A Newsletter from Brazilian Confederation of Industry

CNI

# Economic Report

Year 23 - Number 3 - July/September 2007

# Manufacturing leads economic growth

There are now clear signs that the Brazilian economy is growing. The industry, particularly the manufacturing industry, has become a major actor in fostering GDP growth in the second quarter. The leading role played by the manufacturing activity was not observed in previous quarters. This change in the economic scenario ensures a more solid economic growth and leads CNI to revise the GDP growth estimate upwards, to 4.7% in 2007.

The business climate in this second half of the year is positive. Higher growth rates have been registered in most industrial sectors, and one in four of them have been growing at two-digit rates in 2007. Industrial jobs have been growing at the same pace as production: the sector hired more new workers during the twelve-month period ending in August than commercial establishments, changing a historical pattern.

This stepped-up manufacturing production is supported not only by an increasing foreign demand for major Brazilian exports but also – and mainly – by a significant domestic demand, which has been growing at the highest rates of the past thirteen years. Therefore, the manufacturing production has been growing (i.e. the supply of products has increased) in response to this additional demand. The larger supply of products was also brought up by increased imports, which have been growing at a pace of 20% in 2007 as a result of the appreciation of the real.

Nevertheless, no robust growth in the manufacturing production beyond 2007 is guaranteed. The main factor limiting this growth path is a gradual but continuous increase in inflation rates since April. This pressure may lead the Monetary Policy Committee (Copom) to interrupt the reduction of basic interest rates, restricting credit and demand expansion, particularly of goods with higher added values.

While on the one hand the Central Bank is worried with the increasing aggregate demand, on the other hand the strong rise observed in domestic demand is partly due to a rather expansionary fiscal policy. This contradiction tends to translate into more recurrent and possibly severer monetary squeezes than would be necessary otherwise, affecting the long-run growth path. Real government spending has been growing at approximately 10% a year in 2007, twice the GDP growth pace. Moreover, this increase in public spending is being financed by a significantly higher tax revenue, as tax collection has been increasing at a much faster pace than production. That is, an increasingly higher percentage of Brazil's income is being diverted from the private to the public sector, jeopardizing the quality – and sustainability – of its economic growth.

This higher demand is surely leading to a higher capacity utilization (UCI). However, the risk of an insufficient supply of products seems low, as there are clear signs that the production capacity is also growing in Brazil. The gross fixed capital formation grew by 13.8% in the second quarter of 2007 in relation to the same period in 2006. The apparent consumption of machinery and equipment (domestic production plus imports minus exports) grew by 19.5% over same period. Once again, the scenario could be even better if interest rates in Brazil were not amongst the highest ones in the world.

In sum, this is a favorable moment for the Brazilian economy, particularly for the Brazilian industry. However, the scenario could be better and it is advisable to keep an eye on the future. Reducing the excessively high pace of public spending is a must to reduce the pressure on domestic demand, so that interest rates can continue on a downward path. By spending less, the government could tax less and make more resources available for private investments. This is the path of the virtuous cycle that will enable Brazil to ensure high economic growth rates for a long period.

## Manufacturing grows in response to a higher demand

In previous editions, we emphasized that the shifts of aggregate demand observed in Brazil were not stimulating equally robust increases in the manufacturing production. In this edition, however, we will stress an important change in the economic scenario: the industry is now leading economic growth. National Accounts figures for the second quarter of 2007 reveal a 7.2% increase in the manufacturing production from the same quarter in 2006, while the average economic growth rate was lower, hitting the mark of 5.4% in this comparison.

The growth observed in the manufacturing activity is supported by an increasing foreign demand for food products, steel and ethanol – major Brazilian exports – and by domestic demand, which has been growing at a pace of 5.8% a year – the highest growth rate since 1994, when the Real Plan was launched.

Higher total earnings and an expansionary fiscal policy have enhanced consumption in Brazil. Additionally, lower interest rates have been enhancing credit opportunities, with a particularly strong impact on the demand for consumer goods with a higher added value. In this scenario, the supply of products in Brazil must remain on the rise in the short run to meet this increasing demand.

Products manufactured abroad accounted for a significant percentage of this supply. The volume of imports in Brazil has been growing at a rate of 20% in 2007 as a result of both a higher demand and the appreciation of the real. But this larger supply was also caused by faster production in Brazil, which could be more clearly perceived in the second quarter of 2007.

