Economic Report

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Warning signs in the economy

The year began with some positive results, such as industrial production on the rise. However, there are also clear warning signs in the economy: inflation is rising and the 12-month trade balance has dropped sharply. Given such an environment, CNI estimates that GDP will grow by 1.8%, less than last year. Manufacturing industry will also grow less, by only 1.5%. Investment, which is a critical variable for ensuring faster growth in the short term, will increase by only 2.5%.

The high industrial output observed in the first two months of the year is not sufficient to ensure higher growth rates in 2014. This result was due, first, to a statistical effect associated with the occurrence of more working days in the first quarter of 2014 as compared to the same period last year, as the Carnival holiday fell in March this year. Second, in order to try to bring the inflation down, the Central Bank raised the real interest rate to almost 5% a year.

The downgrading of the Brazilian sovereign debt rating is a direct consequence of the deterioration in public finances and low economic growth, which have enhanced fiscal risks. This situation has not led to loss of the investment grade, which is crucial to keep capital flowing into the country and to attract foreign savings. However, it shows that corrective measures are required and that the quality of the fiscal and monetary policy mix needs to be improved for the public debt dynamic not to be affected.

The energy issue is another factor that is bringing concerns and has been affecting investment decisions. The solution for meeting demand due to the unusual low rainfall patterns implied fiscal costs in the short term and hikes in electricity rates in the medium term; and uncertainties continue about whether it will be necessary to ration energy or not. All of these situations place a burden on the productive sector, affecting confidence and discouraging investment.

The poor performance of Brazilian exports, despite signs of recovery in the global economy, and imports on the rise have a direct bearing on manufacturing industry's production rate. An increasing deficit of manufactured products, which hit the mark of US$106 billion, constitutes demand subtracted from Brazilian industry.

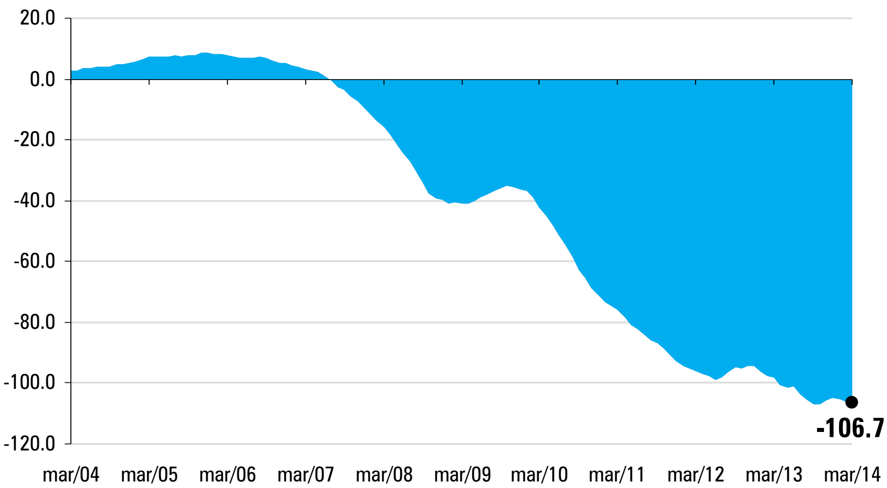
The competitive difficulties facing Brazilian products as a result of high domestic production costs hinder investment focused on foreign markets. A CNI survey (Investments in Industry, 2014) showed that only 3.6% of companies in Brazil are focused on foreign markets, meaning that the current scenario is not very favorable.

There are several reasons for the low-growth scenario observed recently. But they are all related to uncertainties as to the actual implementation of necessary measures to turn this low competitiveness situation around. This would be critical to rekindle confidence, which is essential for investment to be resumed.

Trade balance of manufactured goods

12-month balance - US$ billion

Deficit in the trade of manufactured goods reveals a competitiveness problem



Source: Funcex

Brazilian economy in the first quarter of 2014

CNI

economic activity

Brazilian economy is expected to grow by 1.8% this year

Once again, industry expands less than GDP

After a drop in activity at the end of last year, industry posted positive results in the first quarter of 2014. Industrial production rose by 1.3% (PIM-PF/IBGE) in the comparison between the first two months of this year and the same period in 2013, but this growth was not sufficient to raise production rates to the level recorded in October of last year. Also in the bimonthly comparison, real sales and hours worked in the manufacturing industry increased by 6.6% and 1.2%, respectively (0Industrial Indicators/CNI).

It should be noted that the rise in these indicators was partly due to the increase in the number of working days in February, as in 2014 the Carnival holiday fell in March and not in February, as in 2013. As a result, there were three working days more in the first two months of 2014 than in the same period last year.

Industrial activity in the first two months of 2014 is not expected to remain at the same pace throughout the year

When other elements are added to a prospective analysis of industry in 2014, one notices that barriers to growth are likely to weigh more than the incentives available to stimulate it.

The obstacles include a long cycle of high interest rates, the reversal of certain tax break (such as the IPI reduction for cars and the REINTEGRA program), and a likely more intense increase in production costs, mainly as a result of rising electricity costs (due to a drought) and imported input costs (due to the exchange rate devaluation).

On the side of incentives, reductions in payroll taxes and the higher profitability of exports deserve special mention, although the effects are limited in both cases. This is so because the reductions in payroll taxes will, in principle, be discontinued in late 2014, which may create uncertainty for enterprises. As for the higher profitability of exports, its benefits are restricted by the time that exporting companies need to respond to a situation of improved expectations of profitability in their trading operations.

