Brazilian Economy

PERFORMANCE AND OUTLOOK

SPECIAL EDITION OF THE ECONOMIC REPORT - DECEMBER 2007

CNI

The challenge lies in ensuring high economic growth rates

The Brazilian economy resumed a fast growth pace in 2007 – when its GDP is expected to grow by 5.3%. The economy hadn't been growing at rates in excess of 5% since 2004. The growth pace this year is double the average pace observed during the past ten years. Following the usual pattern in high-growth periods, the manufacturing industry led GDP growth and is expected to expand by 5.8%.

The gains in 2007 are significant: a) GDP has been growing with inflation under control; b) economic growth has been accompanied by a better income distribution; c) the labor market is a source of good news: the labor formalization rate is the highest one in this decade, while the unemployment rate is at an all-time low; d) real interest rates are dropping and the total credit is on the rise, enhancing the household consumption capacity and reducing the financial cost of enterprises; e) the foreign trade situation has been improving, with a significant expansion in Brazil's international reserves and virtual elimination of its foreign debt.

Ensuring this growth pace will be the challenge in 2008. However, despite the abundance of positive indicators in 2007, there are factors which threaten the continuity of economic growth. First, the exchange rate between the real and the US dollar has appreciated well above the average registered for other currencies, with impacts on the competitiveness of major industrial segments.

Second, public spending continues to grow at a faster pace that that of economic growth, creating pressures for a higher tax collection. The excessive taxation is reflected in no improvements in the control and quality of public spending.

Third, the more robust growth of the economy requires investments in infrastructure. Today, the quality and reliability of infrastructure services are critical for ensuring the competitiveness of Brazilian products.

In sum, the fast GDP growth pace observed in 2007 has failed to consolidate a new level of economic growth. The challenge, therefore, lies in improving the business environment, so as to encourage private investments.

THE BRAZILIAN ECONOMY IN 2007

Overview of the economy in 2007

Brazilian GDP follows world's growth pace

The Brazilian GDP will grow by 5.3% in 2007, double the average growth rate registered in the past ten years. The per capita GDP, in turn, will increase by 4.0%, a rate which – if maintained in the following years – will enable Brazil to double its per capita income in less than two decades.

What this also means is that the Brazilian economy will finally manage to grow in 2007 at a rate similar to the world average. This situation is quite unusual: in only one occasion during the past ten years – in 2004 – economic growth in Brazil was at least as dynamic as in the rest of the world. In all other years, the Brazilian GDP growth was, in average, 1.5 percentage points a year below the world GDP growth rate.

In 2007, the industry began to lead GDP growth, ensuring a most robust economic growth. Production in the manufacturing industry is expected to increase by 5.8% in 2007, more than double the growth rate observed in the previous two years. Apart from intense, this growth is also comprehensive and can be felt in most industrial sectors.

This higher production rate was accompanied by job generation. The industry created 422,000 new formal jobs during the twelve-month period ending in November (Caged/Ministry of Labor). The number of new jobs in the industry was higher than the one observed in commercial establishments in the same period (392,000), changing the usual labor allocation pattern.

This enhanced manufacturing activity is supported, on the one hand, by an increasing foreign demand and, on the other, by a significant domestic demand, which has been growing at the highest rate since 1995. The increase observed in the manufacturing production (that is, the higher supply of products) is therefore taking place in response to this additional demand. The supply of products has also increased as a result of higher imports, which grew at rates in excess of 20%

GDP OF BRAZIL AND WORLD GDP

ANNUAL VARIATION (%)

For the second time this decade, the Brazilian GDP followed the growth observed in the world GDP

* CNI Projection

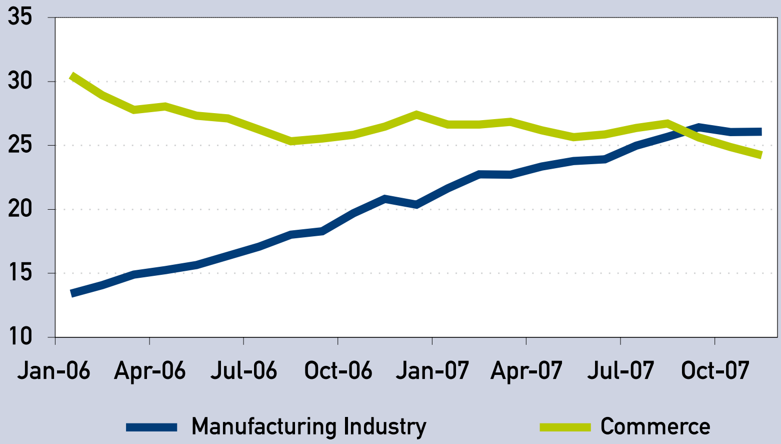
Source: National Accounts/IBGE (GDP of Brazil) and World Economic Outlook/IMF (world GDP) Prepared by: CNI in 2007 also due to the appreciation of the real. The continued appreciation of the real – which reduces the competitiveness of Brazilian products, particularly manufactured products, in the international market – and rising price indices are the main factors which can potentially hinder growth in 2008.

The inflation rate as measured by the IPCA (Expanded Consumer Price Index) is expected to close 2007 at 4.2%, one percentage point above the variation registered in 2006 (3.14%). A higher aggregate demand is seen as the main source of pressure on prices and the factor which interrupted the downward path of interest rates.

PARTICIPATION IN THE NET CREATION OF FORMAL JOBS IN THE INDUSTRY AND IN COMMERCE IN RELATION TO THE TOTAL EMPLOYMENT RATE

ACCUMULATED IN 12 MONTHS (%)

More jobs were created in the industry than in commercial establishments in general



Source: Caged/MTE Prepared by: CNI

A topic which was often addressed in the second half of 2007 is the existence (or not) of a gap between the evolution of aggregate demand and aggregate supply, which can speed up inflation. The enhanced demand has indeed led to a higher use of installed capacity. In the first ten months of 2007, enterprises operated with 82.2% of capacity utilization (Industrial Indicators/CNI) in average, which constitutes an increase of 1.7 percentage points in relation to the same period in 2006.

However, it is unlikely that the manufacturing production will be affected, as there are clear signs that the industrial complex is increasing. The growth observed in the manufacturing production in 2007 was led by capital goods. The gross fixed capital formation will grow by 12.8% this year.

The minutes of Central Bank meetings reinforce its concern with the demand growth pace. However, the marked increase observed in domestic demand stems from an expansionary fiscal policy. Real government spending has been increasing more than GDP. This higher public spending is being covered by a high increase in the tax revenue, as taxes have been increasing much more than production. That is, an increasing percentage of Brazil's income is being transferred from the private to the public sector, jeopardizing the quality of its economic growth.

In sum, the Brazilian economy, particularly its industry, is experiencing a very favorable moment. However, it should be highlighted that the scenario could be better if the high growth pace of public spending were reduced. A less expansionary fiscal policy would reduce the pressure on domestic demand and would make it possible to resume the interest rate reduction process. In addition, by spending less, the public sector could reduce the tax load, increasing the availability of resources for private-sector investments. This would be a decisive step to ensure high economic growth in Brazil for a long period.

PROSPECTS FOR 2008

On the rise: GDP will grow by 5.0% in 2008

GDP is expected to grow by 5.0% in 2008. The positive performance of economic activities next year is based on the following facts:

• *Strong domestic demand*. The factors which led to a consumption hike in Brazil in 2007 are expected to continue in 2008. Jobs will continue on the rise and adjustments in the grants provided under the Bolsa Família (Family Grant) program late this year and a raise in the minimum wage (proposed for April 2008) contribute to a higher household income. Mention should be made that 2008 is an election year, during which government spending historically tends to increase. In response to these developments, interest rates next year will be the lowest ones in the decade.

• *Investment spending*. 2008 is a promising year for both private and public investments. The lower idleness of the industrial complex in the private sector, added to an increasing demand, is creating a favorable environment for investments. Entrepreneurs are optimistic in relation to 2008 in terms of production and are willing to invest (Manufacturing and Mining Survey/CNI). In relation to public investments, it should be stressed that projects contemplated in the PAC (Growth Acceleration Program) can contribute to a higher gross fixed capital formation.

• *Favorable foreign trade scenario*. In 2007, the situation of insolvency in the mortgage market in the US led to discussions on the possibility that the US economy may cool strongly and imminently. There are signs, however, pointing to the opposite direction: that of a less intense cooling down, with minor impacts on the world economy. Emerging countries, particularly China, India and Russia, continue to grow at a pace of about 10% a year, pressing the prices of metallic and agricultural commodities up and increasing the income in Brazil.