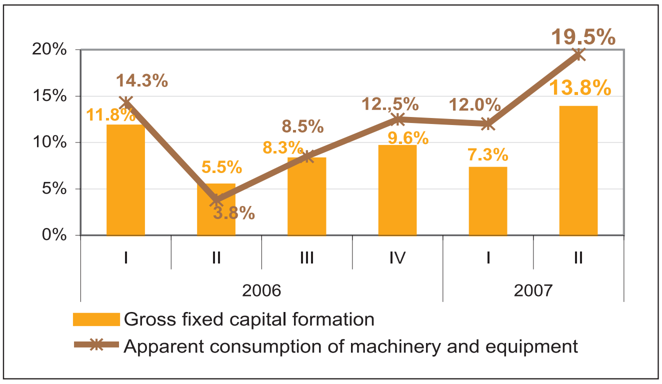
The manufacturing production grew by 2.3% in the comparison between the second and the first quarters of 2007 (seasonally adjusted data of the Monthly Industrial Survey). This is the highest growth rate between two subsequent quarters since 2004. The growth observed in the manufacturing activity was not only intense but also comprehensive in sectoral terms. Production increased in twenty of the twenty-seven sectors covered by the Monthly Industrial Survey, as the second quarters of 2007 and 2006 are compared.

This scenario of enhanced manufacturing activity is expected to continue in the third quarter. According to Anfavea (National Association of Motor Vehicle Manufacturers), motor vehicle production grew by 21.5% in a comparison between the average rates observed in July-August of 2007 and 2006. Physical production in July (PIM/IBGE) shows that the third quarter began with positive indicators: seven industrial sectors – Chemical products; Rubber and plastic; Machines and Equipment; Electric materials; Automotive vehicles; Other transportation equipment; and Furniture – grew at two-digit rates as compared to July 2006.

The growth observed in the manufacturing production was accompanied by a higher capacity utilization (UCI). In July, enterprises used 82.5% of their installed capacity on average (UCI / CNI Manufacturing Indicators), up by 2 percentage points in relation to July in the previous year. This higher UIC led to discussions on the sustainability of the manufacturing production growth.

**Gross fixed capital formation and apparent consumption of machinery and equipment:**

% change from the same quarter in the previous year




Source: IBGE and IPEA

However, it should be stressed that the expansion observed in the manufacturing production recently took place simultaneously with a strong increase in investments. The gross fixed capital formation grew by 13.8% in the second quarter of 2007 in relation to the same quarter in 2006. The apparent consumption of machinery and equipment (as calculated by IPEA) grew by 19.5% over the same period. It should also be highlighted that the apparent consumption of machinery and equipment has been growing at two-digit rates a year since the fourth quarter of 2006. This is a clear sign that Brazil's productive capacity is growing, which reduces risks of insufficient supplies of products in the medium term.

## GDP is expected to grow by 4.7% in 2007

CNI raised its GDP growth estimate from 4.5% to 4.7% in 2007. This upward revision was based on prospects of a more robust growth in industrial production. The four main components of the industry – mineral extraction, manufacturing, civil construction and public-utility industrial services – grew at rates higher than the average one, observed in the economy as a whole, in the second quarter. This is a new fact not observed in the previous quarters, leading us to review Brazil's expected GDP growth this year.

The agricultural/livestock production is expected to grow by 3.0%, less than the 4.5% rate estimated early this year. The agriculture/livestock activity grew by only 1.4% in the first half of 2007 as compared to the same period in 2006. However, the scenario in this sector beyond 2007 is extremely favorable, as high agricultural commodity prices led to an increase in the planted area and, probably, to a larger harvest in 2008. Strongly stimulated by the performance of commercial establishments and financial intermediation, services are expected to grow by 4.4%.

Tax collection is expected to increase by 7.2% in 2007. When tax collection grows at a higher pace than production, a higher percentage of the income generated in Brazil is diverted from the private to the public sector. This reallocation of resources, revealed by official figures in the National Accounts, hinders the prospect of higher productivity and sustained GDP growth.

**GDP: Projections for 2007**

| | GDP Components | 2007 | |
|---|---|---|---|
| | | Rate of change (%) | Contribution (p.p.) |
| Demand | Household consumption | **5.8** | 3.5 |
| | Government consumption | **4.2** | 0.8 |
| | GFCF | **10.5** | 1.8 |
| | Exports | **5.2** | 0.8 |
| | (-) Imports | **20.0** | 2.3 |
| Supply | Agriculture and livestock | **3.0** | 0.2 |
| | Industry | **4.4** | 1.4 |
| | *Extractive (Minerals)* | 5.0 | 0.2 |
| | *Manufacturing* | 4.3 | 0.8 |
| | *Construction* | 4.5 | 0.2 |
| | *Public utilities and services* | 4.2 | 0.2 |
| | Services | **4.4** | 2.8 |
| | Taxes | **7.2** | |
| | **GDP (market prices)** | **4.7** | |

Source: CNI

As for the components of domestic demand, CNI still believes that household consumption will grow by 5.8%, accounting for 75% of economic growth as a whole in 2007. Government consumption is expected to increase by 4.2% in 2007.

