of employees without a formal contract and of employers without the formal CNPJ corporate taxpayer ID number with the ministry of Finance remains high. The informality rate in February was 44%. Before the economic crisis broke out in 2014, the rate was about 40%.

Another statistical figure that also reveals the weakness of the labor market in recent years is the one related to the underutilization of the labor force. The indicator adds the number of actually employed workers to that of workers with less-than-desired engagement in the labor market. The latter include those who work less than 40 hours a week but would like to work more; and those who gave up looking for a job either because of their hopelessness of finding a job or due to their financial inability to bear the costs for transportation, meals outside their home, documentation, among others.

In the moving quarter ended in February, the rate of underutilization of the labor force hit the mark of 24.6%, meaning that 28 million workers were being underutilized. This is the highest percentage recorded for the indicator in the same period since the beginning of the historical series, in 2012.

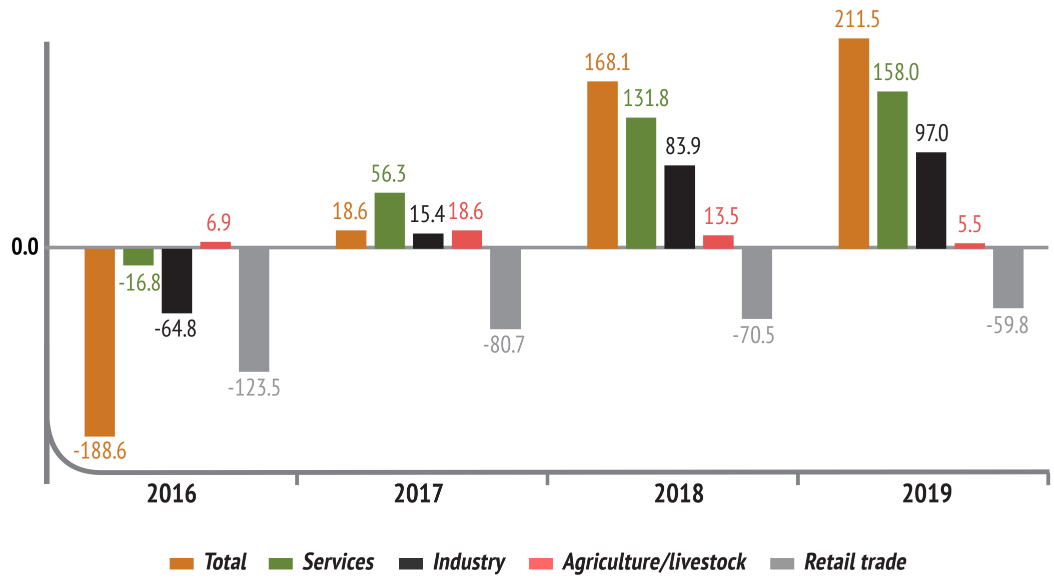
ATYPICAL GROWTH OF FORMAL EMPLOYMENT IN FEBRUARY

In the formal labor market, as measured by the General Registry of Employed and Unemployed Persons (CAGED), 211,500 net jobs were created in the first two months of the year, with the service industry and the industrial sector accounting for most of them, 158,000 and 97,000, respectively. In the retail trade sector, however, there was a net loss of 60,000 jobs over the same period.

It should be highlighted that the net balance in February (173,000 jobs) was the highest one in the same month since 2014. This result seems to have been influenced by an atypical month, as

Significant increase in formal jobs in February

Net balance of formal jobs in the first two months of the year
In thousands



Source: CAGED
**Considers information submitted after the set deadline*

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Carnival was held in March and not in February, when it is usually held. In previous years (2014 and 2011) in which Carnival was also held in March, net job creation rose sharply in February. In March of those years, however, the number of new hires declined. The same phenomenon is likely to be recorded this year.

In the 12-month period to February, the net balance of formal jobs amounted to 575,000. This is a significant result, especially as compared to those observed in recent years. In 12 months to February 2018, Brazil created 102,500 jobs and in 2017 there was a net loss of 1.1 million jobs.

HIGHER REAL INCOME LEVERAGES TOTAL PAYROLL

A substantial increase was recorded in real total payroll early this year, as it rose from 196.6 billion in February 2018 to 205.4 billion in February 2019, according to data from the Continuous Pnad/IBGE survey.

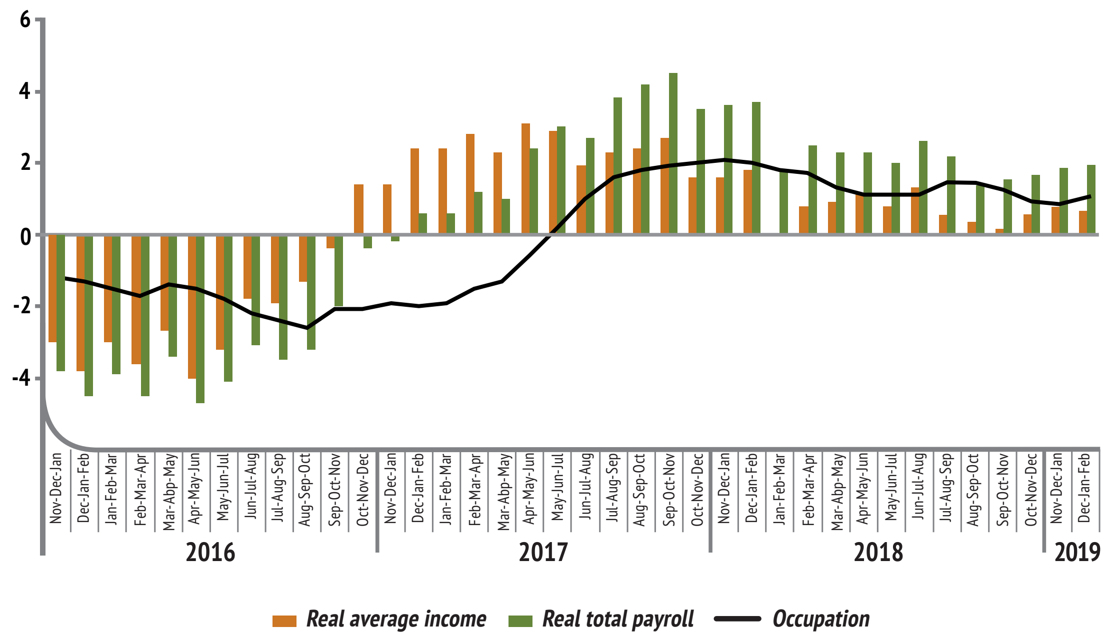
In the first two months of the year, total payroll increased by 4.3% as compared to the same period in 2018. In the comparison between 2018 and 2017, it grew by 3.7%.