• *Statistical effect*. At the end of 2007, the seasonally adjusted economic activity was 2% higher than the average during the year. That is, even if there is no additional production in 2008, GDP will still grow by 2%.

As in 2007, domestic demand will play a key role in fostering economic growth in 2008. Household consumption is expected to grow by 6.2% and to account for three-quarters of GDP growth.

2008 will be a promising year for investments, which are projected to increase by 14.0%. A minor idleness in the industrial complex, added to continued production growth, has been encouraging private investments. Public investments are also on the rise. Municipal elections also lead to an increase in public projects.

On the supply side, the performance of the industrial sector deserves special mention, as it is expected to grow by 5.0% in 2008, more than the 4.8% rate anticipated in the agriculture/livestock sector and the 4.5% rate expected in the service industry.

Inflation is below the target, despite a strong demand

The inflation as measured by the IPCA is expected to hit the mark of 4.1% in 2008, meaning that it will not exceed the inflation target set for the year. There are still some pressures – albeit lower – pushing food prices up due to the hike in international commodity prices in 2007 and 2008, the effects of which have not been fully felt in the domestic inflation yet.

In addition, demand will continue to rise at high rates, and the Central Bank will have to be more alert to any possible inflation inertia contagion if the gap between supply and demand increases. It should be said that investments have been avoiding a higher use of productive capacity, but they have not been sufficient to ensure stability in capacity utilization rates so far.

Believing in a scenario in 2008 in which investments under way will mature and more investments will be made, the Central Bank should only resume the process of cutting interest rates gradually in the second half of next year, more precisely in September, when it will begin to reduce them three times by 0.25 p.p. until the SELIC rate hits the mark of 10.5% a year in December.

Trade surplus drops to US$ 25 billion

Exports will grow at a slower pace in 2008, closing the year at US$ 175 billion. The lower export growth pace was brought about by a further appreciation of the real. This appreciation of the real in 2008 is based on three main facts:

a) the possibility that Brazil will achieve an investment-grade rating, enhancing opportunities for investing resources in Brazil, with positive impacts on the supply of foreign currencies;

b) a greater differential between the Brazilian and the US interest rates, stimulating the entry of financial capital;

c) a continued increase in foreign direct investments, taking advantage of the scenario of economic growth in Brazil.

The value of imports is expected to grow by 25% in 2008, totaling US$ 150 billion. This significant growth is sustained by a strong domestic demand and by the low price of imported products in reals. We therefore estimate that the trade balance in 2008 will amount to US$ 25 billion, much less than the US$ 40 billion registered in 2007.

Because of this lower trade balance surplus and of a higher deficit in the Service Balance, the deficit in the current account balance will amount to US$ 6 billion.

Difficulties to achieve the primary surplus target in 2008

In relation to the fiscal issue, the fact that the Provisional Contribution on Financial Transactions (CPMF) was not extended created a scenario marked by high uncertainties. The budget bill of the Federal Government – which included revenues of R$ 39.0 billion from the CPMF – will have to be revised. The government is expected to cut its spending to make up for the lower tax revenue. However, given the high rigidity of the budget, cutting expenditures will not be sufficient to prevent the primary surplus from dropping in relation to 2007, affecting the achievement of the target set for to 2008.

Although it is unlikely that the target will be achieved, the expectations for the main public sector solvency indicators are positive. As interest rates are expected to drop, the nominal deficit will not rise significantly and will remain below 2.5% of GDP. In addition, with continued economic growth, a further reduction of the public debt in relation to GDP is anticipated.

PROSPECTS FOR BEYOND 2008

Overcoming risks and restrictions: how to sustain economic growth

It is very likely that that the scenario for the Brazilian economy in the short and medium term will be favorable. However, since the main target is for Brazil to become a high-growth economy – and not to perpetuate a sequence of short growth cycles – the real challenge lies in ensuring the required conditions for sustained growth.

For this target to be achieved, it will be necessary to minimize risks and overcome restrictions. There are two types of threats associated to the more favorable scenario anticipated for the coming years: foreign trade risks, as a result of a possible economic recession in the US, and potential domestic restrictions affecting economic growth. For these reasons, 2008 is a key year for the evolution of the Brazilian economy.

Impact of the mortgage crisis in the US is likely to be small

Abroad, if the mortgage-financial crisis faced in the US becomes any worse, the US may experience a strong retraction in household consumption, leading to economic recession. However, the actions taken by the Federal Reserve to minimize its impacts on the banking system can limit the effects and intensity of the crisis.

Although the US economy weight on the world economy has been decreasing, a recession would tend to interrupt a period of remarkable global economic growth and would affect the international trade by reducing the demand for Brazilian exports and, consequently, pushing the prices of commodities down. However, the impact of the US mortgage crisis s likely to be small as compared to those of other crises faced in the past.

Preserving solid key economic principles, promoting advances in pro-competitiveness reforms – by defining an industrial policy, among other measures – and adopting appropriate sectoral policies are key requirements to face any less favorable international scenario.

Domestic restrictions: insufficient infrastructure and enhanced consumption growth

Domestically, two factors can potentially hinder economic growth: the inability of infrastructure services to keep up with a higher demand and a continued increase in domestic spending at a much faster pace than that of supply. The probability that these factors may affect the economic growth pace in 2008 is small, but such risks should not be disregarded in longer-term scenarios.

The low elasticity of the supply of infrastructure items in the short run can create bottlenecks and push costs up, with likely impacts on the path of the inflation rate. In the short term, the risks are more associated with logistical and transportation issues, but energy supply is also a matter of concern in a scenario of faster economic growth and low rainfall. The still low volume of investments in infrastructure and the long time required for projects to mature deserve special attention.

Overcoming this restriction will require, necessarily, more investments, among other actions. For the public sector, anticipating any likely bottlenecks and improving the management of projects are key measures for ensuring more efficient and rational public policies.

However, it is also crucial to ensure appropriate conditions for the increasing and indispensable participation of the private sector in the supply of infrastructure items. Because private activities respond to market stimuli and profitability expectations, defining regulatory frameworks, ensuring legal security to contracts, and drawing up clear public policies are key requirements for the private sector to invest in this area.

Higher public spending restricts economic growth

The continued increase in public spending at a higher pace than that of GDP growth is not sustainable in the long run. This imbalance results in an excessively high and bad-quality tax load which imposes unnecessary costs and hinders the economy's productivity. The rigidity of expenditures – with excessive earmarked spending and compulsory expenses – and the lack of mechanisms for limiting more expenditure with wages and social security benefits will keep this trend unchanged. Competition with current spending hinders the investing capacity of the public sector.

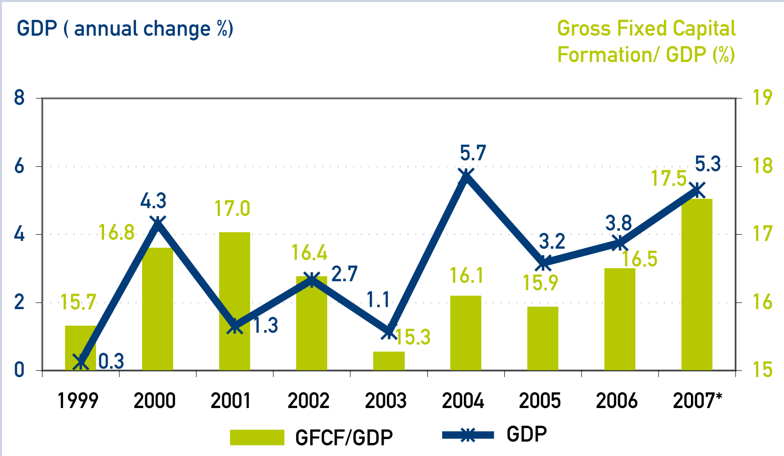
In sum, in the medium term, ensuring the continuity of a high economic growth pace depends on the capacity to adapt the supply growth pace to the demand growth pace. Apart from any possible pressure on domestic markets, with risks for the inflation rate path, the gap between the two rates will determine whether the current account will be reverted or not. With deficits in coming years, Brazil will once again be a destination for foreign savings.

This situation is not completely negative, provided that foreign savings are applied to ensure a more substantial rise in investment rates as a proportion of GDP. Despite the current increase in capital formation, the investment/GDP ratio in Brazil is still low as compared to the one observed in countries experiencing a fast growth pace. If Brazil is to become a high-growth economy, it must necessarily increase investment rates.