CNI maintains the estimate of an increase of 10.5% in the gross fixed capital formation. This growth is associated with a drop in basic interest rates, enhanced use of installed capacity, and a higher spending in infrastructure. Exports of goods and services are expected to increase by 5.2% this year and imports are estimated to grow by 20.0%. As a result, the net contribution of the foreign trade sector to GDP formation is expected to be negative by 1.6 percentage points in 2007.



## Higher labor formalization rate in metropolitan areas

In the wake of a more dynamic economic activity, the labor market improved the quality of new jobs. According to IBGE's Monthly Job Survey, of the 594,000 new jobs created in the last twelve-month period ending in August, 590,000 were formal jobs in the private sector. As a result, the formality index – the ratio between formal, military and statutory jobs divided by total occupation – rose to 54.9% in August, the highest level of the series since the Monthly Job Survey began to be carried out, in March 2002.

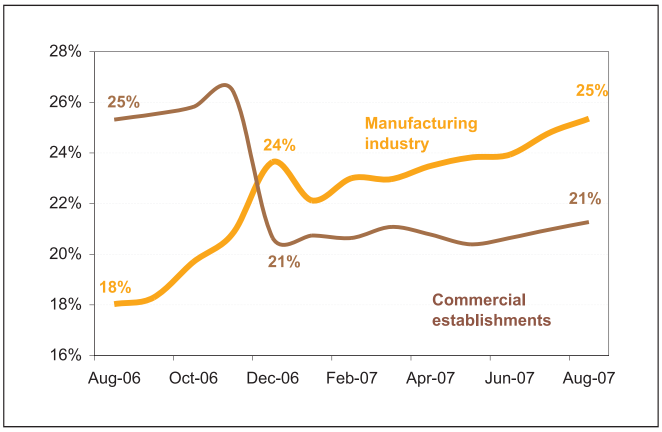
Informal occupations have moved in opposite directions: on the one hand, the number of self-employed individuals increased by 3.5% in August (137,000 additional jobs) in the comparison with the same month in the previous year and, on the other hand, informal jobs in the private sector dropped by 6.2% in the same period (189,000 less jobs).

In sectoral terms, Services and Civil construction accounted for most of the increase observed in total jobs since August 2006 – 11.7% and 4.9%, respectively.

As for formal jobs, manufacturing has had an increasing participation in creating them. According to CAGED (General Record of Employed and Unemployed Persons), which is maintained by the Ministry of Labor and Employment, the participation of manufacturing in all formal jobs created over the past twelve months has exceeded those in commercial establishments – breaking a long term pattern.

**Formal jobs:**

Participation (%) of manufacturing and commercial establishments in all jobs created in 12 months



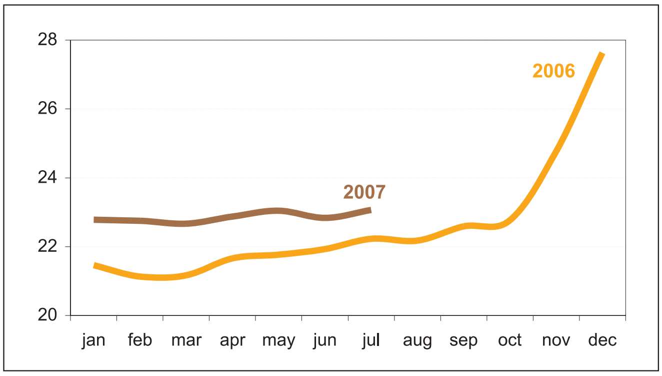

Source: CAGED / MTE

The increase in the number of jobs in August from the same month in the previous year (2.9%) was almost twice the increase observed in the Economically Active Population (1.7%). The job creation at this pace faster than the increase in the number of people who began searching for jobs pushed the unemployment rate down. In August, the unemployment rate was 9.5%, i.e. 1.1 percentage points below the one registered in August last year. If this rate continues on a downward path, the annual average may hit the mark of about 9.5% in 2007.