This increase in total payroll in the first two months of the year was mainly driven by the average real income, which rose by 3.1% over the same period against 1.7% in 2018 in relation to 2017. Employment growth, however, was much less significant: it grew by only 1%, half the figure recorded in 2018 in relation to 2017.

Over the coming months, real total payroll will likely remain on the rise, but to a lesser extent due to the lower employment growth expected for the year. The average real income is also likely to increase at a lower rate due to a still high unemployment rate and to the effect of a moderate inflation expected for 2019. As a result, real total payroll is expected to increase by 1.5% in 2019, against 2.0% in 2018.

Total payroll will likely increase at a lower rate in 2019

Real Average Income, Occupation and Real Total Payroll - variation in relation the same moving quarter in the previous year
As a percentage (%)



Source: Continuous Monthly Pnad/IBGE survey

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Low economic activity suggests that interest rates may be reduced in 2019

IPCA rate remains below the target center

In 2019, the dynamic of the inflation rate has been less favorable than that observed in 2018. The Broad Consumer Price Index (IPCA) rose to 4.58% in the 12-month period to March. In 2018, inflation increased by 2.68% over the same period. This more rapid rise in the indicator was caused by the inflation rate recorded in March (0.75%), the highest one seen in the month since 2015 (1.32%).

Despite this rise, the rate will likely remain below the target center set by the Monetary Policy Committee (Copom), namely, 4.25%, and close the year at 4.21% as projected by CNI.

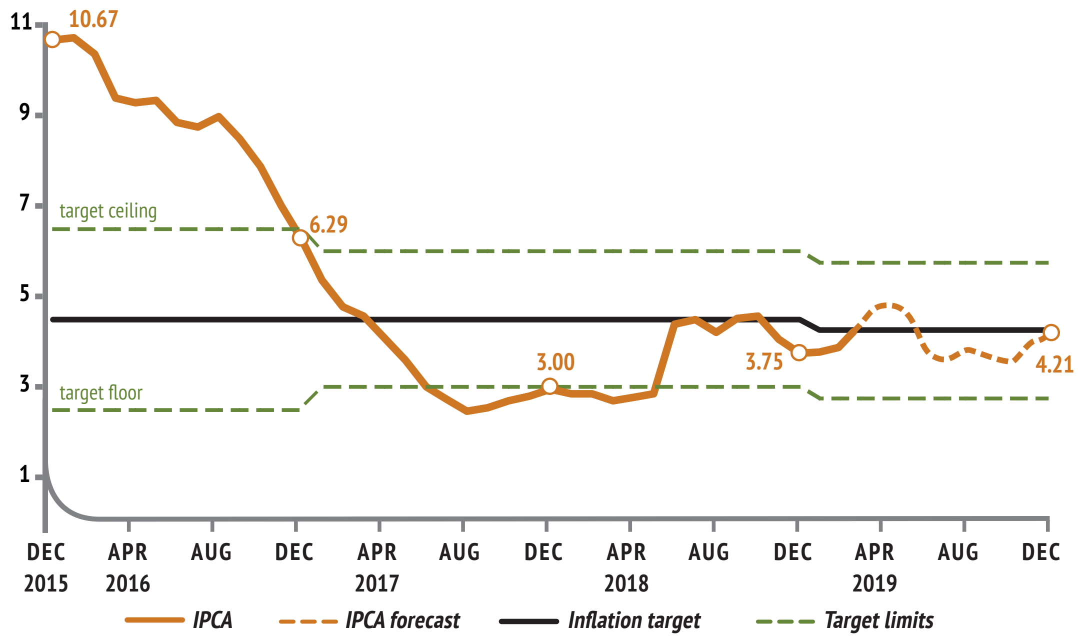
The food group is the one that drove the inflation rate up the most in 2019. The group experienced a significant variation of 4.2% in the first quarter of the year. In the last 12 months to March, food prices rose by 8.6%, after declining by -4.4% during the same period in 2018. It should be stressed that the items whose prices rose more sharply were those more affected by seasonal factors, such as tomatoes, potatoes, beans and fruits, meaning that the rise in food prices does not characterize a general trend for the coming months of the year.

Service prices, which are usually pressured by the strong inertia caused by their indexation to past inflation and to the minimum wage, remain on a downward path. This behavior is determined by the slow recovery of economic activity and, consequently, by the still weak recovery of the labor market. The group experienced a variation of 1.23% in the year to March. In the last 12 months, inflation in service prices rose by 3.6%, against 3.9% over the same period in 2018.

Government regulated prices rose by 1.3% altogether in the first three months of the year and by 7.4% in 12 months. This hike was influenced by an increase in the cost of electricity resulting from changes in the rates of the PIS (Social Integration Program benefits)/Cofins (Contribution to Social Security Financing) taxation on fuels in February and by increases in fuel prices, public transportation fares, and air fares in March.

IPCA above the center of the inflation target in March

Broad Consumer Price Index - IPCA
12-month figure (%)



Source: IBGE
Prepared by: CNI

Despite this growth in relation to 2018, inflation will likely remain low due to inflationary inertia, high economic idleness, and a still high unemployment rate, keeping demand down. Considering this base scenario - that is, if there are no supply shocks influenced by exceptional events, such as the truck drivers' strike held in May of last year - a slowdown in current inflation is expected and the IPCA index is likely to close the year at 4.21%, within the range of the inflation target for 2019, from 2.75% to 5.75%.

SELIC RATE MAY BE FURTHER REDUCED

Economic activity in 2019 will not increase at the required pace to significantly reduce the high economic idleness prevailing in Brazil and allow for a faster recovery of the labor market. Moreover, uncertainties about the progress of reforms - particularly of the pension reform - have been preventing private investment from being resumed at more than a modest rate.

At the same time, a still favorable IPCA scenario can be observed in the first quarter, as well as positive expectations on the index for the remainder of the year on the part of economic agents. In this scenario of prices below the inflation target and need for economic stimulus, there is room for monetary easing.

The Selic rate, which started 2018 at 7.0%, was reduced to 6.5% in March of that year. Since then, the Monetary Policy Committee has kept the rate unchanged in eight meetings in a row. CNI expects to see a reduction of 0.25 p.p. from the second half of the year and the Selic rate to remain at 6.25% per year until the end of 2019. Should this occur, the basic interest rate will drop to a new historically low level this year.