In the long run, the main hindrance lies in education. The intensity of economic growth crucially depends on the productivity growth pace – where the key issue is the quality of education. Besides the fact that Brazil has low schooling rates as compared to other emerging countries, the supply of skilled labor in the country can be insufficient to meet the needs of businesses as investments are stepped up.

GDP AND INVESTMENT RATE

Increase in the investment rate sustains GDP growth



* CNI Projection

Source: National Accounts/IBGE (GDP of Brazil) and World Economic Outlook/IMF (world GDP) Prepared by: CNI

Economic Activity

GDP grows by 5.3% in 2007

Economic activities were more intense in 2007 than anticipated earlier this year. CNI projections for GDP growth rose to 5.3%, against the 4.2% estimated in the first quarter. Projections were systematically revised upward, as the combined effects of lower interest rates and a higher public spending on aggregate demand became clear.

This year, economic growth was marked by four main characteristics:

a) the manufacturing industry led GDP growth;

b) the growth registered in the manufacturing production was comprehensive and included most industrial sectors;

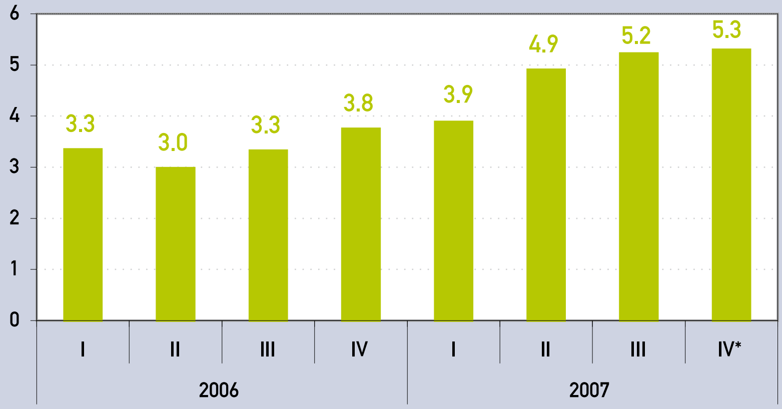
c) the increase in the manufacturing activity was largely determined by a higher domestic demand;

d) the higher production rate was accompanied by a higher capacity utilization, which has been encouraging investments in expanding the industrial complex.

GDP OF BRAZIL

VARIATION ACCUMULATED IN 4 QUARTERS (%)

Since the second quarter of 2006, the economic growth rate is becoming more intense



* CNI Projection

Source: National Accounts/IBGE Prepared by: CNI

Manufacturing industry leads economic growth

In the three first quarters of 2007, production in the manufacturing industry grew, in average, by 5.5% in relation to the same period in the previous year (National Accounts/IBGE). And there are signs that the increase observed in the manufacturing activity will become more intense in the fourth quarter of 2007. The industry's physical production in October 2007 exceeded production in the same month in 2006 by 10.3% (PIM/IBGE).

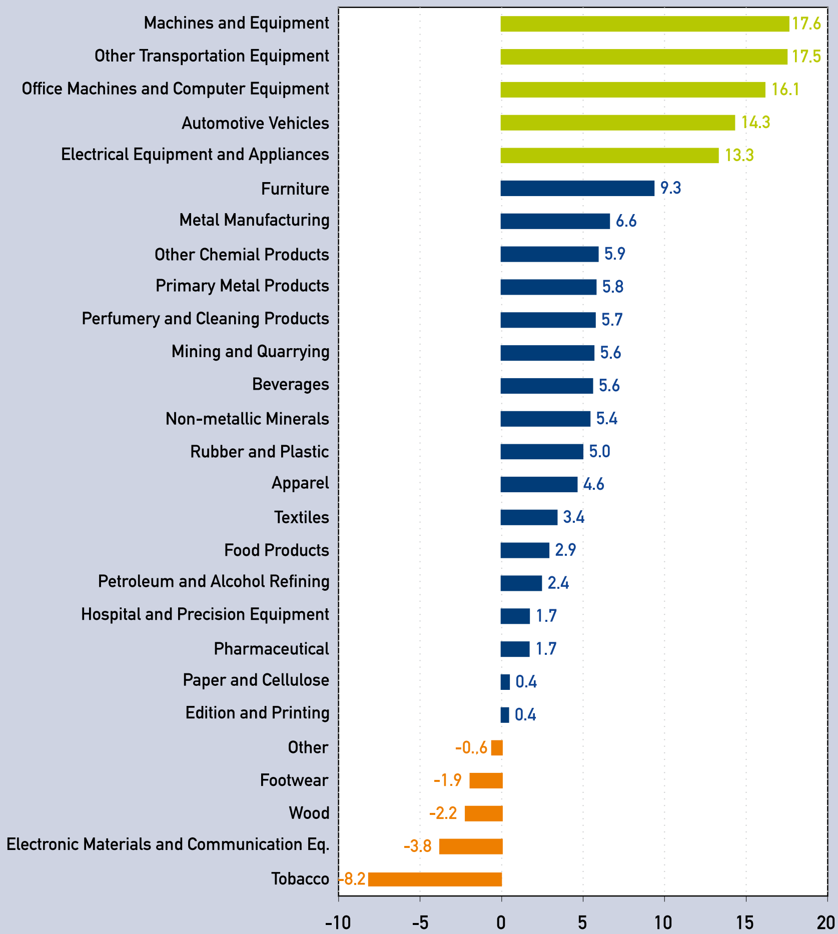
The positive performance of the manufacturing industry ensures more robust economic growth rates. GDP grew at a rate in excess of 4% on five occasions in the past 17 years (1993, 1994, 1995, 2000 and 2004) and in all those years the manufacturing industry grew more than the economy in average. In 2007, the same situation can be observed: the manufacturing industry is expected to grow by 5.8%, leading GDP growth.

Apart from intense, the growth registered in the manufacturing production is comprehensive: it involves 22 of the 27 industries surveyed by IBGE. In five of them – Machines and Equipment;Computer Equipment; Automotive vehicles; Other

MANUFACTURING PRODUCTION BY ACTIVITY SECTOR

VARIATION IN JAN-OCT 2007/ JAN-OCT 2006 (%)

Manufacturing production grew in almost all sectors. Products with a higher added value had the best performance in 2007.



Source: PIM/IBGE Prepared by: CNI

transportation equipment; and Electrical materials – two-digit growth rates were observed in 2007.

Growth focused on the domestic market

Domestic demand – made up of household consumption, government consumption, and gross fixed capital formation – grew at a rate of 6.6% a year in 2007 and has become the main engine of economic growth. Domestic demand increased at the fastest pace observed since 1995, when monetary stability led to a substantial increase in the purchasing power of the population.

While in 1995 the Real Plan led to a higher demand, in 2007 this increase was determined by a combination of three factors:

a) *A higher real payroll.* The increase registered in the manufacturing activity was accompanied by a significant generation of new jobs. Total earnings in the industry, for example, have been growing at 5% a year.

b) *Enhanced cash transfer from the government to the population.* Payments made under the Bolsa Família (Family Grant) cash transfer program increased by 9.5% in real terms in a comparison between the first ten months of 2007 and 2006 and LOAS (Social Security Organic Law) disbursements grew by 12.9% in the same period.

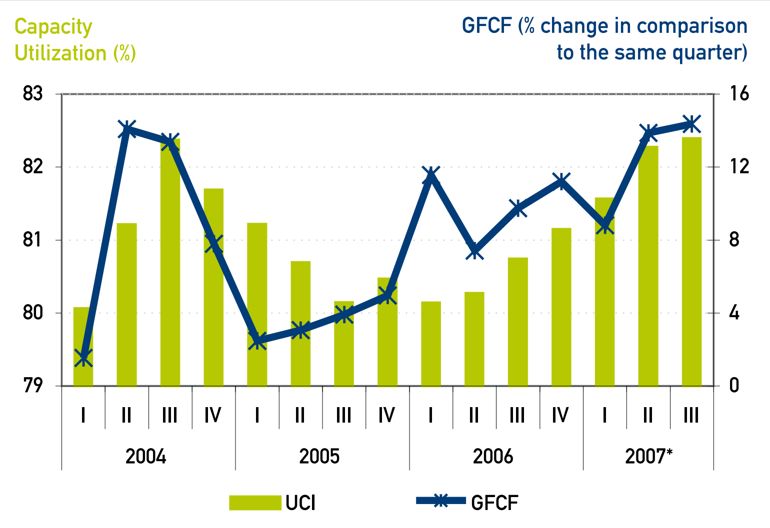
c) *Drop in the real interest rate.* The real interest rate is about 7% a year, the lowest one in this decade.