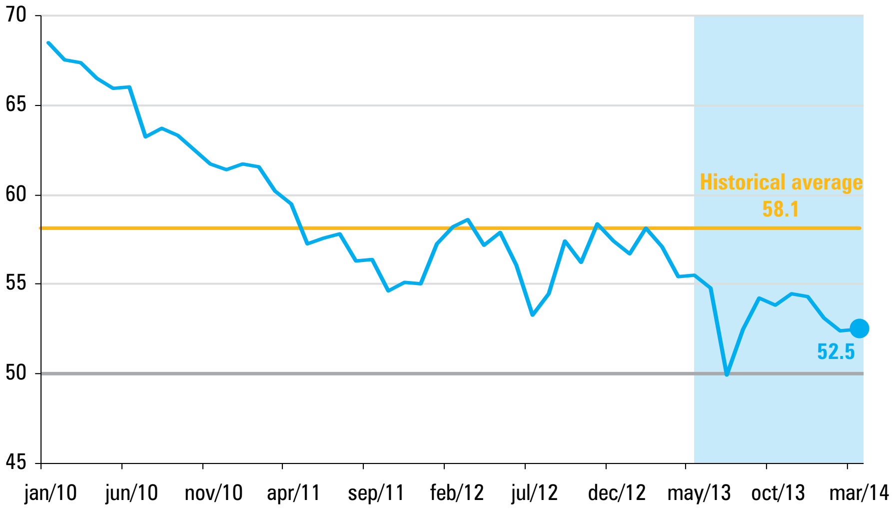
In such a scenario of uncertainties, industrialists are not very confident. The Business Confidence Index (ICEI/CNI) has been below its historical average (58.1 points in March) since 2012 and has been dropping even further since July of last year. The results observed in the first three months of 2014 indicate that this negative scenario is likely to continue: January (53.1), February (52.4) and March (52.5).

As a result of this low confidence, investment intentions in industry in 2014 are the lowest since 2010, when the indicator began to be calculated through CNI's Investments in Industry survey. Late last year, 78.1% of the interviewed entrepreneurs indicated that they had plans to invest this year. In 2011, the percentage was 91.1%.

Business Confidence Index (ICEI)

In points

Business confidence remains weak in 2014



Source: CNI

Thus, CNI expects manufacturing industry to grow by 1.5% in 2014, i.e. less than last year (1.9%).

Still, industry at large is likely to expand by 1.7% in 2014, i.e. 0.4 percentage point more than in 2013. This rate is expected because the mining industry will resume growth this year (2.0%), after the 2.8% drop recorded last year. As for the two other segments of industry, i.e. construction and public-utility industrial services, the forecasts are that the former will increase by 1.5% and the latter by 2.5%.

The service sector is expected to experience a slowdown. In 2013, it expanded by 2.0%. In 2014, it is likely to grow by 1.7%. A slowdown in household consumption and the lower growth recorded in the manufacturing industry largely explain this shift.

In the agricultural sector, a growth rate of 3.0% is expected in 2014. This rate is lower than the one registered last year (7.0%), but higher than those projected for industry and services this year.

Investment will increase at a modest rate in 2014

On the demand side, investment is a critical variable. Gross Fixed Capital Formation (GFCF) grew significantly in 2013 (6.3%), but largely as a result of exceptional movements. The most important of these movements was the increase observed in truck sales, which was driven by amendments to laws on greenhouse gas emission standards.

However, the forecasts for investment growth in 2014 are much more modest. The exceptional movements recorded in 2013 are not likely to be repeated this year, at least not to the same degree.

Moreover, the combination between fiscal constraints, low confidence of industrialists, and a higher interest rate is likely to restrict the rate of investment growth to 2.5% in 2014. Thus, the investment rate (GFCF as a percentage of the GDP) is expected to stand at 18.5%, only 0.1 percentage point above the rate recorded in 2013.

The growth rate of household consumption is likely to decrease for the fourth year in a row. In 2010, it increased by 6.9%. After that year, it decreased gradually: 4.1% (2011), 3.2% (2012) and 2.3% (2013). This year, household consumption is expected to grow by 1.7%. This movement is justified by a continued rise in the interest rate, a slowdown in credit, and a persistently high inflation rate.

As for government consumption, a moderate reduction in its growth rate is expected, from 1.9% in 2013 to 1.8% in 2014. Although government spending usually increases in election years, it is believed that the current state of public finances will prevent this demand component from rising more sharply.

Considering the exchange rate at R$ 2.45/US$ 1 in late 2014 (CNI estimate) and household consumption on the decline, imports are likely to increase by 3.0% this year, significantly less than in 2013 (8.4%).

Exports should also rise less than last year, but the reduction in its growth rate is expected to be less intense than in that of imports. CNI estimates that exports of goods and services will rise by 2.0% in 2014 after dropping by 2.5% in 2013.

This behavior is primarily due to the lower growth of manufactured exports, as industry will continue to face difficulties to compete in the international market this year.

Thus, CNI projects a 1.8% GDP growth in 2014, down from the 2,3% rate recorded last year.

CNI estimate for GDP
Percentage variation and contribution of GDP components

	GDP components	2014 Growth rate (%)	2014 Contribution (p.p.)
Demand side	Household consumption	1.7	1.1
	Government consumption	1.8	0.4
	Gross formation of fixed capital	2.5	0.5
	Exports	2.0	0.3
	(-) imports	3.0	0.5
Supply side	Agriculture/livestock	3.0	0.2
	Industry	1.7	0.4
	Mining and quarrying	2.0	0.1
	Manufacturing	1.5	0.2
	Construction	1.5	0.1
	Public administration, health and public education	2.5	0.1
	Services	1.7	1.2
	GDP	**1.8**	

employment and income

Labor market loses momentum

Employment falls in metropolitan areas

Occupation levels in the labor market declined in early 2014 after growing for three months in a row. Jobs in metropolitan areas (PME/IBGE survey) decreased by 217,100 in January and by 137,500 in February.