However, it should be highlighted that, for interest rates to be kept at a low level without inflationary pressures, complementary policies must be adopted and measures taken to ensure permanent macroeconomic stability, especially in the fiscal field.

With the Selic rate at 6.50% a year and inflation expected to remain at about 4% in the next 12 months, according to the FOCUS survey carried out by Brazil's Central Bank, the real interest rate (ex-ante concept, which considers future inflation) hit the mark of 2.4% a year in March.

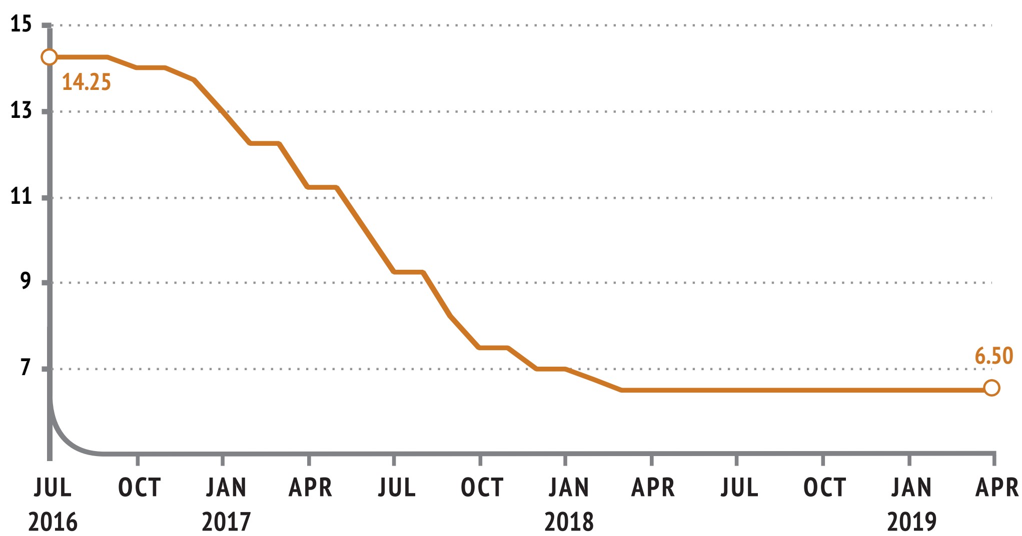
THERE IS ROOM FOR IMPROVEMENTS IN THE CREDIT MARKET

The credit market has been showing signs of recovery since the beginning of 2018 in response to the cycle of reductions in the basic interest rates of the economy. However, there is room for better results.

In relation to interest rates, the effects of a declining Selic rate on the cost of free credit could have been more significant. In 2011, when the average Selic rate was close to 12%, the

The Selic rate may drop to a new historically low level in 2019

Basic interest rate
End-of-period rate (% a year)



Source: Central Bank of Brazil

average interest rate on credit operations with non-earmarked funds was 38%. In 2018, even though the Selic rate was reduced to 6.5%, the average rate applied to non-earmarked funds was 39%. Currently, this rate is 38.5%.

Total credit stocks, which had declined over the last three years, have in turn increased once again in the inter-annual comparison. In February, total credit stock increased by 1.7% in real terms as compared to the same period in 2018. Between 2018 and 2017, it had decreased by 3.1% on the same comparison basis.

This improvement was brought about by the balance of the loan portfolio of individuals, which grew by 5% in February. However, the balance for corporations continues to decline (-2.2%). It should be noted, however, that corporate credit stocks declined by -9.3% and -14.3% in 2018 and 2017, respectively, on the same basis of comparison.

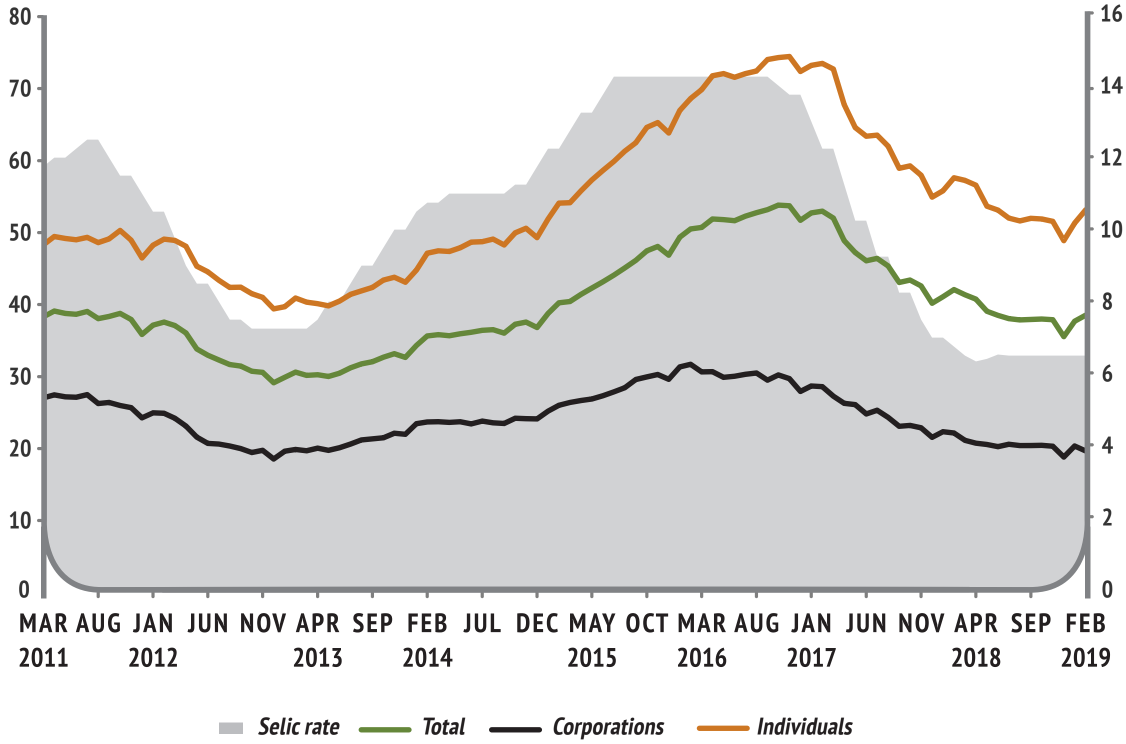
Lending continues in turn to increase. In the comparison between the 12-month period to February 2019 and the same period in 2018, total lending increased by 7.2% in real terms. For corporations, it increased by 8.3%, while for individuals a 5.9% increase was observed. The increase in lending to corporations was very positive, considering the results recorded in previous years: drop of 2.8% in 2018 and decrease of 20.2% in 2019.