While the first two factors are associated with the higher income of the population, which stimulates household consumption, the third factor is associated with a higher credit availability, which has been particularly favoring the sales of higher value-added products, such as durables (automobiles, computers and furniture particularly) and capital goods (civil construction and machinery and equipment).

In addition, the growth observed in the manufacturing production is also supported by an increasing

INSTALLED CAPACITY USE AND GROSS FIXED CAPITAL FORMATION

High capacity use level stimulates investments



* CNI Projection

Source: Industrial Indicators/CNI (Capacity Utilization) and National Accounts/IBGE (GFCF) Prepared by: CNI

foreign demand for food products, steel, and ethanol – major export products for Brazil. The exported quantum of goods and services in Brazil grew by 6.7% in the comparison between the average growth rates in the first three quarters of 2007 and 2006. Although this pace is slowing down – exports grew by two-digit figures during most of the first half of this decade – it is still higher than the average economic growth rate.

Enhanced supply of products

With the aim of meeting the increasing demand of families and of the government (in the form of a higher consumption), of enterprises (in the form of investments), and of the rest of the world (in the form of exports), expanding the supply of products in Brazil is a must. Products manufactured abroad largely account for this higher supply. The volume of imports in Brazil grew at a rate in excess of 20% in 2007, stimulated not only by a higher demand, but also by the appreciation of the real. Another factor - and the most important one - accounting for a higher supply is production growth in Brazil. And the productive capacity of enterprises needs to be adjusted to this additional demand.

In October 2007, enterprises were operating with an average 84.3% of capacity utilization (CNI Industrial Indicators), the highest level of use in all the historical series, initiated in 2003. In 2007, the indicator rose by two percentage points in relation to the same period in 2006. This increase has led to discussions on the sustainability of the manufacturing production growth pace beyond 2007.

The robust growth observed in the manufacturing production is surely leading to a higher capacity utilization. However, the risk of restricting the supply of products seems unlikely, as there are clear signs that Brazil's industrial complex will be expanded.

The gross fixed capital formation grew by 12.4% in average in the first three quarters of 2007 in relation to the same period in 2006. The manufacturing production growth in 2007 was led by capital goods, which increased by 18.8% in the comparison between the January-October period in 2007 and in 2006. The apparent consumption of machinery and equipment (as calculated by the IPEA) has been growing at two-digit rates since the fourth quarter of 2006.

The year of 2007 was marked by a strong increase in investments. It should be stressed that 85% of all investments to be executed this year have been fully or partially made (Manufacturing and Mining Survey, special edition/ CNI). Moreover, prospects for 2008 are very favorable still: 42% of all Brazilian corporations intend to increase the volume of their purchases of machinery and equipment in 2008 in relation to 2007.

2008 follows the trends observed in 2007

GDP is expected to grow by 5.0% in 2008, sustained by the positive performance of domestic demand. Household consumption is estimated to increase by 6.2% in 2008, slightly above the 6.0% growth anticipated for 2007. Household consumption is expected to account for three quarters of economic growth as a whole. Government consumption, in turn, is expected to increase by 4.2% in 2008.
As in 2007, the gross fixed capital formation will play a prominent role in leading economic growth, as it is estimated to increase by 14.0% in 2008, after having grown by 12.8% in 2007. This more robust growth is associated with a continued drop in interest rates (both in the selic and in the long-term interest rate) from the second quarter of 2008 on and to a more intense manufacturing activity, particularly in the civil construction industry.

Exports of goods and services (as calculated according to the National Accounts methodology) will increase by 4.5% in 2008 – the lowest rate since 1996. The current exchange rate level (about R$ 1.80/US$ 1) has a negative impact on the competitiveness of Brazilian products in the international market. According to CNI's Survey, the optimism of entrepreneurs in relation to production and turnover early in 2008 does not apply to exports. Only 5% of all investments anticipated for 2008 are focused on foreign markets. That is, more than in 2007, the focus of production in 2008 is on the domestic market.

On the other hand, imports of goods and services are estimated to continue to grow at a rate of 20.0% in 2008 (according to the National Accounts methodology). Because imports are expected to grow at a pace four times faster than that of exports, the net contribution of the foreign trade sector will be negative by two percentage points in 2008.

On the supply side, the performance of the industrial sector deserves special mention, as it is expected to grow by 5.0% in 2008, more than the 4.8% rate anticipated in the agriculture/livestock sector and the 4.5% rate expected in the service industry.

Taxes will increase by 7.5% in 2008, after having risen by 8.2% in 2007 already. This is a negative element in the GDP growth composition. When tax collection grows at a faster pace than that of production, a higher percentage of the income generated in Brazil is diverted from the private to the public sector, increasing the tax load. This reallocation of resources revealed by the National Accounts does not favor a higher productivity and sustained GDP growth.dução, parcela maior da renda gerada no Brasil é desviada do setor privado para o setor público, elevando a carga tributária. Essa realocação dos recursos revelada pelas Contas Nacionais é desfavorável ao aumento da produtividade e à expansão sustentada do PIB.

PROJECTED GDP GROWTH IN 2008

VARIATION (%)

Domestic consumption and investments will result in a growth of 5% in 2008 led by the industry

GDP Growth Forecast

Componentes do PIB		2008 Growth Rate (%)	2008 Contribution (in p.p.)
Demand	Household consumption	6.2	3.8
	Government consumption	4.2	0.8
	GFCF	14.0	2.5
	Exports	4.5	0.7
	(-) Imports	20.0	2.7
Supply	Agricultural and Livestock	4.8	0.2
	Industry	5.0	1.5
	Services	4.5	2.9
	Taxes	7.5	
	GDP	5.0	

Prepared by: CNI

Jobs and Wages

Job formalization is being consolidated

In 2007, formal jobs were created in massive numbers, particularly in the private sector. Between January and October 2007, formal jobs created in the country's six largest metropolitan regions hit the mark of 671,000 (data from IBGE's Monthly Job Survey – PME). At the same time, there was a natural decrease of 43,000 informal jobs and 23,000 not registered occupations.

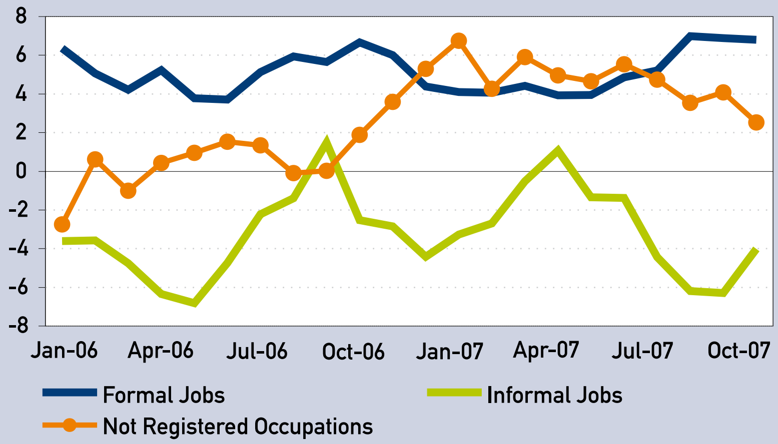
In percentage terms, the total occupation rate grew by 3.1% in October as compared to the same period in the previous year, while formal jobs in the private sector grew by 6.8% during the same period – more than double the economic growth pace. It should be mentioned that formal jobs in the private sector grew at a faster pace than that of informal occupations for 33 months in a row in the annual comparison.

The conjugation of these events raised the job formality index (sum of formal jobs under the Consolidated Labor Laws and the Unified Legal Regime – RJU - and total occupation) to 55% in October, the highest level of the Monthly Job Survey series since March 2002, when the survey began to be carried out. The increase observed in the labor market formality index can be basically attributed to two reasons: a) a more robust and comprehensive economic growth in sectoral terms; and b) stricter inspection actions carried out by the Ministry of Labor and Employment. With lower interest rates and a higher supply of credit, domestic consumption began to grow at a faster pace, paving the way for new investments in production and expanding the supply of jobs, thus creating a virtuous growth circle. In terms of inspections, from January to August 2007 the Ministry of Labor and Employment inspected, in average, 28,000 enterprises every month, 19.5% more than the monthly average in 2003 – a year in which a huge increase in informal jobs was registered.