Despite this negative result, employment remained stable in February as compared to the same period last year, after experiencing a slight drop (-0.1%) in January.

The decline registered by the PME/IBGE survey diverged significantly from the occupation data recorded by the General Register of Employed and Unemployed Individuals (CAGED/MTE) in the first two months of the year. In January, the CAGED recorded an increase of 29,500 job openings and, in February, a marked increase of 260,800 jobs.

Although methodological differences between the two surveys impose limitations on any comparative analysis, the differences between these results are noteworthy, particularly in February, when the difference was even more significant, namely, of 398,300 jobs.

Metropolitan unemployment rate

As a % of the labor force

Despite a decline in labor supply, a reduction in the labor force keeps the unemployment rate down in the first two months of 2014

Source: IBGE

Labor market in industry is still the most affected one

Jobs in the mining and quarrying, manufacturing and public-utility industrial services sectors increased by 120,000 in the first two months of 2014. This was the greatest contribution of all sectors of the economy.

Nevertheless, the result for industry in the first two months of 2014 was lower than in the previous year (down by 2.6% as compared to same period last year).

In the 12-month period to February, industry (including its three segments) was the sector in which the sharpest reduction in jobs was registered, of 84,000 jobs, representing a drop of 2.25%. This performance is well below those recorded for the trade (0.2%), services (-0.2%) and public administration (3.0%) sectors.

Labor force declines and keeps the unemployment rate on a downward path

The labor force (PEA-PME/IBGE) – which is made up of employed individuals and unemployed persons looking for a job – decreased in the first two months of the year. In January, it declined by 0.8% in relation to the same period last year. In February, it dropped by 0.5%. This drop partially offset the effect of lower occupation rates on unemployment and ensured a historically low unemployment rate, as it closed February at 5.1% of the labor force.

The unemployment rate has remained on a downward path in almost all the historical series initiated in March 2002. However, a reversal in this trend in the months ahead in 2014 is expected. This change will be brought about by a slowdown in job creation and a reduction in demand for jobs from workers due to inflationary pressures on wages. Inflation is likely to rise in 2014, leading it to end the year close to the target ceiling – at 6.4%, as projected by CNI. This result is expected to reduce household income and slow down household consumption. In such a scenario, an increase in job search is expected, which will in turn lead to a higher unemployment rate in the year: 5.7%.

Labor market formalization continues to increase

Despite the slowdown in the labor market in the first two months of 2014, formal jobs continue to be created in the six largest metropolitan areas (PME/IBGE survey), to the detriment of informal ones.

Formal jobs, which continuously advance since October 2009, rose by 1.7% in February as compared to the same period last year. On the other hand, informal jobs, which have been on the decline for 12 consecutive months, dropped by 12.9% on the same comparison basis.

Thus, the formality index – which is calculated by the sum of all formal, military and statutory jobs divided by all occupations – remains steady at a high level, having hit the mark of 63.2% in February 2014.

Average real income will increase less in 2014

The average real income of metropolitan workers (PME/IBGE survey) increased by 3.1% in February as compared to the same period last year, slightly less than the rate recorded in January (3.6%).

Besides a low minimum wage increase, due to the lower GDP growth recorded in 2012, the occupation rate is likely to continue on a downward path in 2014. Reinforcing this scenario, the labor force – which decreased in the first two months of 2014 – will likely shift upwards in the coming months due to inflationary pressures on the purchasing power of workers.

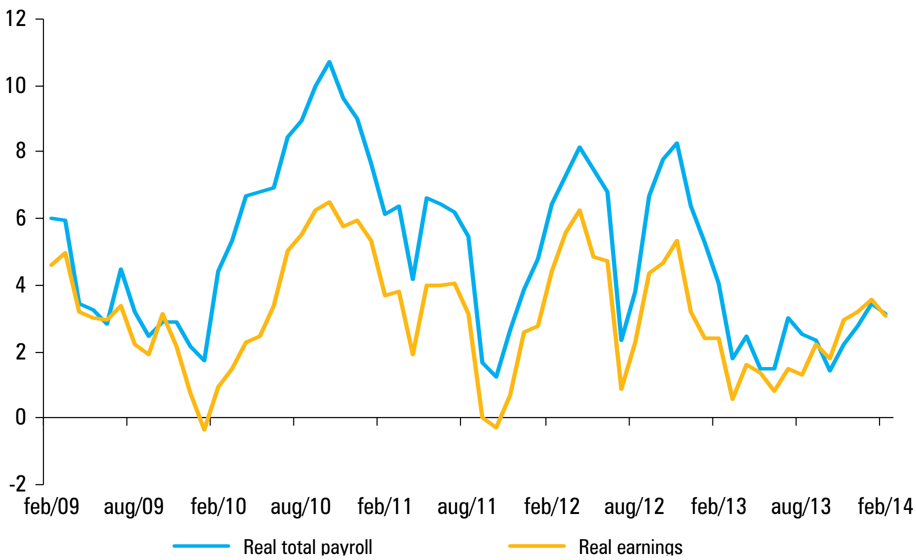
Therefore, despite the positive results seen in the first two months of the year, real income growth in 2014 will keep pace with its performance in 2013, when it grew by 1.8%, below the average observed in previous years: between 2006 and 2012, real income grew at a rate of 3.5% a year. In such a scenario, the average real income is projected to grow by 1.5% in 2014.

Total earnings also increased in early 2014 – by 3.4% in January and 3.1% in February. However, given the trend observed for income, they are expected to close the year at a lower growth rate than that recorded in 2013, when they increased by 2.6%. Importantly, between 2006 and 2012, the average growth of total earnings was 5.9%.