For the remainder of the year, credit market lending and recovery of credit stocks is expected to continue to increase. In addition, the implementation of the Positive Credit Record (Supplementary Law 166/2019) and the expectations that the actions of the BC+ agenda on banking spreads will continue and that the Selic rate will be further reduced may make room for more significant reductions in the final credit cost.

Such expectations of improvements in the credit market may increase Brazil's credit-to-GDP ratio, which in February was 47%, well below the international average. According to the World Bank, the average international credit-to-GDP ratio in 2018 was 130%.

Potential impact of the reduction in the Selic rate for borrowers

Average interest rate on credit operations with non-earmarked funds
As a percentage (%)



Source: Central Bank of Brazil

FISCAL POLICY

Containment of spending will likely ensure a primary result below the target in 2019

Nominal result may still lead to a further increase in public debt

Fiscal data for the first two months of the year and a substantial containment of non-compulsory spending by the federal administration suggest that the primary and nominal results will improve once again in 2019. Apart from meeting the primary target by a large margin, the primary and nominal deficits will likely be lower than those seen in 2018. Nevertheless, the nominal deficit is likely to be higher than necessary to at least stabilize public sector debt in 2019.

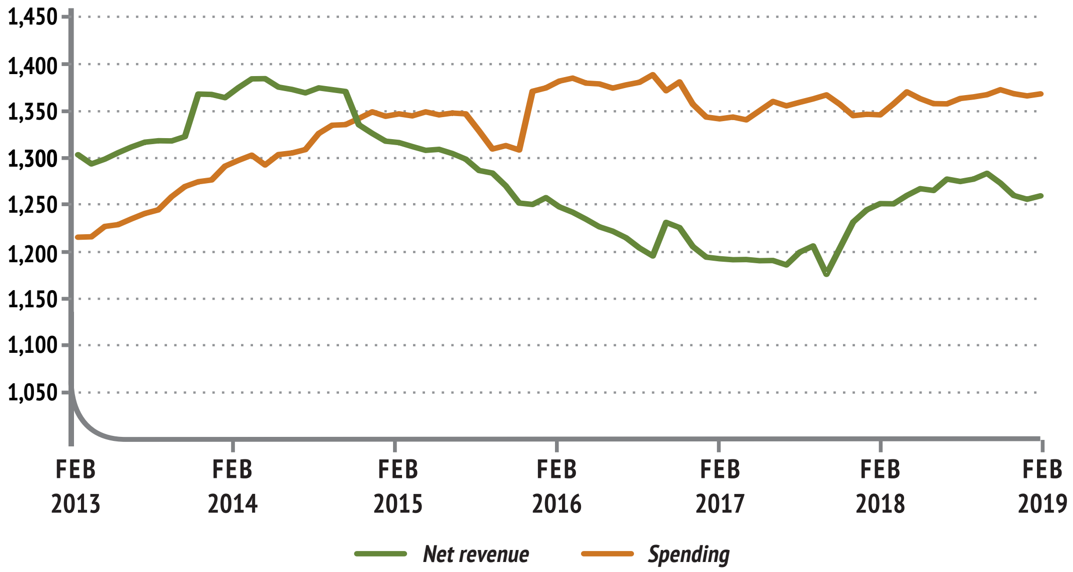
Given that medium- and long-term risks still persist, this improved short-term fiscal scenario will likely occur despite the reversal of the positive performance of revenues recorded in the last two years. The effects of two factors that contributed to increased revenues (installment payment of debts with the federal tax authority and increase of the PIS/Cofins contribution on fuels) will become less intense in 2019. In addition, revenues from concessions and permits will likely be lower in relation to 2018 and revenues from financial compensation for exploitation of natural resources are not likely to grow as significantly as in the previous year.

REVENUES AND SPENDING OF THE FEDERAL ADMINISTRATION DECREASE SLIGHTLY IN THE FIRST MONTHS OF 2019

The net revenue of the federal government decreased in real terms (IPCA deflator) by 0.2% in the first two months of 2019 as compared to the same period in 2018. However, this result was brought about by the reduction in revenues

Net revenue of the federal government in 12 months decreased by 2.1% in real terms between October 2018 and February 2019

Evolution of federal government primary spending and net income
12-month figure (billion reals in February 2019)



Source: National Treasury Secretariat/Ministry of Finance
Prepared by: CNI

resulting from the payment of debts with the federal government in installments (PERT/PRT and installment payment of active debt) and from the decrease in revenues from the PIS/COFINS contribution on fuel resulting from the reduction in taxation on diesel oil from June of last year.

Among the main components of federal government revenue, special mention should be made of a real increase of 5.2% in social security revenues in the first two months of 2019 in relation to the same period in 2018. This result was influenced by the increase in total payroll and the reduction in transfers to third parties, which is explained by changes in the tax collection system from August 2018.

Mention should also be made of the positive performance of revenues not managed by the Internal Revenue Service in the first two months of 2019, as they increased by 4.9% in real terms against the same period in 2018. In this case, this growth is mainly explained by the increase in financial compensation for the exploitation of natural resources, which was favored by increased oil production and by the adoption of oil prices in reals due to the exchange rate devaluation.

Revenues managed by the Federal Revenue Service have in turn decreased by 0.7% in the first two months of 2019 as compared to the same period in 2018. This decrease was due to the behavior of revenues from debts paid in installments and from the PIS/Cofins contributions on fuel, as already mentioned above, and it occurred despite a significant increase in revenues from corporate income tax caused by restrictions imposed on tax compensation through a law passed in mid-2018.

On the spending side, a real decrease of 0.1% was recorded the first two months of 2019 in relation to the same period in 2018. Increased spending on social security and increased non-compulsory spending were offset by a decrease in other compulsory expenditures, except for those with pensions and personnel.

Social security spending was the main source of pressure on federal government spending, as it increased by 1.9% in the first two months of 2019 against the same period in 2018. This result is explained by an increase in pensions caused by an increase in the minimum wage and by the indexation of pensions higher than the minimum wage in January, as well as by an increase in the number of people receiving pensions.

Non-compulsory spending was another major source of pressure on public spending in early 2019, as it increased by 2.0% in the first two months of the year as compared to the same period in 2018.

In the case of other compulsory expenditures, except for those with pensions and personnel, the real decrease of 3.4% observed in the first two months of 2019 was mainly due to the effects of the approval in previous years of legal measures that led to a reduction in spending on subsidies and on the federal student program (FIES).