EMPLOYED POPULATION BY POSITION IN THE OCCUPATION

VARIATION AS COMPARED TO THE SAME MONTH IN THE PREVIOUS YEAR (%)

Creation of formal jobs is predominant



Source: Monthly Job Survey (IBGE). Prepared by: CNI

Formal jobs grow in all the manufacturing industry

Corroborating this scenario, the General Register of Employed and Unemployed Persons (Caged) of the Ministry of Labor and Employment registered the creation of 1.9 million formal jobs throughout the country in the period from January to November 2007, exceeding the number of jobs created in the whole year of 2004 – when the highest number of new formal jobs in the Brazil's history was observed.

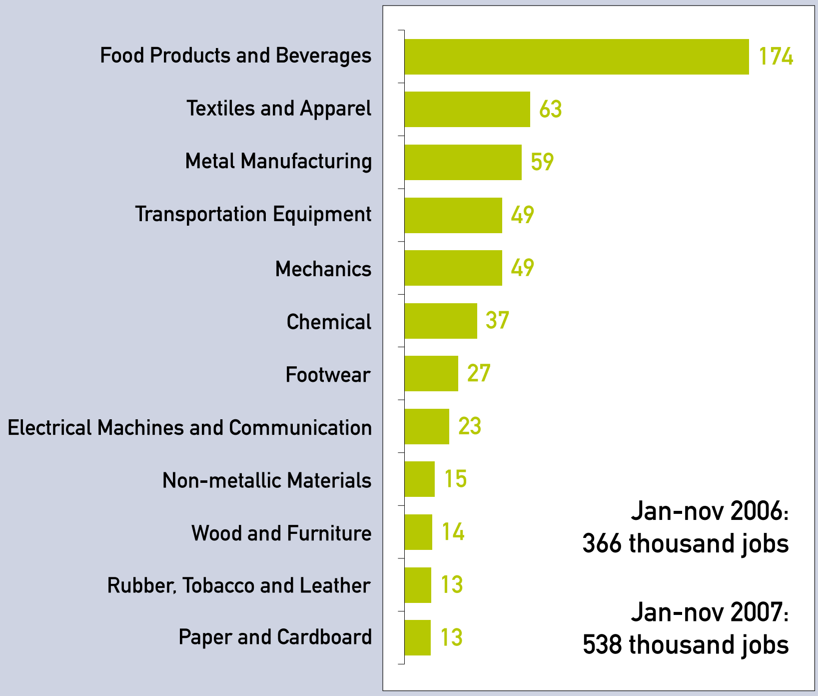
In sectoral terms, the manufacturing industry created 538,000 jobs throughout the national territory in the first eleven months of 2007 (47% more than the balance in the same period in the previous year). This higher dynamism could be felt in all economic sectors – with no exceptions –, resulting in a lower heterogeneity in jobs created in the industry. The food industry, which plays a prominent role in the flow of jobs in the manufacturing industry, accounted for 36.5% of all new jobs created throughout the year. During the same period in 2006, this industry accounted for 41% of the 366,000 jobs created in the industry.

While total occupation rates in metropolitan areas grew consistently throughout the year, the search for a job was not as intense. The economically active population grew at a lower pace than that of new jobs in all months in 2007. This phenomenon can be explained by the significant growth observed in the labor force last year – in August 2006, the labor force increased by almost one million people in the 12-month indicator.

INDUSTRIAL JOBS

NET VARIATION IN THE TWELVE-MONTH PERIOD ENDING IN OCTOBER 2007 (IN THOUSAND UNITS)

Lower heterogeneity in the creation of jobs in sectoral terms



Source: Caged (MTE). Prepared by: CNI

More active labor market

The lower growth of the labor force in relation to the more vigorous expansion observed in occupation rates led the unemployment rate to drop in 2007 to below the levels observed in all months in the previous year (except in January). As a result, the annual average of this indicator is expected to hit the mark of 9.5% in 2007 – 0.5 percentage points below the average in the previous year.

A striking feature of the labor market in 2007 was that the average unemployment rate was below the one observed in previous years with a higher activity rate (ratio between the labor force and the population aged 10 and above). This phenomenon indicates that the average annual unemployment rate in 2007 dropped despite the fact that more people were in the labor market in relation to the total population. In other words, the labor market is managing to absorb a higher number of participants as compared to previous years. This is because, as opposed to what was observed in the recent past, the economy is growing more intensely in an environment marked by higher investments in production.

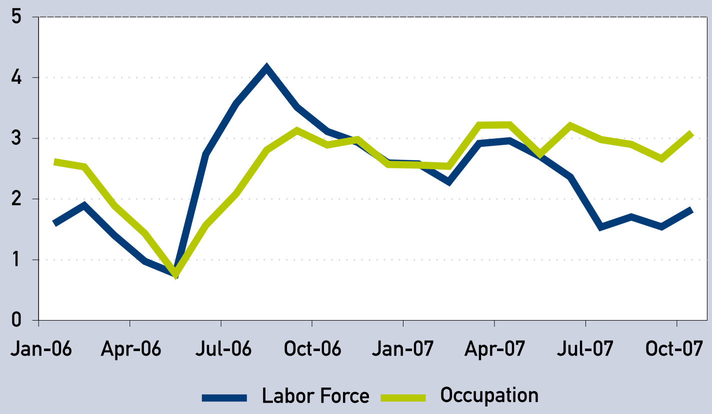
The usually earned real income continued to grow this year, albeit at a slower pace. The deceleration observed in the inflation rate in 2006 ensured higher wage gains and also paved the way to the best wage negotiations in the past 10 years (Dieese data). In 2007, however, the inflation stopped falling and even began to rise a little, thus attenuating the increase in the real income.

Total earnings – which are calculated by multiplying the actually earned real income by the occupation rate – also grew more slowly in 2007 than in 2006. In the accumulated rate up to September 2007, total earnings had grown by 3.8%, while during the same period in the previous year they had increased by 7.7%.

It should be highlighted that, as opposed to the situation in 2006, when total earnings grew more as a result of a higher income rate, the increase registered in total earnings in 2007 was, to a large extent, determined by a higher occupation rate.

EMPLOYED POPULATION AND LABOR FORCE

VARIATION AS COMPARED TO THE SAME MONTH IN THE PREVIOUS YEAR (%)

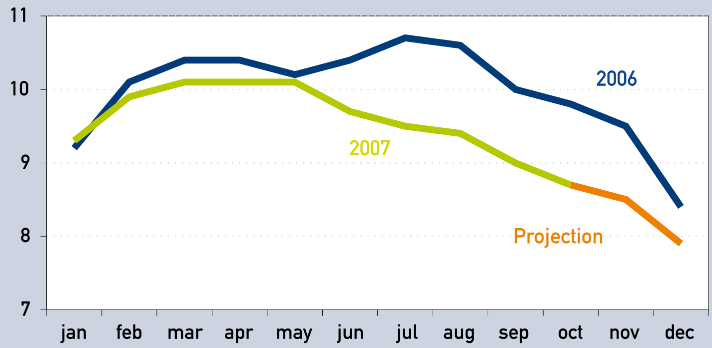


Source: Monthly Job Survey (IBGE). Prepared by: CNI

Labor force is expanding less...

UNEMPLOYMENT RATE

PARTICIPATION OF THE LABOR FORCE (%)

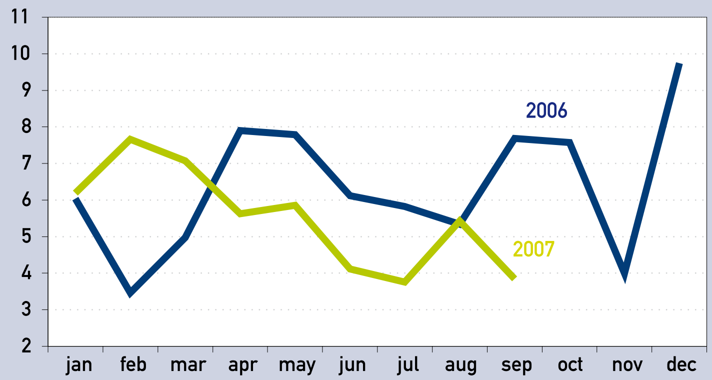


Note: The figures for November 2007 and December 2007 were estimated by CNI.
Source: Monthly Job Survey (IBGE) and CNI

...reducing the pressure on the unemployment rate.