Real total earnings actually received, as measured by the Monthly Job Survey, increased by 1% in July after dropping in June. In the comparison with July 2006, this income category grew by 3.8%. It is a less intense (annual) pace of expansion than the ones observed earlier in 2007. The higher inflation observed in recent months was a major cause of the drop registered in real earnings.

**Real total payroll**

% variation from the same month in the previous year




Source: PME

# INFLATION, INTEREST RATES AND CREDIT

## Inflation close to the center of the 2007 target

The inflation rate as measured by the IPCA has been rising since April. Late in August, the inflation index had risen by 4.18% in twelve months, over one percentage point above its variation in 2006 (3.14%). Although the risk of losing control over inflation is low, larger domestic and foreign demands make it imperative to coordinate the monetary and fiscal policies better – and to adjust them to the international scenario as appropriate.

In recent years, hikes in the prices of commodities such as the ones in Energy and Metallic Minerals groups did not significantly affect the behavior of consumer prices in Brazil. Currently, however, the country is experiencing more robust growth rates, and higher agricultural commodity prices in the international market are beginning to impact domestic markets.

Negative shocks in the world supply of these products and the growth pace of the global demand have translated into significant price hikes in past quarters. The prices of commodities falling under the Food and Beverages group – corn, wheat, soybeans, beef, pork and poultry, sugar and coffee, among others – rose by almost 10% in the first eight months of 2007 from an already high level (14.2% hike in 2006).

**Commodities: international prices**

% change

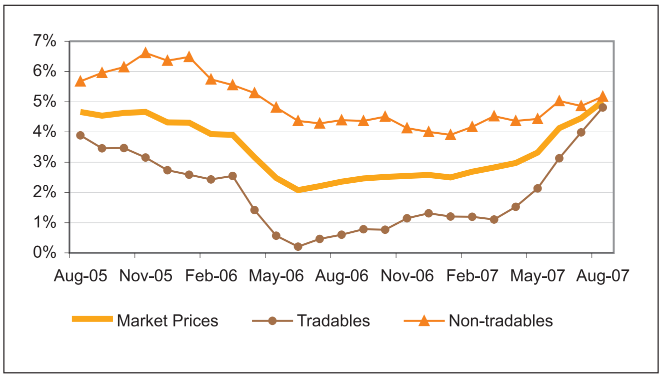
| | 2004 | 2005 | 2006 | 2007* |
|---|---|---|---|---|
| **Total** | **22.5** | **33.9** | **14.0** | **11.4** |
| Energy (Oil, Natural Gas and Coal) | 30.3 | 41.8 | 7.1 | 14.2 |
| Food and Beverage | 2.3 | 5.8 | 14.2 | 9.5 |
| Industrial inputs | 14.9 | 26.9 | 42.5 | 3.9 |
| Agricultural Raw Materials | -1.0 | 7.5 | 13.6 | -0.9 |
| Metals | 24.5 | 36.3 | 53.6 | 5.2 |

Source: IMF (*) January-August, 2007.

Breaking the IPCA index into major categories of goods shows how these international pressures have been internalized. While on the one hand regulated prices are still relatively under control, with a variation of 2.38% in the twelve-month period ending in August, this variation is less than half the one registered in market prices as a whole in the same period (5.01%). Amongst these, a strong hike in the prices of tradable goods deserves special mention, for their variation in twelve months soared from 1.10% late in March to 4.81% in August. These goods, whose price dynamics favored inflation control for five consecutive quarters (from July 2005 to March 2007), are expected to continue to push the IPCA index up in the next few months.

**Inflation: Market prices, prices of tradable and non-tradable goods**

% change in 12 months




Source: IBGE

Besides the Food and Beverages subgroup, whose prices rose by 6.73% between January and August, the higher costs of Personal Expenses (4.35%) and Education (4.19%) contributed to push the IPCA index up in the period.

In any case, the international conjuncture and a higher domestic demand had even stronger effects on General Price Indices – which capture price hikes also in the wholesale. The General Price Index-Internal Availability (IGP-DI) and its main component, the Wholesale Price Index-Internal Availability (IPA-DI), rose by 5.19% and 5.49%, respectively, in the twelve-month period ending in August.