Average Real Income and Real Total Earnings

Variation (%) in relation to the same period last year

Despite the good performance observed in the first two months of the year, the average real income and total earnings are likely to increase at moderate rates in 2014



Source: IBGE

inflation, interest rates, and credit

Inflation close to the target ceiling in 2014

Positive effect of reductions in taxes on electricity comes to an end

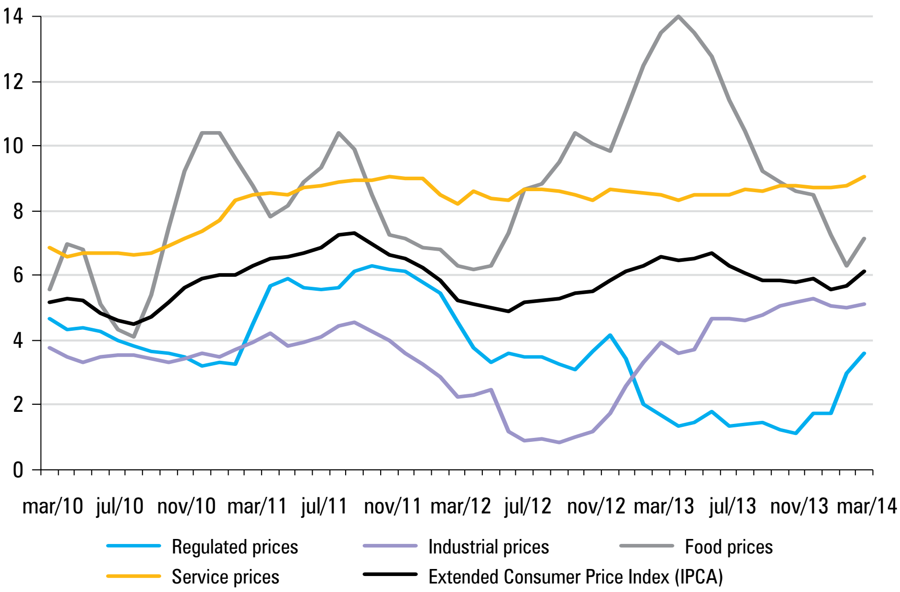
Inflation remains under close watch. The Extended Consumer Price Index (IPCA) is significantly above the inflation target and the forecasts for the remainder of the year are not favorable. CNI estimates that the IPCA in 2014 will be 6.4%, very close to the target ceiling.

The 12-month IPCA has been above 4.5% since September 2010. This long period has been contributing to consolidating a scenario of inflationary inertia and preventing inflation from meeting its target in the short and medium term. Despite a slight downturn in January (12-month figure of 5.59%, against 5.91% in December), the IPCA exceeded the 6.0% threshold once again in March, when its 12-month figure was 6.15%.

IPCA by groups

12-month figure (%)

More intense hikes in all IPCA groups in March



Source: IBGE – Prepared by: CNI

Hikes in food prices (up by 1.92% in the month) were the main cause of this rise, but not the only one. All the IPCA groups (prices of food products, industrial products, services and regulated prices) increased in the 12-month figure.

Regulated prices rose from a 12-month figure of 1.7% in January to 3.6% in March. This shift reflects the end of the positive effect of reductions in electricity taxes. A reduction in energy rates pushed price levels down in February and March 2013. Because this calculation is based on 12-month figures, this effect disappeared in February and March 2014 in statistical terms, pushing prices up.

This 12-month hike ended up being enhanced by continued (and even sharper) increases in other regulated prices. Thus, regulated prices, which closed 2013 with a 12-month hike of 1.7% and ensured an inflation rate of less than 6.0%, will likely rise by about 3.7% until the end of 2014.

The 12-month hike in food prices is expected to hit the mark of 7.1% in March. After dropping in February to its lowest level (6.3%) since March 2012, March data suggest that this relatively "low" level (as compared to the recent behavior of prices in this group) is not likely to continue.

The positive performance observed in the second quarter of last year, characterized by stability and even by a drop in food prices, is not likely to be repeated in 2014. With the upturn in the 12-month figure for this group, the IPCA has once again risen above the 6.0% rate. CNI estimates that food prices will end 2014 with a 12-month figure close to 9.0%. The behavior of industrial product prices is also contributing to push the inflation up. The 12-month figure to March was calculated at 5.1%, which is in line with the sharper upturn registered since October 2013.

This hike can be partly attributed to the currency depreciation observed at the end of last year, which pushed the prices of imported goods and inputs up. This effect is likely to continue to be felt over the coming months, despite the recent leveling of the exchange rate. CNI estimates that the prices of industrial products will have risen by 5.1% by the end of the year.

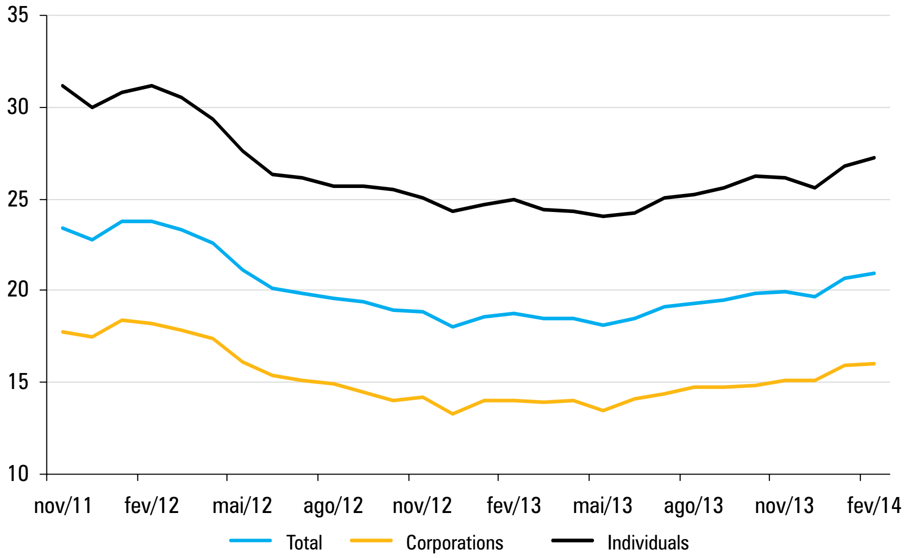
Service prices continue to rise as a result of strong inflation inertia. The 12-month figure to March was calculated at 9.0%, slightly higher than the one observed in 2013. By the end of the year, CNI expects this figure to drop moderately to 8.2%, but it will still continue to contribute heavily to keeping the IPCA at a high level.