REAL PAYROLL

VARIATION AS COMPARED TO THE SAME MONTH IN THE PREVIOUS YEAR (%)



Source: Monthly Job Survey (IBGE). Prepared by: CNI

Lower growth of total earnings was attenuated by a higher increase in the occupation rate

Interest Rates, Credit and Inflation

Uncertainties in relation to the path of the future inflation interrupts drop in interest rates

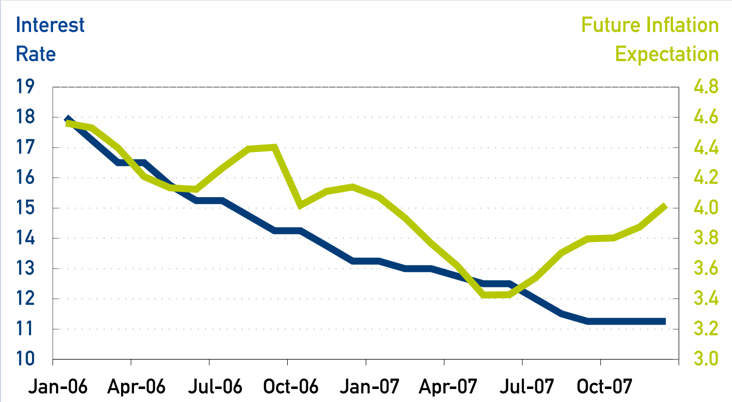
In 2007, the Central Bank was even more cautious in managing the monetary policy: the pace of reductions in interest rates decreased by half as compared to 2006 (dropping by only 2 percentage points – p.p. – to 11.25% at the end of the year). As a result, long-term interest rates (TJLP) – a benchmark for BNDES operations –, which had dropped by 2.9 p.p. (to 6.85%) in 2006, remained virtually stable in 2007, dropping by only 0.6 percentage points.

Real ex-ante interest rates – which are measured by the relation between the Selic rate and the 12-month-ahead expected inflation – reached its lowest historical level this year and are expected to hit the mark of 7% in December. This movement, particularly in recent months, was caused by stronger expectations that the inflation will rise, since the interest rate remained unchanged during almost all the second half of the year. As a result, the curves of the inflation expectation indicators and of the Selic rate target began to move away from each other since July of this year, creating a less comfortable short-term scenario.

OVER-SELIC INTEREST RATE AND MEDIAN OF INFLATION EXPECTATIONS

VARIATION IN TWELVE MONTHS (%)

Curves of future inflation expectations and interest rates move in opposite directions



Source: Central Bank of Brazil Prepared by: CNI

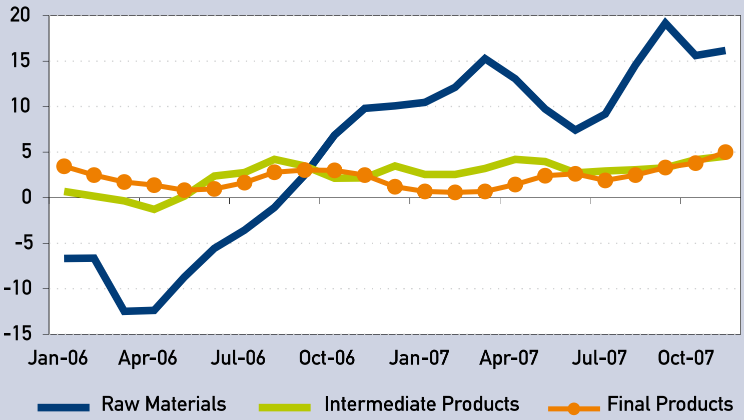
Inflation is expected to rise for both external and domestic reasons. Externally, there were clear signs of inflationary pressures in the wholesale market as a result of hikes in the international prices of gross raw materials. Commodity prices in the Food category rose by 18.1% between January and October 2007 (IMF data). Therefore, the Wholesale Price Index - IPA (which accounts for 60% of the General Price Index - IGP/FGV), which had deflated in the rate accumulated in 12 months between November 2005 and March 2006, began to increase at a faster pace in the months that followed and rose to 7.5% in November.

Were it not for the continuous appreciation of the real and for the strategy adopted by Petrobras not to transfer the hikes in international energy prices (such as those of petroleum and gas) to consumers,

INFLATION IN THE WHOLESALE MARKET (WHOLESALE PRICE INDEX-INTERNAL AVAILABILITY) BY PRODUCTION STAGES

VARIATION IN TWELVE MONTHS (%)

Raw materials led pressure on inflation in the wholesale market

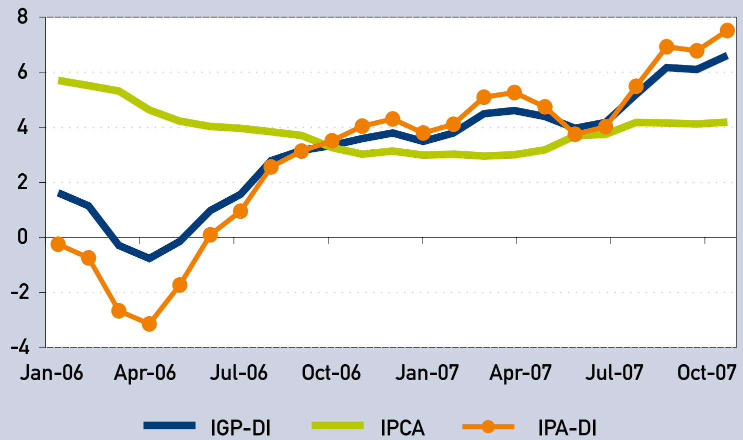


Source: FGV. Prepared by: CNI.

INFLATION INDICES

VARIATION IN TWELVE MONTHS (%)

Inflation in the wholesale market was partly transferred to consumers



Source: IBGE and FGV Prepared by: CNI

the pressures pushing the inflation up for consumers would be more pronounced.

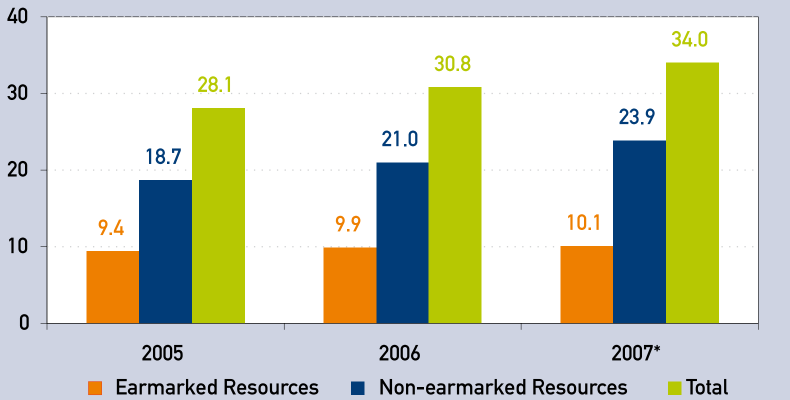
Domestically, the faster economic growth experienced in the country, supported by a higher domestic consumption – via more jobs and a higher income – enhanced the possibility that price hikes would be transferred to consumers. As a result of an increasing demand, the industry's capacity utilization increased significantly (CNI data), to levels above the ones registered in 2004. It should be mentioned that, as opposed to the situation in that year, two elements shortened the gap between demand and supply in 2007: a) the higher domestic demand is being partly met by imports, given that the real has appreciated; and b) investments are increasing more than in 2004.

However, the current scenario is one marked by uncertainty as a result of a higher probability that the initially localized inflationary pressures may have a negative bearing on the path of the domestic inflation.

The 12-month indicator in the Consumer Price Index (IPCA) increased from 3% in April to 4.2% in November. Disaggregated, the IPCA also shows beyond any doubt that the Food and Beverages group – which has a weight of 21% in the aggregate index – is pushing the inflation up more than any other: it accounted for about half the IPCA in 2007. Therefore, the scenario this year was marked by a small rise in the inflation rate and the IPCA index will close the year at 4.2%, which is still 0.3 p.p.,below the central target set by the National Monetary Council (CMN).

CREDIT WITH NON-EARMARKED AND EARMARKED RESOURCES (% OF GDP)

More credit is available as a result of an increase observed in operations with non-earmarked resources



* In October

Source: Central Bank of Brazil Prepared by: CNI

Credit operations grow at a faster pace

The balance of credit operations of the domestic financial system increased more strongly once again in 2007. After experiencing an average annual growth rate of 20.7% between May 2005 and May 2007, this indicator began to rise progressively until it hit the mark of 26.3% in October. As a result of this increase, total credit rose to 34% of the Gross Domestic Product (GDP) – an increase of 3.2 p.p. in relation to January.