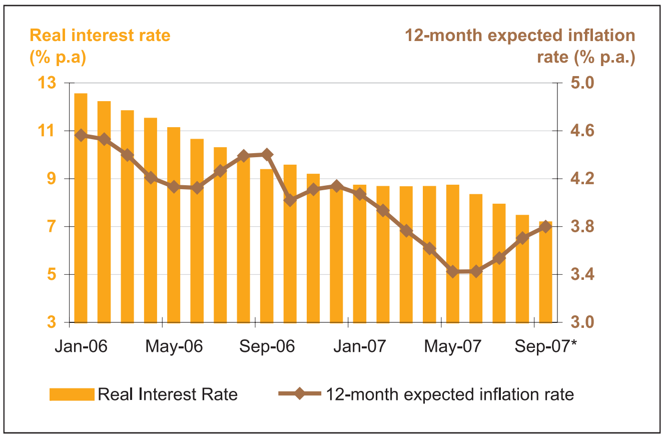
Breaking the IPA-DI into categories of goods at different processing stages, a higher price increase can be observed in the group of gross raw materials: the monthly inflation rose from 2.01% in July to 6.31% in August – a hike of 14.58% in twelve months. The prices of intermediate and final goods were still increasing at more modest rates in the twelve-month period ending in August: 3.07% and 2.48%, respectively. As for the categories of IPA according to the origin of goods, prices of agricultural products rose by 6.15% in August alone and had a variation of 14.87% in twelve months. The prices of industrial products increased by 0.61% in August, but they still accumulate a twelve-month variation that is much lower than the one registered for agricultural products: 2.65%.

## Copom minutes suggest that cuts in the Selic rate may be interrupted

In the third quarter, the Copom decided to cut the Selic rate twice: by 0.50% in July and by 0.25% in September. As a result, the over-selic interest rate hit the mark of 11.25% a year. Discounting the expected inflation in the next twelve months (3.80%), the relative stability of real interest rates at about 8% a year – observed in the first five months of the year – was discontinued and it dropped to 7.18% a year in mid-September.

The minutes of the last Copom meeting showed that, in September, the monetary authorities were even considering the need to interrupt the process of reducing interest rates. Amongst the factors they considered, special mention should be made of the levels of capacity utilization, the expectation of lower contributions from the foreign trade sector to keeping the domestic inflation under control and uncertainties related to the propagation of stimuli already enhanced by the monetary policy. There are increasingly clear signs that the process of relaxing the monetary policy will be interrupted before this year is over.

**Real interest rates and expected inflation**




Source: Central Bank of Brazil
(*) CNI estimates based on data available on Sept.14th.

## Credit: spread still accounts for over half of the cost of loans for enterprises

The outstanding balance of loans in the financial system continues to grow, hitting the mark of 32.7% of GDP (July). The increase in relation to the 30.8% rate observed late in 2006 reflects a higher total credit outstanding with non-earmarked resources, which increased from 21% to 22.9% of GDP during the period. Concerning loans for business with non-earmarked resources, the average spread over banks' borrowing rates rose to 12.1% a year in July, over half the cost actually borne by enterprises in credit operations – about 23% a year.

The amount disbursed by BNDES in the twelve-month period ending in August hit the mark of R$ 61.7 billion – a growth of 35% from the previous twelve months. The industry maintained its 50% participation in total disbursements in 2007.

In the capital market, the total amount raised through public offerings – initial and secondary ones – in 2007 has exceeded R$ 40 billion, which is equivalent to 150% of the amount registered in 2006 (R$ 27 billion). The international financial turbulences observed recently are expected to reduce the pace of offerings in the second half of this year, but prospects in the medium term are still favorable.

# Fiscal Policy

## Expansionary fiscal policy will be maintained

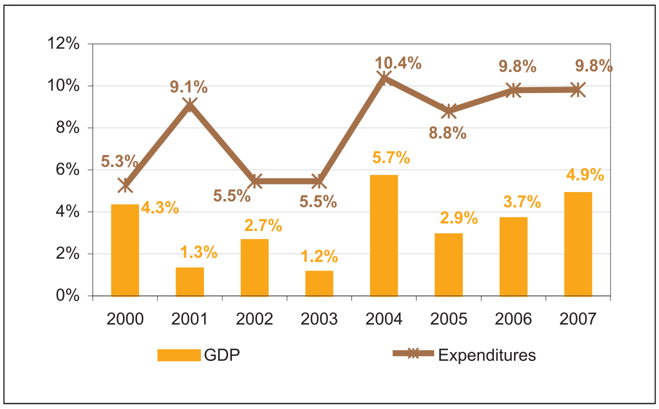
Public spending continues to rise at a fast pace. The spending of the federal government rose by 9.3% in real terms in the first seven months of this year – in relation to the same period in 2006. At state and municipal level, the spending rose by approximately 6.4% using the same comparison basis. In both cases, the increase in public spending exceeded the real growth of the economy, which in the first half of 2007 was 4.9%. The systematic increase in public spending at a much faster pace than GDP growth, observed in the Brazilian economy since 2000, is a trend expected to continue.