DIFFERENT SITUATION IN REGIONAL GOVERNMENTS: REVENUES AND SPENDING ON THE RISE IN EARLY 2019

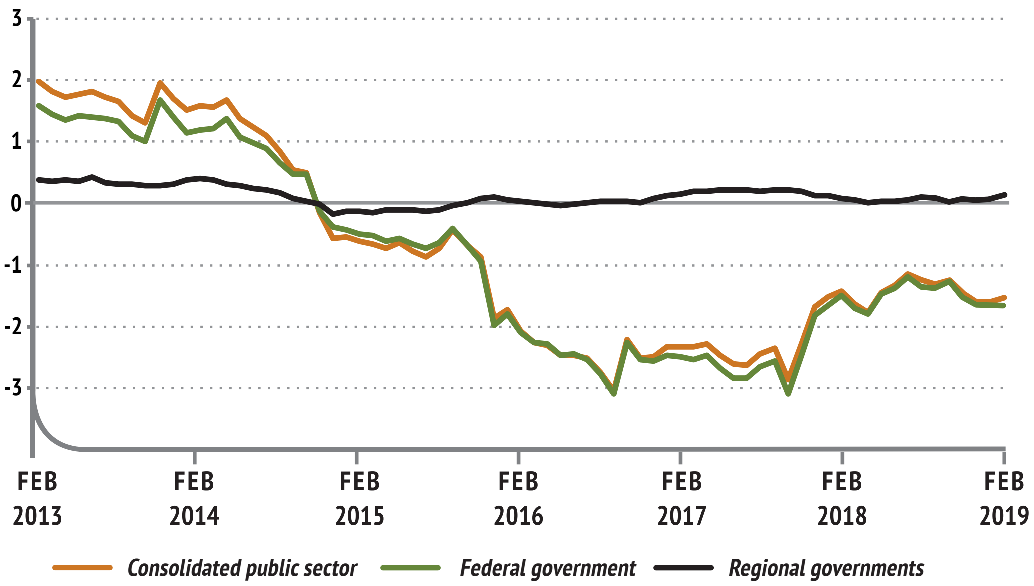
Unlike those of the federal government, revenues and spending of regional governments increased in early 2019. Based on available data on the revenues of states and municipalities and on the behavior of their primary result, CNI estimates that the spending of regional governments increased by 1.7% in real terms in the first two months of 2019 against the same period in 2018.

As for their revenues, available data show a real increase of 3.2% on the same comparison basis. Revenues from the turnover tax (ICMS), which is the main source of revenue for regional governments, increased by 0.7% in real terms in line with the slow pace of economic activity growth.

With regard to transfers from the federal administration, which constitute the second main source of funds for states and municipalities, a real increase of 7.0% recorded in the first two months of 2019 against the same month in 2018 can be explained by an increase in shared tax revenues (from the Income Tax and the IPI - tax on industrial products) and in the financial compensation for exploitation of natural resources.

12-month public sector primary deficit remained virtually stable in the first two months of 2019

Primary result of the consolidated public sector and by levels of government
(% of GDP)



Source: Central Bank
Prepared by: CNI

PRIMARY DEFICIT DECLINES SLIGHTLY IN THE FIRST QUARTER OF 2019

Increases in the primary surplus of regional and state governments accounted for a slight decline in the primary deficit of the consolidated public sector in the first months of 2019. The public sector recorded a primary deficit of R$105.8 billion (1.54% of GDP) in the 12-month period to February 2019. In December 2018, the result was negative by R$108.3 billion (1.59% of GDP).

This decline in the primary deficit and a reduction of 0.13 percentage points of GDP in nominal interest spending led the 12-month nominal deficit to fall from 7.14% in December 2018 to 6.95% of GDP in February 2019. However, this decline in the nominal deficit was not sufficient to avoid a slight increase in the gross debt-to-GDP ratio, which increased from 77.2% in December 2018 to 77.4% in February 2019.

PRIMARY DEFICIT LIKELY TO REMAIN ON A DOWNWARD PATH UNTIL THE END OF 2019

The downturn in federal government spending in real terms will likely intensify until the end of 2019 and, given that a small improvement in net revenue is expected, ensure a reduction in the primary deficit. The primary surplus of regional governments will in turn increase during the remainder of the year as a result of the end of a reduction approved for debt repayment installments paid by the states to the federal government in July 2018. The primary deficit of the consolidated public sector is therefore likely to close 2019 below the level observed until February and below the one recorded in 2018 as well.

The net revenue of the federal government is likely to experience a growth close to zero (0.1%) in 2019 in relation to 2018. This small improvement in relation to the outcome observed in the first two months of the year (-0.2%) will likely be brought about by an increase in revenues managed by the Internal Revenue Service (1.9%, according to CNI's estimate). The effect of the real GDP growth expected for 2019 (2.0% according to CNI - see the section "Economic Activity") will likely offset the negative impacts of the non-repetition in 2019 of the volume of revenues from debt repayment in installments to the federal tax authority and of the reduction in the PIS/Cofins taxation on diesel oil. On the other hand, net revenue growth will be constrained by an expected decrease in revenues not managed by the Internal Revenue Service (-3.5%) and by a slowdown in the pace of increase of social security revenues.

With respect to federal government spending, a real decrease of 0.8% has been projected for 2019 in relation to 2018. This result will likely be explained by a drop in non-compulsory spending, due to a significant financial programming of approximately R$30 billion, and in other compulsory expenditures, except for spending on social security and personnel.

Spending on personnel is in turn expected to close 2019 with a real growth of 5.5%, reflecting the salary adjustments granted in January. Social security spending will likely to close the year with a real expansion of 1.2%, with the increase in the value of pensions being partially offset by the positive effects of measures taken to revise irregular pensions.

In this scenario, CNI estimates that the federal government and its state governments are likely to close the year with a primary deficit of R$111.6 billion (1.53% of GDP as estimated by CNI). This outcome would be well below the R$ 142.5 billion target set for 2019 and lower than the primary deficit of R$112.7 billion (1.65% of GDP) recorded in 2018.

For regional governments, revenues are expected to continue to grow at the same pace. Continuity of economic activity will keep on increasing revenues from the turnover tax (ICMS) and, because oil prices and production will remain at high levels, transfers received from the federal administration will continue to grow at the same pace.