In short, the likely scenario in 2014 is one of food and service prices rising above 8.0% a year, industrial product prices on the rise due to the exchange rate devaluation, and no contribution from reductions in taxes on regulated prices to bring the inflation down. The result of this scenario translates into CNI's projections of a 6.4% IPCA at year's end.

Average interest on loans

Percentage per year (%)

Interest rates for final borrowers are trending upward



Source: Central Bank of Brazil

Selic rate is back at the level recorded at the end of 2011

A long period with inflation above the target center, the failure to make the IPCA converge towards its projected target, and adverse inflation forecasts for 2014 led the Monetary Policy Committee (Copom) to take intense monetary tightening measures.

The Monetary Policy Committee resumed the cycle of Selic rate hikes in April 2013. Since then, the Selic rate was raised nine times consecutively, from 7.25% to 11.00% a year.

The effects of monetary tightening on inflation are not felt immediately. Thus, the main impact of rising interest rates is yet to be felt. In the last two meetings of the Copom (February and April), the Selic rate hikes were reduced from 0.5 to 0.25 p.p., suggesting that the cycle of increases in that rate is coming to an end. CNI estimates that the Copom will once again raise the Selic rate at its meeting in May by 0.25 p.p., ending the monetary tightening with a 4.00-p.p. accumulated hike.

The Selic rate will hit the mark of 11.25% a year and will remain at this level throughout 2014. With such a rate and considering the expected inflation, the average Selic rate for the year will amount to 4.4%, more than twice as high as the one recorded in 2013 (2.0% a year).

Monetary tightening is reflected in high interest rates on loans

Successive increases in the Selic rate translate into higher interest rates for final borrowers. Average interest rates on loans to individuals hit the mark of 27.2% a year in February, 3.2 percentage points above the level observed in May 2013.

This hike affects even lower-risk companies. The Brazilian Preferential Rate (preferred customers) rose from a minimum 10.8% a year in February 2013 to 14.6% a year in January 2014.

The increase in the Selic rate coupled with low economic growth has led to a general slowdown in credit. The average 12-month growth rate of credit to individuals, which amounted to about 17.5% in early 2013, slowed to 16.5% in the same period in 2014. For corporations, this rate dropped from 16.9% to less than 15.0% between February of last year and the same month this year.

Over the coming months, interest on loans is likely to continue to trend upward, as the effect of a high Selic rate on these rates is not felt immediately. As a result, a further slowdown in credit is also expected throughout 2014.

fiscal policy

Marked increase in spending early in the year

Primary Surplus continues on a downward path

In the first months of 2014, fiscal policy became more expansionist than last year. The spending of the Federal Government and state and municipal governments has increased significantly. The public sector primary surplus dropped once again as a result of a higher Federal Government spending and a lower increase in revenues.

After closing 2013 with a real growth of 6.9%, federal spending increased by 9.4% in the first two months of 2014 as compared to the same period last year. These higher expenditures can be largely attributed to discretionary spending. Current expenses grew by 11,3% in real terms in the first two months of 2014, while investment (GND 4 of the Integrated Financial Management System – SIAFI) more than doubled (108,7) in relation to the first two months of 2013.

In an attempt to meet the primary surplus target, the Federal Government apparently delayed payments in the last months of 2013. In the case of investment, R$ 9.0 billion were paid in outstanding commitments from previous years in the first two months of 2014. In the same period in 2013, this amount was R$ 4.3 billion, meaning that it grew, in real terms, by 107.1%, a percentage similar to that observed for total investment.

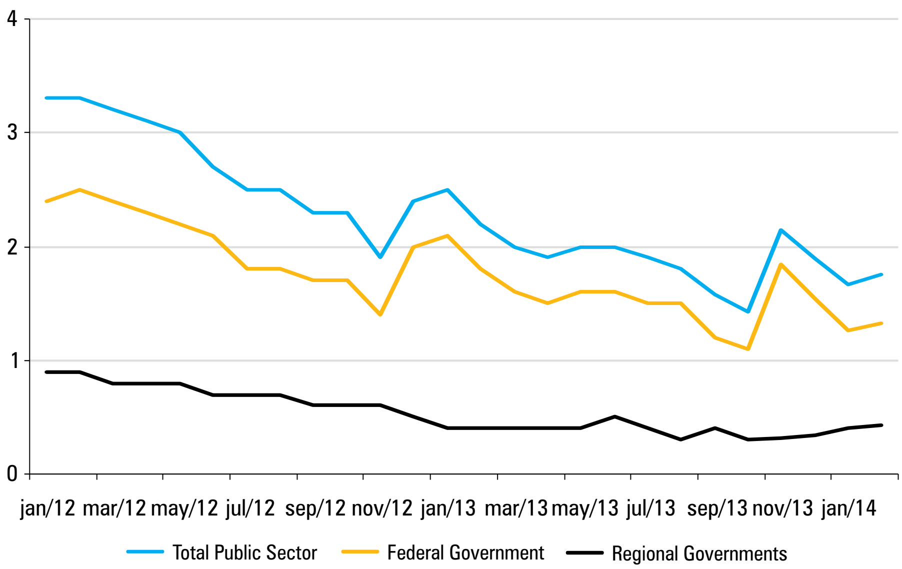
In terms of revenues, the Federal Government experienced an opposite movement to that seen in spending. Net revenues experienced a real increase of 1.6% in January and February of 2014 in relation to the same period last year. In 2013, net revenues grew by 5.9% in real terms as a result of extraordinary revenues of R$ 20 billion in debt installments and of R$ 15 billion from the tender for the Libra oil field.