The increase observed in total credit outstanding with non-earmarked resources was prominent, accounting for 91% of the increase in total credit in 2007 as a whole – it rose from 20.9% in January to 23.9% of GDP in October. This rest of the increase in credit availability can be attributed to the so-called earmarked resources. Actually, credit with earmarked resources remained virtually stable at 9.9% as a percentage of GDP throughout 2007. A small increase to 10.1% of GDP was registered in October – for the first time since May 2001, the figure increased to two-digit levels in GDP.

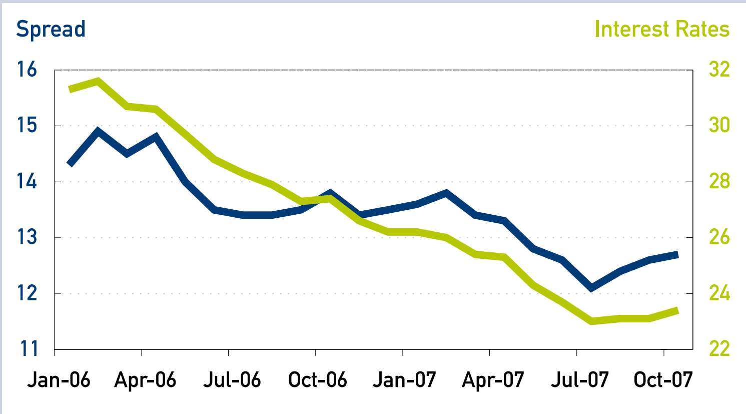
The volume of non-earmarked resources for operations with individuals continues to grow at a faster pace (32.5% in October) than that of operations with businesses (27.9% in the same month) in the indicator as compared to the same month in the previous year. However, from mid-2005 to early 2007, the rate of operations with individuals began to slow down. In the opposite direction, operations with businesses began to increase – and are still growing – at a faster pace, creating a situation where the growth pace of the two figures is quite similar (with a difference of 4.6 p.p. between their annual variation rates). It should be stressed that, in October 2005, the difference between these growth rates was six times higher: 27.6 percentage points.

Spread on the rise again as cuts in interest rates are interrupted

Following the downward path of the interest rate, interest rates applied to financial investments of legal entity tended to drop up to July. In the accumulated rate between January and October 2007, this indicator dropped by 2.8 p.p. (to 23.4% a year). Although it also followed a downward path, the spread dropped more slowly: only 0.8 p.p. during the same period, to 12.7% a year. It should be highlighted, however, that both indicators began to rise from July on without any apparent explanation. As opposed to 2006, when it was on the rise, the default rate for individuals began to drop this year: the percentage of the balance in arrears for more than 90 days in relation to the total credit available dropped by 0.4 p.p., to 2.3%. The default rate for individuals also decrea-

INTEREST RATES FOR BUSINESSES AND SPREAD (% A YEAR)

Bank intermediation costs rise again



Source: BCB Prepared by: CNI

sed: by 0.6 p.p. from January to October, to 7%.

Despite the drop in interest rates and lower default rates, the credit environment is still characterized by a lot of red tape and hindrances. Implementing the so-called positive record is a key measure that could speed up credit operations. This measure would ensure a major differentiation between the rates charged for granting credit to good and bad payers, favoring those who pay off their debts in strict compliance with their respective contracts. However, the government doesn't seem to be giving due priority to this measure.

Funding through the share market doubled in 2007

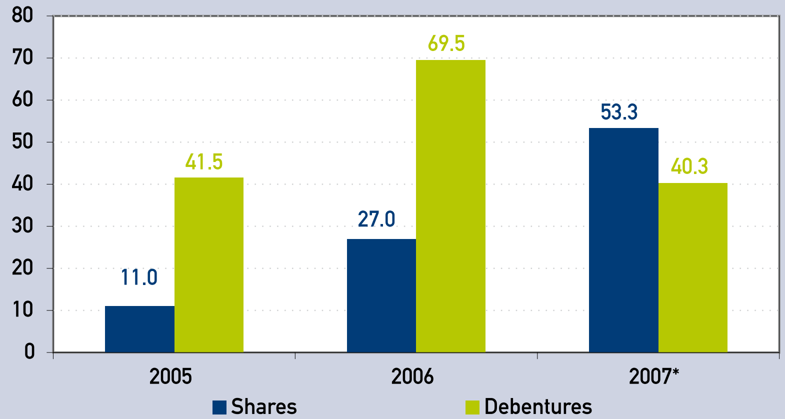
Other forms of funding grew at robust rates this year. It was an excellent year for the Brazilian share market. The offer of shares virtually doubled in relation to the flow observed in 2006 – 53.3 billion up to October 2007, while in the twelve months of the previous year the balance was 27 billion. As a result, while funding through shares in the stock exchange in 2006 accounted for 22.1% of the total, this year the percentage increased to 50.8%.

On the other hand, the issue of debentures in 2007 will be lower than the balance registered last year. Funding through debentures has decreased in recent years. Between 2004 and 2005, funding through debentures grew by about 300%, but in the 2005-2006 period it grew at a much more modest rate: 68%.

The growth registered in funding operations through the share market contrasts with the modest increase observed in operations through BNDES, the main funder of long-term investments. In October 2007, the percentage increased by 16.6% in relation to the same month in the previous year.

CAPITAL MARKET: TOTAL ENTRY REGISTERED IN THE CVM (FEDERAL SECURITIES COMMISSION) (R$ BILLION)

Offer of shares grows substantially for the second consecutive year



* Up to October

Source: Federal Securities Commission (CVM). Prepared by: CNI

Fiscal Policy

Target set for the primary surplus is exceeded as a result of a higher revenue

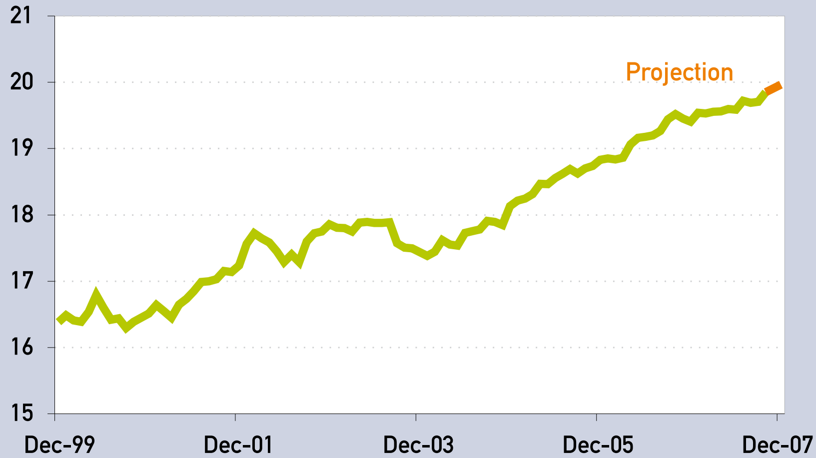
The significant increase registered in the tax revenue will enable the public sector to exceed the primary surplus target in 2007. The tax revenue grew more than the economy at large and more than enough to make up for higher expenditures. Therefore, the fiscal adjustment pattern observed in Brazil for years remained the same: higher spending covered by a higher tax load.

Achieving fiscal targets is important to preserve a scenario of economic stability. However, fiscal adjustment measures must be improved aiming the reduction of current spending in relation to GDP. Two reasons justify the need to change fiscal adjustment patterns. The first one is that a sound fiscal adjustment would provide an additional stimulus to economic activities. A lower current spending would make it possible to reduce the tax load, which in turn would encourage more private and public investments. The second reason is that one should not expect an increasing tax revenue to continue to exceed the growth rate of the economy at large forever.

EVOLUTION OF THE NET REVENUE OF THE FEDERAL GOVERNMENT

ACCUMULATED IN 12 MONTHS (% OF GDP)

Tax revenue grows at a faster pace than that of GDP in the past 4 years.



Source: STN/MF

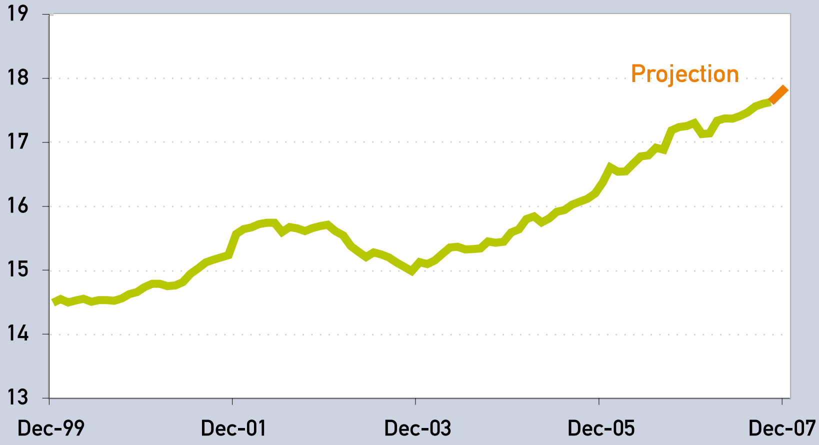
Note: The figures for November 2007 and December 2007 were estimated by CNI.