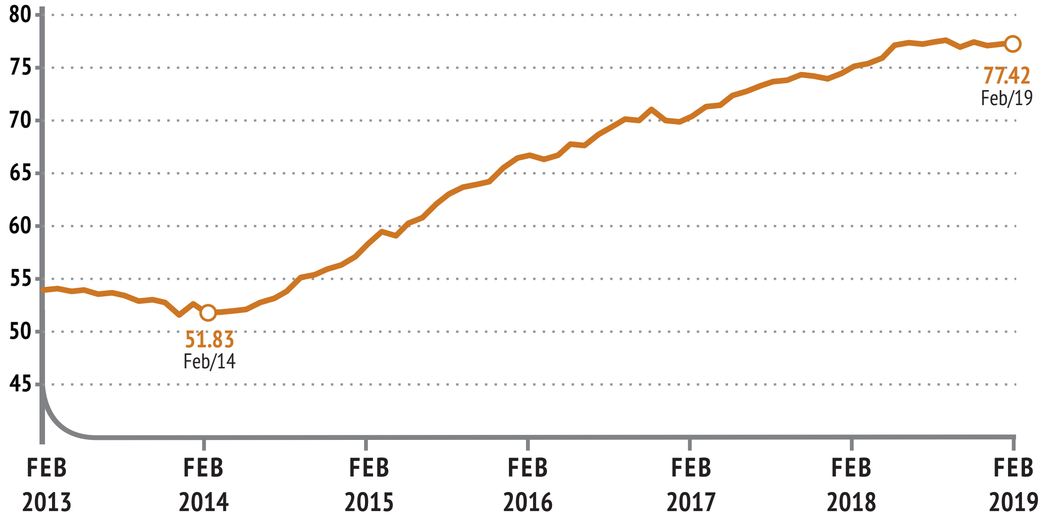
It is likely that there will be less room for spending to grow, given the resumption, since July 2018, of full payment of state debt repayment installments under a renegotiation agreement between states and the federal administration. The primary surplus of states will therefore likely increase to R$10.5 billion in 2019 (0.14% of GDP as estimated by CNI).

As a result, the consolidated public sector primary surplus is expected to record a deficit of R$101.1 billion (1.39% of GDP) in 2019. This result would represent a positive margin of R$30.8 billion in relation to target set for 2019 of a deficit of R$132 billion and would be below the deficit of R$108.3 billion (1.59% of GDP) observed in 2018.

The drop in the primary deficit will be added to a reduction of 0.3 percentage points of GDP in nominal interest spending and reduce the nominal deficit from 7.14% in 2018 to 6.65% of GDP in 2019. However, the nominal deficit will still be above the level required to stabilize the gross debt-to-GDP ratio. Despite the return of R$40 billion by the BNDES to the National Treasury, the gross debt-to-GDP ratio will likely close 2019 at 78.2%, against 77.2% in 2018.

Gross debt-to-GDP ratio increased by 0.2 percentage points in the first two months of 2019

Trajectory of the Public Sector Gross Debt
Percentage (%) of GDP



Source: Central Bank of Brazil

FOREIGN TRADE SECTOR

Direct investment records highest result in the last six years

Crisis in Argentina jeopardizes exports of manufactured goods and trade balance

Brazil's external accounts remain robust and relatively stable in relation to the exchange rate in the first quarter of the year, contributing to predictability both in international trade and in the production costs of entrepreneurs.

The scenario abroad has been showing signs of greater protectionism in the trade relations between the world's largest economies, tending to generate vulnerability in global growth. Some examples include the rupture between the United Kingdom and the European Union, which is scheduled for April 12 (until the closing date of this report), after a lot of inconclusive discussions on the terms of this separation, and the trade war between the United States and China, which has become less intense in recent months but has clearly imposed export barriers on both countries.

The intensification of both tariff and non-tariff trade barriers has been jeopardizing trade flows and tending to slow down global growth even more, impacting more negatively on exports from emerging countries such as Brazil.

In the domestic scenario, the exchange rate and the so-called Brazil Risk (EMBI) remain more stable than in the second half of last year, a period marked by extreme turbulence in those indicators. The exchange rate hit the mark of R$3.85/US$ 1 on average in the last 30 days (until April 5, 2019), which represents a depreciation of 3.2% in relation to the average recorded in the previous month. The Brazil Risk remained at 248 points on average over the same period this year.

The trade surplus amounted to US$10.5 billion in the first three months of the year. Despite showing a surplus, the trade balance declined by 14.1% in relation to the first quarter of last year. The crisis in Argentina continues to have a negative effect on Brazilian exports of manufactured products, which have a significant impact on the trade balance, as they are goods of a higher value. Increased exports of basic products have not been sufficient to preserve the trade balance and the exchange rate depreciation contributed even more to the decline in the price of these goods.

Finally, the 12-month current account deficit amounted to US$13.9 billion, up by 40% in relation to the one recorded over the same period last year. However, direct investment hit the mark of US$89.5 billion over the same period, the highest value since July 2013, more than offsetting the current account deficit.

EXCHANGE RATE AND BRAZIL RISK SHOW LESS VOLATILITY IN THE FIRST QUARTER OF THE YEAR

In the quarter from January to March, the exchange rate recorded an average level of R$3.77/US$1, which represents a depreciation of 16% in relation to the same period in 2018. In the last 30 days, the exchange rate averaged R$3.85/US$1(up to April 5, 2019), up by 3.2% in relation to the average in the previous month and by 17% in relation to the same period the year before.

Despite the depreciation of the real against the US dollar in the year-on-year comparison, the exchange rate is less volatile than in the second half of last year. Since the beginning of the year, its highest value was R$3.97/US$1 (on March 28, 2019). Over the last twelve months, the real depreciated by 16.3% against the US dollar.

The Country Risk (EMBI) reached 250 points (on April 5, 2019) and is also more stable than in the second half of last year, when it rose to 349 points. The Risk remained at 248 points on average both during the first quarter of the year and in the last 30 days (up to April 5, 2019).