This combination between spending on the rise and slowdown in revenues led to a decline in the primary surplus. In the 12-month period to February 2014, the Federal Government primary result hit the mark of 1.3% of GDP, against 1.55% registered until December 2013.

Consolidated and by government level public sector primary surplus

In relation to GDP in the last 12 months (%)

The public sector primary surplus fell by 0.6 percentage points of GDP between January 2013 and February 2014



Source: Central Bank of Brazil - Prepared by: CNI

Revenues of states and municipalities resume upward path

The spending of regional governments, which had increased by 4.6% in 2013 in relation to 2012, rose by 8.2% in January 2014 against the same month last year. On the other hand, the revenues of states and municipalities, which had grown by 3.3% in real terms in 2013, soared to 12.4% in January 2014 in relation to the same month last year. These revenues rose more sharply as a result of transfers made by the Federal Government to states and municipalities to make up for the waiving of the Tax on Circulation of Goods and Services (ICMS) on exports, whose share that had not been settled in 2013 was transferred to the states in January 2014.

Thus, the 12-month primary surplus of states and municipalities increased from 0.35% in December 2013 to 0.45% of

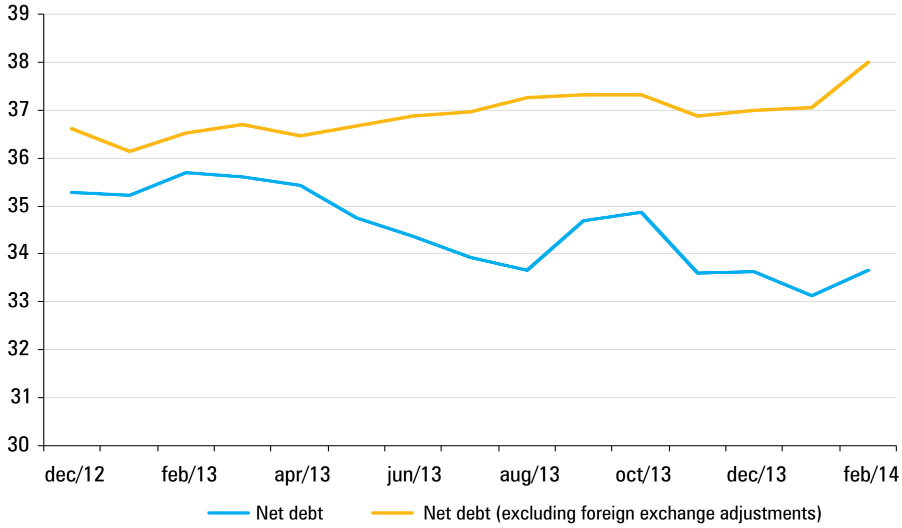
GDP in February 2014. However, this increase was not sufficient to offset the drop recorded in the Federal Government primary surplus. Thus, the 12-month primary surplus of the consolidated public sector fell from 1.9% in December 2013 to 1.75% of GDP in February 2014.

Despite this decline in the primary surplus, lower interest payments made it possible for the 12-month nominal deficit to remain stable at 3.3% of GDP between December 2013 and February 2014. The Net Deb/GDP ratio has also remained virtually stable since December 2013, having increased from 33.6% to 33.7% of GDP in February 2014. The Gross Debt/GDP ratio, in turn, rose and hit the mark of 57.5% in February against 56.8% in December 2013, mainly as a result of interest payments on the gross debt stock.

Evolution of the Public Sector Net Debt

In relation to GDP (%)

The drop observed in the Net Debt/GDP ratio between December 2012 and February 2014 was caused by exchange rate-based adjustments in the domestic and foreign debt



Source: Central Bank of Brazil - Prepared by: CNI

High financial programming reduces rate of increase in federal spending

Fiscal policy is likely to become less expansionist in the coming months. The financial programming of approximately R$ 31.0 billion by the Federal Government is expected to reduce the growth rate of current and capital expenses until the end of the year. In addition, expenses with personnel are also projected to increase at a lower rate in the coming months. As a result, Federal Government spending will likely close 2014 with a real growth of 2.8% as compared to 2013.

The net revenue of the Federal Government will in turn increase at a slightly higher rate until December. Revenues from taxes and contributions, for which no increase was recorded in the first two months of 2014, are expected to recover throughout the year and, as a result, net revenues are likely to post a 1.9% growth in real terms. In this scenario, a R$ 73.0 billion primary surplus has been estimated for the Federal Government and its state enterprises in 2014 (1.4% of CNI's projected GDP). For the R$ 80.8 billion target to be achieved, the Federal Government will have to make an additional financial programming of R$ 7.8 billion.

In the case of states and municipalities, revenue growth is expected to stabilize as a result of a less intense positive impact of the regularization of transfers from the Union. Although spending is also likely to grow at a slower pace, the primary surplus is expected to decline slightly in relation to the one recorded in February 2014 and to close 2014 at about R$ 21 billion (0.4% of GDP). This amount would exceed the target set by the Federal Government (R$ 18.2 billion).