Concerning the federal administration, increases have been registered in all the main components of primary expenditures – staff, social security and fixed/capital expenses. The highest increase was registered in staff expenditures, which rose by 10.4% in the first seven months of 2007 as compared to the same months last year. This increase was due to wage readjustments approved for different careers in 2006 and to an increase in the number of civil servants.

In relation to fixed and capital expenses, which had the second steepest increase among the main spending component (9.4%), special mention should be made of discretionary spending, i.e. spending that public managers have more powers to approve. Fixed expenses (except for LOAS, FAT and subsidies/subventions) increased by 9.2% in the first seven months of the year. Investments, in turn, grew by 21.7%.

Besides the spending with staff and discretionary spending, expenses which are impacted by adjustments in the minimum wage also increased. This category includes benefits afforded by LOAS (14.6%), spending of the FAT with unemployment insurance and salary bonuses (17.6%), and social security benefits (8.7%).

**Evolution of Federal Government Spending and GDP**




Source: STN/Ministry of Finance and IBGE
Prepared by: CNI

## Tax collection grows significantly and increases primary surplus

The significant increase in spending is being made up for by an equally significant or even more significant increase in public-sector revenues. In the Federal Government, the net tax collection grew by 9.7% in real terms between the first seven months of 2006 and 2007. Information provided by the Brazilian Internal Revenue Service (STN) on revenues in August shows that this trend continues: the available data show that the revenues of states and municipalities had a slightly lower real increase from August 2006, namely, 7.6%.

Within the Federal Government, the growth observed in the net tax collection was caused by a higher collection of the income and IPI (tax on industrial products) taxes and of social security contributions. As for the revenue of states and municipalities, the component that increased most were the transfers received from the Federal Government.

As a result of a higher revenue, both the Federal Government and regional governments registered an increase in their primary surplus in the first seven months of 2007 in the comparison with the same period last year. In the Federal Government, the primary result grew from 3.24% of GDP in 2006 to 3.44% of GDP in 2007. In the states and municipalities, the increase was even higher, i.e. the primary surplus rose from 1.02% to 1.53% of GDP.

As a result, the primary surplus of the public sector grew from 4.83% of GDP in the first seven months of 2006 to 5.58% of GDP in the same period in 2007. Given the lower spending with interests on the public debt, which in the same comparison basis dropped from 7.31% to 6.52% of GDP, the higher primary surplus made it possible to reduce the nominal deficit significantly – from 2.49% to 0.94% of GDP. In the twelve-month period ending in July, the nominal deficit was 2.08% of GDP. As a result of the lower pressure from the nominal deficit and a higher GDP, the debt/GDP ratio dropped from 44.9% in December 2006 to 44.4% of GDP in July.

## Primary surplus target may be exceeded

The positive trend of fiscal indicators will continue until the end of 2007, and it is very likely that the Federal Government will exceed the target set for the primary result – R$ 53.0 billion, without taking into account the R$ 11.3 billion made available to the Pilot Investment Project (PPI). According to the “below-the-line” criterion calculated by the Central Bank, the primary surplus of the Federal Government is expected to close 2007 at R$ 54.0 billion, or 2.25% of GDP. Considering that states and municipalities and federal state enterprises will achieve their targets, the primary surplus of the consolidated public sector is likely to hit the mark of 3.9% of GDP. In this case, the nominal deficit would close the year at approximately 1.75% of GDP and the debt/GDP ratio at 43.0%.

## Spending of the Federal Government in 2008 may once again exceed GDP growth

The budget bill submitted by the Federal Government to Congress anticipates a 6.7% real increase in spending in 2008. Considering that the real GDP growth estimated in the budget is 5.0%, expenditures may account for 18.9% of GDP. In 2007, they are expected to account for 18.55% of GDP.

It should be mentioned that discretionary spending (non-compulsory spending) is the item that is expected to increase most, namely, 10.4% in real terms. Spending with staff, in turn, will increase by 5.8% in real terms.

On the revenue side, the budget bill anticipates a new increase in the federal component of the tax load. The total tax collection of the Federal Government may grow by 7.8% in real terms in 2008. As a result, the total revenue will rise from 24.2% to 24.9% of GDP, meaning that it will increase by 0.7% percentage points of GDP in this tax load component. Because a certain percentage of this growth will be transferred to states and municipalities (0.3 percentage points of GDP), the net revenue of the Federal Government will increase by 0.4 percentage points of GDP.