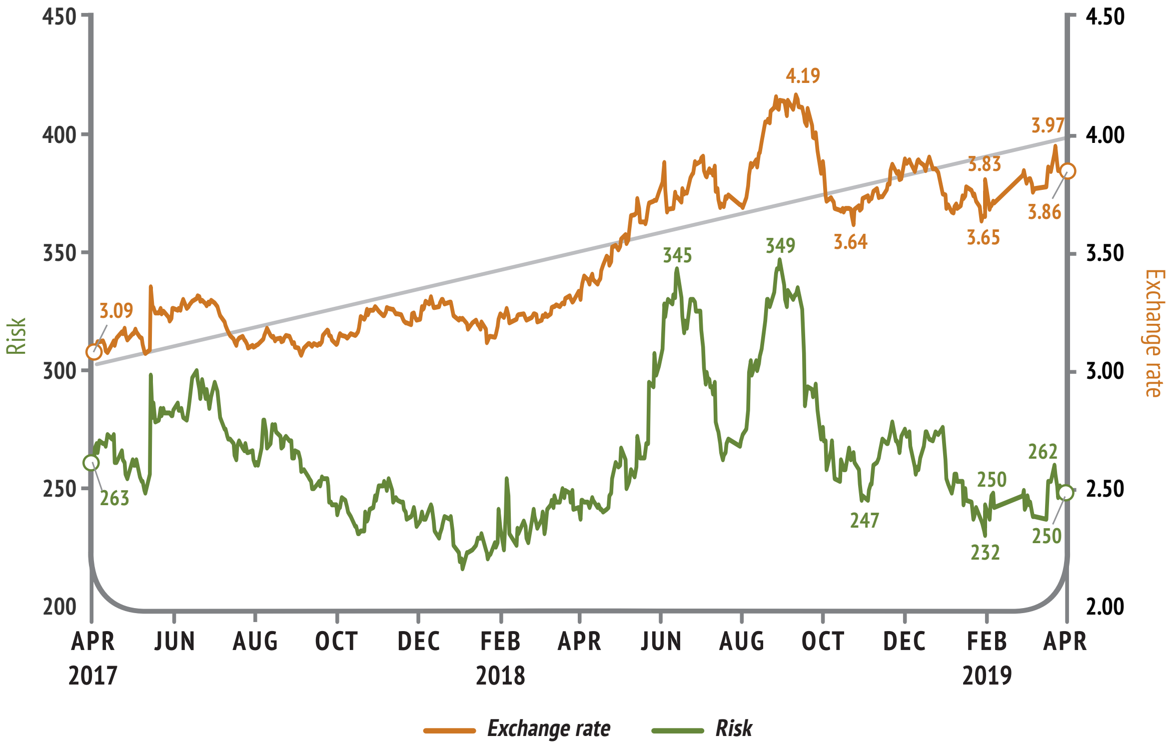
In the external scenario, two main factors have been contributing to the stability of the exchange rate: the trade agreements entered into between the United States and China for reducing tariff barriers and the more flexible monetary policy promoted by the Fed, which has kept interest rates at the same level since January of this year.

In the domestic scenario, the efforts made by government to have the pension reform approved, regardless of all the difficulties involved, have indicated that it adopted a posture of greater fiscal responsibility in relation to public accounts, keeping the Country Risk more under control, which in turn contributes to ensuring stability in the exchange rate.

The exchange rate is projected to close 2019 at R$3.82/US$1, but it could be lower if the structural economic reforms under discussion currently are approved.

Stability of Brazil Risk influences exchange rate volatility

*Daily exchange rate (Ptax * Closing Rate) and the Brazil Risk (EMBI)*
In R$/US$ and points



Source: Central Bank of Brazil and JP Morgan.
Prepared by: CNI.
** The Closing Ptax rate is the arithmetic average of bid and offer rates published in daily bulletins.*

REDUCTION IN GLOBAL GDP AND DEPRECIATED EXCHANGE RATE JEOPARDIZE TRADE SURPLUS

In the first three months of the year, the trade balance surplus amounted to US$10.5 billion, down by 14.1% in relation to the surplus recorded in the same period last year, of US$12.2 billion.

Both exports and imports have declined, but the decrease in exports seen since October of last year was more pronounced than the decline in imports, leading to a lower trade balance. As compared to the figure recorded in the first quarter of 2018, exports decreased by 3.7% and imports declined by 0.7%.

Breaking down the trade balance by aggregate factor, the category of basic products was the only one that showed an increase in exports, of 7.3% in relation to the first quarter of last year. Exports of manufactured and semimanufactured products fell by 9.6% and 3.8%, respectively, representing a decrease of US$1.8 billion and offsetting the US$1.8 increase observed in exports of basic products.

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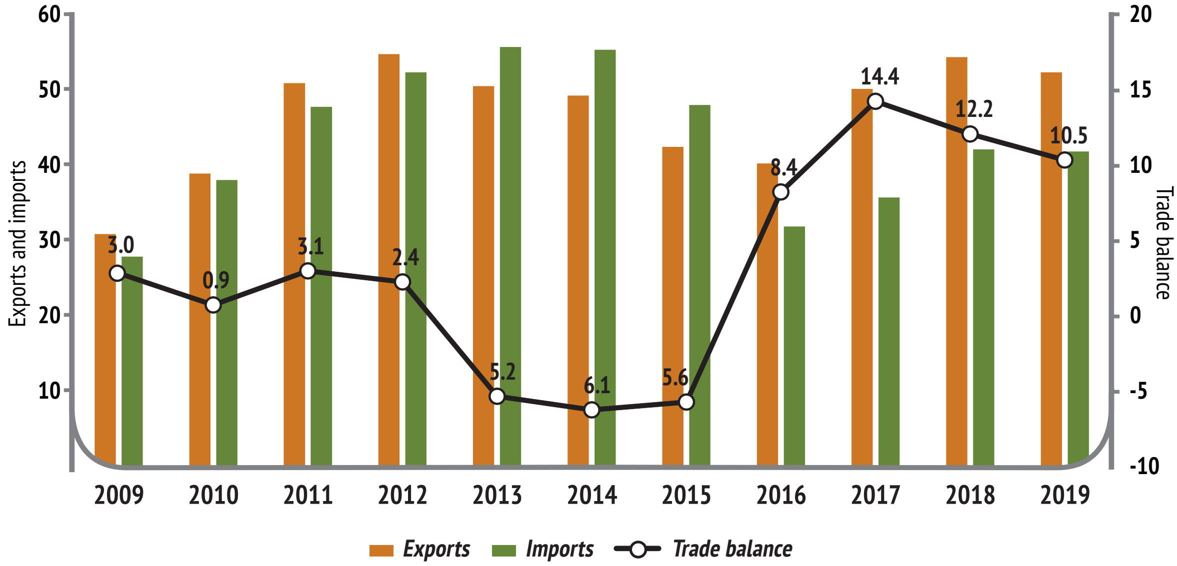
In relation to imports, the value of basic and semimanufactured products increased by 6.7% and 18.7%, respectively, on the same comparison basis. Imports of manufactured products dropped by 2.4% or by US$0.9 billion, while those of basic and semimanufactured imports accounted for US$0.6 billion sent abroad.