In such a scenario, the consolidated public sector primary surplus would amount to R$ 94.0 billion (1.8% of GDP) and would be below the target of R$ 99.0 billion. This result would be lower than the primary result of 1.9% recorded in 2013. This decline, coupled with an expected increase in interest spending – which is likely to rise from 5.1% of GDP in 2013 to 5.3% in 2014 – will raise the nominal deficit to 3.5% of GDP.

Despite a high nominal deficit, the Net Debt/GDP ratio is expected to be similar to that observed in 2013, as the effect of the deficit will be offset by the effects of the depreciation of the Real in exchange rate-based adjustments in the domestic and foreign debt and by the growth of the nominal GDP. Thus, CNI projects a Net Debt/GDP ratio of 33.8% in December 2014, up from 33.6% in December 2013.

foreign trade sector and exchange rate

Trade surplus at risk

Downgrading of the sovereign rating had no major impacts on markets

The rating of Brazil's sovereign bonds was downgraded in March as expected. Standard&Poor's downgraded Brazil's rating but did not strip the country of its investment grade status, thus a higher impact on markets was prevented, including on the exchange market. By the end of the year, other agencies may also downgrade their ratings, but they are not likely to strip Brazil of its investment grade either.

In the first two months of 2014, the exchange rate remained between R$ 2.35/US$ and R$ 2.45/US$ and at the end of March it dropped by 2.8% in just four days, to R$ 2.26/US$. The exchange rate is likely to depreciate to some extent, but it will continue to oscillate sharply due to both the domestic political scenario and the external environment, particularly due to uncertainties about the course of U.S. monetary policy. The exchange rate is likely to close 2014 at R$ 2.45/US$ 1, with an annual average of about R$ 2.35/US$ 1.

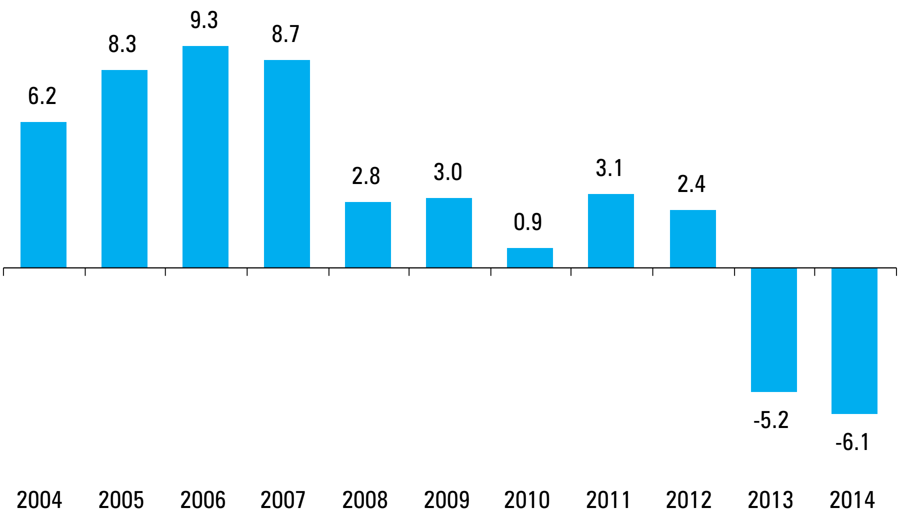
Trade deficit hits new record in the first quarter

Exports totaled US$ 49.6 billion in the first quarter of 2014, down by 4.1% in relation to the same period in 2013. Imports totaled US$ 55.7 billion in the same period, down by 2.2% as compared to the figure recorded in 2013. As a result, the trade balance registered a record deficit of US$ 6.1 billion in the period, up by 15.8% in relation to 2013.

Brazilian trade balance

January-March figure - in US$ billion

The trade deficit increased by 15.8% in the first quarter of 2014 in relation to the previous year



Source: MDIC/SECEX

It should be recalled that the marked growth of imports recorded in the first quarter of 2013 was largely explained by the late registration of oil imports in 2012. In addition, the negative result recorded in the first quarter of 2014 occurred despite the fact that the exchange rate was kept at a level about 15% more depreciated than in the first quarter of 2013.

The poor performance of exports in 2014 can be mainly attributed to the exports of manufactured goods, which dropped by 9.5% in the first quarter of 2014 in relation to the same period in 2013.

With regard to imports, the drop recorded in the first quarter (of US$ 333 million as compared to the first quarter of 2013) was mainly due to a reduction in imports of fuels and lubricants (down by US$ 1 billion in the period). Similarly to exports, the exchange rate depreciation apparently had no bearing on the evolution of imports early this year.

In the months ahead, a further drop in the trade surplus is expected, as a result of which it will be the lowest one since 2000. There are many reasons for this decline. Exports of rigs are not likely to be repeated in 2014. In 2013, these exports totaled US$ 7.7 billion and avoided a trade deficit (there was a surplus of US$ 2.6 billion in that year).

Moreover, in the case of manufactured goods, the situation in Argentina in particular is not likely to improve and exports to other markets will continue to face difficulties . Recent CNI surveys (Investments in Industry and Barriers to Brazilian Exports) show that enterprises have been investing less and less with a focus on external markets and that the difficulties they have been facing to export their goods are increasing manifold (red tape, infrastructure, tax system, etc.).

With respect to exports of basic goods, the sharp drop in the export prices of iron ore recorded in the first quarter is not likely to be reverted before the end of the year. In the first months of the year, this trend was partly offset by increases in the prices of other commodities, particularly of agricultural commodities, primarily due to adverse weather conditions in some commodity-producing regions that reduced the supply of these products. This effect is likely to lose momentum towards the end of the year.