Therefore, the fiscal policy is not expected to change in 2008. The continuous increase observed in public spending will continue to be financed by a higher tax load.

# Exchange Rate and Foreign Trade

## International financial turbulence brings volatility to the exchange rate

The crisis in the US real estate market generated substantial risk aversion in the international financial market and led to a search for less risky assets. The higher demand for the US currency ended up interrupting – temporarily – the appreciation of the Brazilian real.

The exchange rate, which early in August was less than R$ 1.90/US$ 1, hit the mark of R$ 2.11/US$ 1 in mid-August, interrupting a steady appreciation path – between April and July, the real appreciated by over 2% a month, but in August it dropped by 4.4%. Since mid-August, however, the real has been appreciating again. By mid September, the exchange rate had dropped to R$ 1.86/US$ 1.

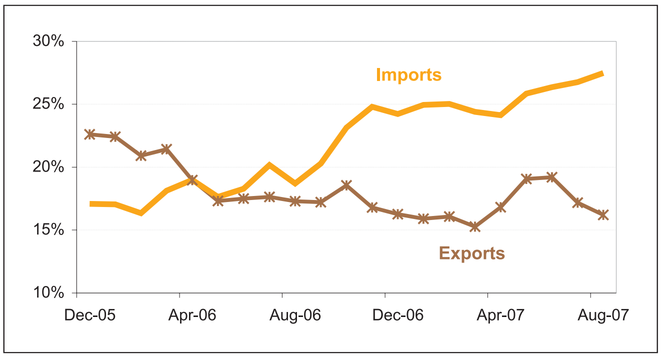
As indicated in previous editions of this Newsletter, different factors are leading to the appreciation of the real in relation to the US dollar – including the entry of short-term capitals, foreign direct investments, and the trade balance. Obviously, the flow of foreign investments and international demand can drop if the financial crisis worsens, with impacts on export prices. This scenario, however, is not the most likely one. The reaction of the Federal Reserve, the American Central Bank, which reduced the basic interest rates in the US economy and ensured grater liquidity in the market, shows its intent on preventing a more serious crisis and a more intense cooling off of that economy.

## Demand for primary goods ensures exports growth

Late in August, exports totaled US$ 102.4 billion, a figure that is 15.9% higher than the one registered in the same period in 2007. The growth rate in twelve months, however, dropped once again – after an interruption caused by the effect of a strike of Internal Revenue Service auditors in May and June 2006, as compared to the same months in 2007.

**Brazilian Exports and Imports**

% growth rate in 12 months




Source: Secex / MDIC

The performance of primary products, which experienced the highest increase in the first eight months of 2007, was particularly positive: 24% in the comparison with 2006. This positive performance was ensured by price gains and – mainly – by an increase in the exported quantum: in the comparison between the first eight months of 2006 and 2007, prices and the quantum grew by 10% and 14%, respectively.

The balance for the year (January-August) was very much influenced by beef, pork and poultry exports, which benefited from the absence of the barriers and embargoes that prevailed last year: poultry exports grew by 44.8%, pork exports increased by 19.7%, and beef exports rose by 19.3%. In recent months, the exports of copper ore (+87%) and of corn in grains (+177%) stood out.

In the first eight months of the year, the exports of manufactured products grew by 11.2%. This growth is largely due to price gains (7.6% accumulated in the year up to August) with a lower increase in the quantum (4.4% in the same comparison). It should also be highlighted that the quantum growth in August was null. Likewise, the greater importance of prices in increasing the sales of semi-manufactured products abroad can be clearly perceived. Price gains during the period amounted to 14%, while the quantum grew by 2%.

For the end of the year, there are also optimistic forecasts for the world economic growth, although the financial crisis leads us to expect a less heated demand. The export quantum is expected to increase by approximately 5% in 2007. Even with slower price gains, they will continue to account for most of the exported value growth. As a result, the forecast of US$ 157 billion in exports at the end of 2007 remains the same, up by 14% in the comparison with 2006.

## Imported quantum is increasing at a fast pace

Despite the volatility of the US dollar in August due to the financial crisis, the real continues to appreciate and, therefore, to have a high purchasing power. Moreover, the additional stimuli observed in the first half of the year are still present: a significantly higher domestic demand and recovery of the manufacturing activity.