The drop in the trade surplus was enhanced by the performance of the flow of semimanufactured and manufactured products, and because of the low value added of commodities the increase in net exports of goods included in this group was not sufficient to keep the trade surplus at the same level observed last year. A more depreciated exchange rate aggravated this situation, leading to a decline in the price of exports. The poor performance of manufactured goods in the trade balance is largely due to the crisis in Argentina, which has caused a slowdown in automobile exports.

By the end of 2019, a higher trade surplus than the one recorded in 2018 is expected, mainly due to the slowdown in global growth, which had a negative effect on exports. CNI projects a trade balance surplus of US$ 45 billion at the end of the year, with exports amounting to US$ 240 billion and imports totaling US$ 195 billion.

Decline in exports of manufactured and semimanufactured goods compromises trade surplus

In US$ billion



Source: SECEX/MDIC
Prepared by: CNI.

INCREASED DIRECT INVESTMENT ENSURES THE ROBUSTNESS OF EXTERNAL ACCOUNTS

Brazil's external accounts continue to show solid outcomes, with a fair margin of coverage of the deficit in current transactions by the volume of direct investments.

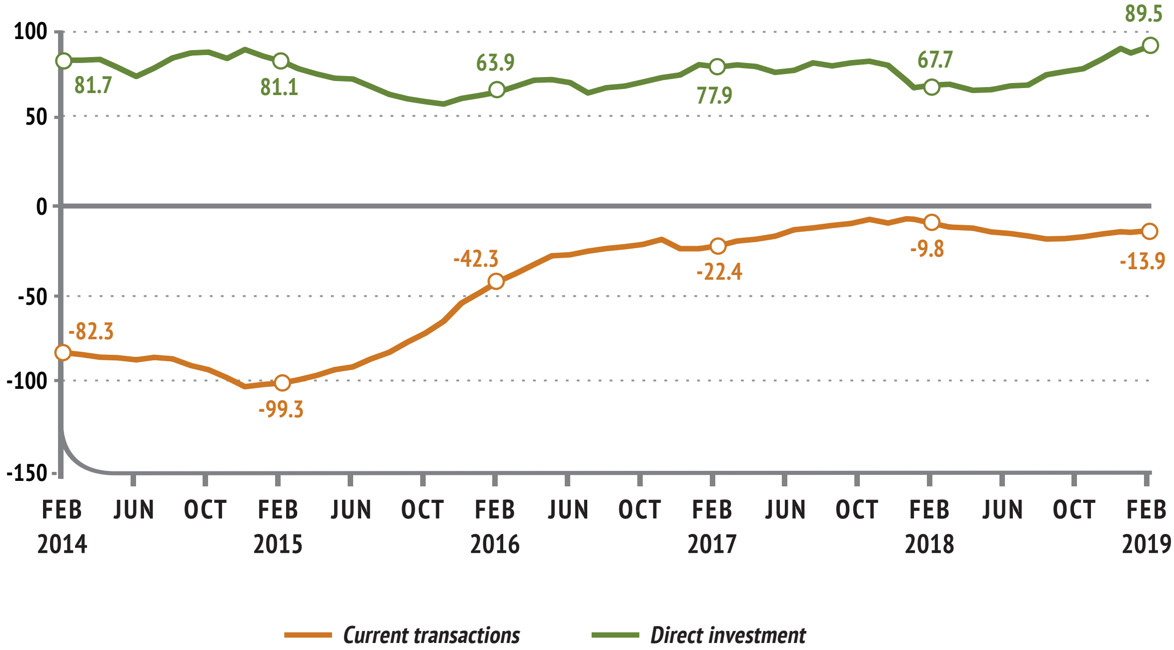
In February, the deficit in current transactions amounted to US$1.1 billion, down by 44.5% as compared to the same period last year. In the 12-month period to February, the deficit amounted to US$13.9 billion, up by 40% in relation to the US$9.8 billion deficit recorded in the same period last year. The decline in the current account balance was mainly due to the decrease in net exports as of March 2018. Nevertheless, the trade surplus remains high enough to keep the deficit in current transactions at a safe level considering the high volume of direct investment being recorded.

Direct investment in twelve months to February amounted to US$89.5 billion, the highest figure seen since June 2013. This amount is more than sufficient to cover the current deficit, as it represents approximately 6.5 times the deficit observed over the same period. The balance of direct investment increased by 32.2% during the same period last year, which is equivalent to an additional US$21.8 billion.

By the end of the year, the deficit will likely reach US$25 billion, about 1.3% of GDP as estimated by CNI for the end of the year. The increase in the deficit is likely due to the decline in the trade balance resulting mainly from the slowdown in global growth.

Direct investment exceeds current account deficit

12-month balance in current transactions
Direct investment in 12 months
In billion US$



Source: Central Bank of Brazil
Prepared by: CNI

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OUTLOOK FOR THE BRAZILIAN ECONOMY

	2017	2018	2019 previous forecast (Brazilian Economy December/18)	2019 current forecast
ECONOMIC ACTIVITY				
GDP (annual change)	1.1%	1.1%	2.7%	**2.0%**
Industrial GDP (variação anual)	-0.5%	0.6%	3.0%	**1.1%**
Household consumption (annual change)	1.4%	1.9%	2.9%	**2.2%**
Gross fixed capital formation (annual change)	-2.5%	4.1%	6.5%	**4.9%**
Unemployment rate (annual average - % of the labor force)	12.7%	12.3%	11.4%	**12.0%**
INFLATION				
Inflation (IPCA index - annual change)	2.9%	3.8%	4.1%	**4.2%**
INTEREST RATES				
Nominal interest rate				
(average rate for the year)	9.92%	6.56%	6.83%	**6.42%**
(year's end)	7.00%	6.50%	7.50%	**6.25%**
Real interest rate *(ex-post - average annual rate and deflation: IPCA)*	6.2%	2.8%	3.0%	**2.4%**
PUBLIC ACCOUNTS				
Primary result (% of GDP)	-1.69%	-1.59%	-1.57%	**-1.39%**
Nominal result (% of GDP)	-7.80%	-7.14%	-7.82%	**-6.65%**
Public sector's gross debt (% of GDP)	74.07%	77.22%	79.50%	**78.20%**
EXCHANGE RATE				
Nominal exchange rate - R$/US$				
(average for December)	3.29	3.88	3.80	**3.82**
(average for the year)	3.19	3.66	3.64	**3.78**
FOREIGN TRADE SECTOR				
Exports (US$ billion)	217.7	240.0	235.0	**240.0**
Imports (US$ billion)	150.8	181.2	190.0	**195.0**
Trade balance (US$ billion)	67.0	58.7	45.0	**45.0**
Current account balance (US$ billion)	-7.2	-14.5	-22.0	**-25.0**

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