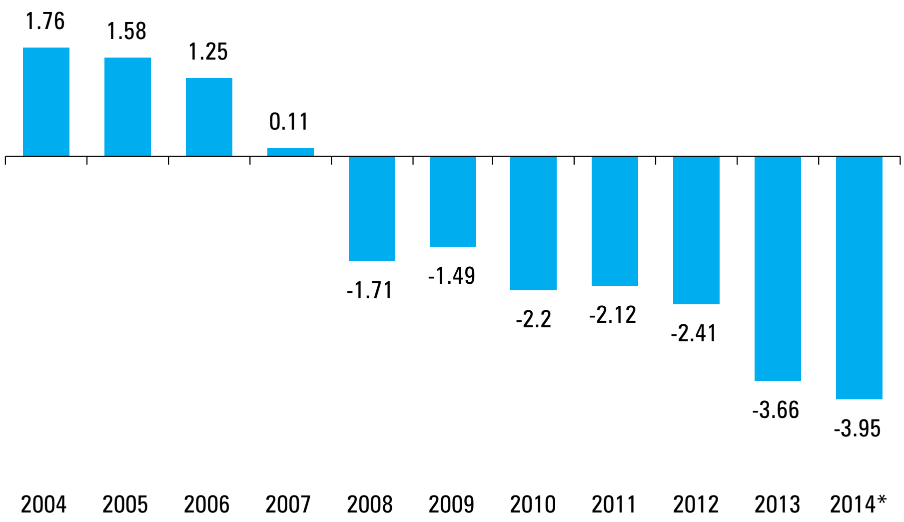
In such a scenario, a further decline in total exports is expected, as a result of which they will close the year at US$ 240 billion, down by 1% in relation to 2013.

As for imports, a more depreciated exchange rate and a slower growth rate suggest that they would tend to drop. However, imports of inputs and raw materials hardly drop sharply. This is so because, in many cases, there are no similar domestic goods or producing them domestically would require expensive changes in production processes, which would entail unfeasible investments in a scenario of rising investment costs and unstable exchange rates. Additionally, the share of imported products in domestic consumption (about 25%) ensures that any increase in household consumption will have an impact on imports. Finally, the need to continue to import gasoline and diesel fuel, whose imports will also be stimulated by the activation of thermal plants, will prevent oil imports from dropping more sharply.

Saldo em transações correntes

Em proporção do PIB (%)

Déficit em transações correntes segue crescendo



Source: Central Bank of Brazil - * CNI Forecast

As a result, imports are likely to drop by 0.5%, to US$ 238.5 billion. Thus, the trade surplus would amount to only US$ 1.5 billion. Considering all the uncertainties, an even lower trade balance is possible, or even a small deficit.

Foreign direct investment will be lower than the current account deficit

The 12-month current account deficit totaled US$ 82.5 billion in February 2014, up by 30% in relation to the 12-month period in February 2013. This figure represents 3.7% of GDP, as compared to 2.8% recorded in February 2013. The 12-month foreign direct investment to February totaled US$ 65.7 billion, up by only 3% in relation to the previous 12-month period.

The current account deficit is likely to continue to grow in 2014 as a result of a higher services deficit and a trade balance on the decline. Expenditure on equipment rental should rise due to an increase in the number of rigs in operation. Revenues from international travel are not expected to increase sharply, as seen in other countries that hosted World Cups. Therefore, the current account deficit is likely to amount US$ 88 billion or to 3.9% of CNI's projected GDP.

Foreign direct investment will be lower in 2014 and will not be sufficient to cover the deficit for the second consecutive year. Lower global liquidity and prospects of lower growth in the medium term (at the same time that the economies of developed countries are likely to grow at a faster pace) explain the drop in FDI and the current account financing difficulties facing Brazil.

prospects for the Brazilian economy

	2012	2013	2014 *previous projection dec/13*	2014 *projection*
Economic activity				
GDP (annual variation)	1.0%	2.3%	2.1%	**1.8%**
industrial GDP (annual variation)	-0.8%	1.3%	2.0%	**1.7%**
Household consumption (annual variation)	3.2%	2.3%	1.7%	**1.7%**
Gross fixed capital formation (annual variation)	-4.0%	6.3%	5.0%	**2.5%**
unemployment Rate (annual average - % of the labor force)	5.5%	5.4%	5.6%	**5.7%**
Inflation				
Inflation (IPCA - annual variation)	5.8%	5.9%	6.0%	**6.4%**
Interest rates				
Nominal interest rates				
(average rate in the year)	8.63%	8.29%	10.48%	**11.03%**
(year end)	7.25%	10.00%	10.50%	**11.25%**
Real interest rate (annual average and deflated rate: IPCA)	3.1%	2.0%	4.4%	**4.4%**
Public accounts				
Nominal public deficit (% of GDP)	2.48%	3.28%	3.70%	**3.50%**
Public primary surplus (% of GDP)	2.39%	1.90%	1.40%	**1.80%**
Net public debt (% of GDP)	35.1%	33.6%	33.9%	**33.8%**
Exchange rate				
Nominal exchange rate - R$/US$				
(average in December)	2.08	2.35	2.45	**2.45**
(average in the year)	1.95	2.15	2.35	**2.35**
Foreign trade sector				
Exports (US$ billion)	242.6	242.2	249.0	**240.0**
imports (US$ billion)	223.2	239.6	240.0	**238.5**
Trade balance (US$ billion)	19.4	2.6	9.0	**1.5**
Current account balance (US$ billion)	-52.4	-81.4	-72.2	**-88.0**

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