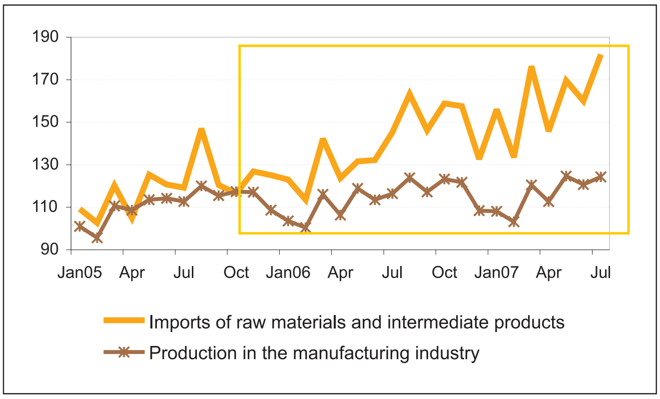
Imports totaled US$ 74.9 billion in the first eight months of 2007, meaning that they increased by 26.9% in relation to the same period in 2006. The imported value has been growing mainly as a result of enhanced purchases and not of import prices. In the first eight months of this year, the imported volume increased by 22% – according to data provided by Funcex. Prices, in turn, grew by only 4%.

Imported volumes in all categories are growing, but purchases of consumer goods continue to stand out, as they increased by 31.8% in the comparison between the first eight months of 2007 and 2006.

Imports of raw materials and intermediate goods grew by 28.5% in the comparison between the first eight months of 2006 and 2007, while imports of capital goods increased by 27.3%. While on the one hand the higher imports of capital goods is good news, as they show that the industry has been investing in meeting demand, on the other hand imports of raw materials continue to exceed the growth observed in the manufacturing production, indicating that domestic raw materials are being replaced by similar imported raw materials.

**Imports of intermediate products and production in the manufacturing industry**

2002 = 100




Source: IBGE and Funcex
Prepared by: CNI

Imports are expected to continue to grow at a fast pace until the end of the year – spurred by the increase registered in imported volumes. Therefore, total imports are expected to hit the mark of US$ 115 billion late in the year – more than double the amount in 2004.

## The gap between the growth pace observed in imports and exports is increasingly larger

Despite the prospects that exports will continue to grow at a slow pace, the gap between the growth observed in exports and imports is becoming increasingly larger. The trade balance in July and August was, respectively, 33% and 27%, lower that the ones observed in the same months in 2006. As a result, the balance accumulated in 2007 amounted to US$ 23.9 billion, down by 5% in relation to 2006, when it totaled U$ 25.2 billion. At the end of the year, the trade balance is expected to total about US$ 42 billion.

**2007 estimates**

| | 2006 | 2007 (projection) |
|---|---|---|
| ***Economic Activity*** | | |
| GDP (annual % change) | 3.7% | 4.7% |
| Industrial GDP (annual % change) | 2.8% | 4.4% |
| Unemployment rate (annual average - % of EAP) | 10.0% | 9.5% |
| ***Foreign Trade*** | | |
| Exports (US$ billion) | 137.8 | 157.0 |
| Imports (US$ billion) | 91.4 | 115.0 |
| ***Inflation*** | | |
| Inflation (IPCA - annual % change) | 3.1 | 4.0 |
| ***Public Sector*** | | |
| Nominal deficit (% of GDP) | 3.0 | 1.75 |
| Primary Surplus (% of GDP) | 3.9 | 3.9 |
| Net Debt (% of GDP) | 44.9 | 43.0 |
| ***Interest Rates*** | | |
| Nominal Interest Rates (end of period, % annual rate) | 13.3% | 11.0% |
| Real Interest Rates (annual average, IPCA-deflated) | 11.8% | 7.8% |
| ***Exchange Rates*** | | |
| Nominal Exchange Rate, R$/US$ (annual average) | 2.18 | 1.97 |

**ECONOMIC REPORT - Economic Policy Unit** - Year 23 Number 3 - July/September 2007- ISSN 1676-9880. Technical staff: Flávio Castelo Branco (coordinator), Luiz Flávio Maia, Marcelo Ávila, Marcelo Souza Azevedo, Mário Sérgio Carraro Telles, Paulo Mol and Renato da Fonseca. Desktop Publishing: UNICOM / Núcleo de Criação. **Confederação Nacional da Indústria.** SBN-Quadra 01-Bloco C - Ed. Roberto Simonsen - Brasília-DF - CEP: 70040-903 - Tels.: 55 (61) 3317-9989/9992/9993 – Fax: 55 (61) 3317-9994 – E-mail: sac@cni.org.br. Home page: www.cni.org.br.

Available data on September 21, 2007.