The net revenue of the Federal Government grew by 8.6% in real terms between January and October 2007 in relation to the same period in 2006. This is a significant result, especially if one takes into account that a real growth of 5.3% in GDP was registered in the first three quarters of 2007. Improvements in the results of enterprises and an increase in total earnings were the factors which contributed most to this result. Because these factors have not changed in the last months of the year, the net revenue is expected to hit the mark of 20.0% of GDP in 2007, up from 19.3% late in 2006.

The primary spending of the Federal Government also grew by 8.6% in real terms in the first

EVOLUTION OF THE TOTAL PRIMARY SPENDING OF THE FEDERAL GOVERNMENT

ACCUMULATED IN 12 MONTHS (% OF GDP)



Primary spending increases by 2.7 p.p. in the past four years.

Source: STN/MF Note: The figures for November 2007 and December 2007 were estimated by CNI.

ten months of 2007 as compared to the same period in 2006, and it will close 2007 at 17.9% of GDP, up from 17.2% in 2006.

The composition of this higher spending once again reveals a concentration in current spending. The real increase in spending amounted to 8.2%, leading the amount spent between January and October to account for 16.35% of GDP, against 15.96% in 2006. As a positive development, it should be pointed out that there was a real growth of 21.6% in investments, which increased from 0.52% to 0.59% of GDP in the period.

A similar behavior to that of the Federal Government was observed in state and municipal governments. The main revenue sources of these units of the federation experienced a real growth of 7.9% in the first ten months of 2007 in relation to the same period in 2006. Given the primary result achieved up to October, expenditures grew by about 4.6% in the same comparison basis.

Nominal deficit drops with a higher primary surplus and lower interest payments

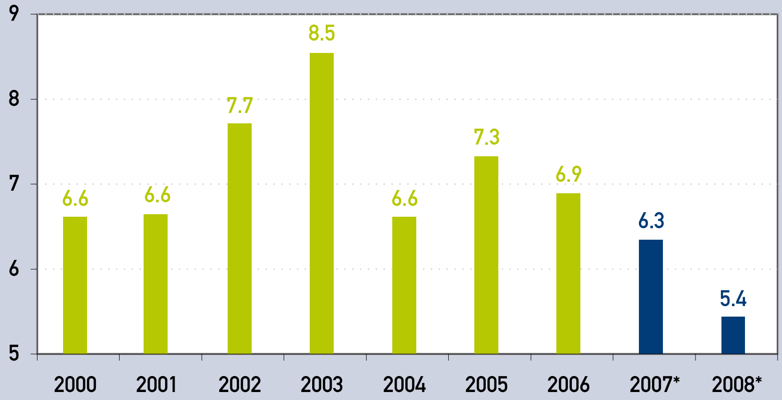
The public sector will easily exceed the primary surplus target set for 2007, which is 3.8% of GDP. CNI expects the Federal government and state and municipal governments and their enterprises to close the year with a primary surplus amounting to 4.1% of GDP. If this expectation is confirmed, the primary surplus will grow in relation to 2006, when the positive result was 3.88% of GDP.

This primary surplus result in relation to the target will be largely ensured by the result of regional governments and their enterprises. These spheres of the public sector are expected to have a primary surplus of 1.2% of GDP, while the target is 0.98% of GDP. Apart from exceeding the target, the primary surplus of regional governments was higher than in 2006, when it amounted to 1.09% of GDP.

The Federal Government is expected to have a surplus of 2.2% of GDP, exceeding the goal of 2.1% set for the year. Thus its result will be equal to the one achieved in 2006. Federal state enterprises will in turn have a better primary result and, as opposed to what was observed in 2006, they will achieve the target set for the year (0.7% of GDP). The primary surplus of federal state enterprises, which in 2006 was 0.58% of GDP, is expected to increase to 0.7% this year. Therefore, the federal contribution to the margin by which the

EVOLUTION OF PUBLIC SPENDING WITH INTEREST PAYMENTS

PERCENTAGE OF GDP (%)



Interest payments by the public sector in relation to GDP are expected to decrease for the third year in a row in 2008

* CNI Projection

Source: Central Bank of Brazil

primary surplus will exceed the target will amount to 0.1 percentage points (p.p.) of GDP.

A lower spending with interest payments is another positive factor of fiscal variables. In 2007, interest payments rates will account for 6.3% of GDP, down from 6.9% last year. Continued reductions in the interest rate and the lower interests charged on fixed rate bonds played a major role in ensuring this result.

Because of the expected results for the primary surplus and interest payments, we expect to see a significant reduction in the nominal deficit, which should drop from 3.0% of GDP in 2006 to 2.25% of GDP in 2007.

Finally, as a result of a lower nominal deficit and economic growth, the public debt in relation to GDP is expected to decrease from 44.9% last year to 42.9% in 2007.

Debt/GDP ratio will decrease in 2008, even though the primary surplus target will not be achieved

The Annual Budget Bill (PLOA) shows that necessary fiscal adjustment improvements will not be introduced in 2008. This is evinced by the fact that the bill contemplates a further increase in spending and a higher net revenue. However, since the Provisional Contribution on Financial Transactions (CPMF) was discontinued, the Federal Government lost R$ 39.0 billion that it expected to collect, a sum amounting to 1.4% of GDP which was anticipated for 2008 in the PLOA. Much uncertainty still prevails in relation to the compensatory measures that will be adopted. However, it will be difficult to ensure the net revenue contemplated in the bill and the government will have to reduce its spending.

With the end of the Provisional Contribution on Financial Transactions (CPMF), we expect other taxes to increase more than GDP once again. However, we believe that the difference will be smaller than the one observed in 2007, since improvements in the results of enterprises are more significant in the first moments of economic boom periods. For this reason, we expect the net revenue of the Federal Government to drop by 1.0 p.p. of GDP, hitting the mark of 19.0% of GDP in 2008.

In order to make up for its lower revenue, the Federal Government will have to reduce the primary spending anticipated in the PLOA. However, it will not be possible to reduce it as required to avoid a lower primary surplus, since the budget is largely made up of compulsory expenses. In relation to the main components of primary spending, cuts could be applied to:

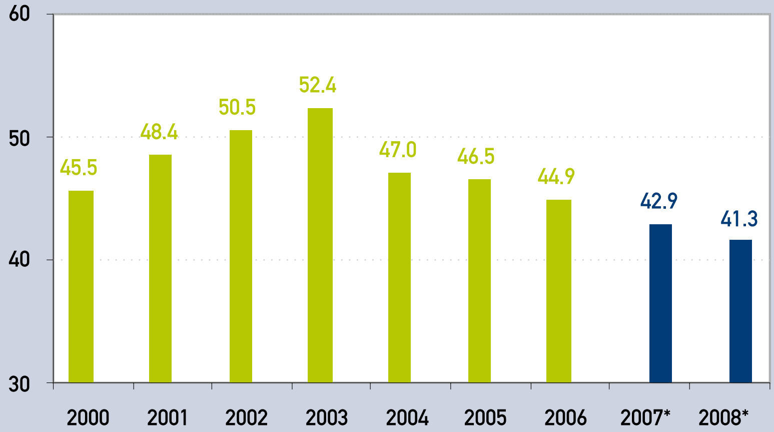
- *Staff*: the budgeted amount is R$ 130.7 billion, of which R$ 6.0 billion were earmarked for wage readjustments and new staff. Therefore, expenditures with staff in 2008 could be limited to R$ 124.7 billion.

- *Fixed and Capital Expenses:* the PLOA bill anticipated a significant increase in spending, particularly in "other fixed and capital expenses" (OCC). These expenses are largely discretionary and in many cases the sums allocated to covering them in 2007 might be maintained. Only a higher spending with health care (as provided for in the Constitution), the *Bolsa Família* program, and the FUNDEB would be maintained as anticipated. If so, it would be possible to reduce expenditures with fixed expenses and investments by about R$ 15.8 billion.

PATH OF THE PUBLIC SECTOR'S NET DEBT IN RELATION TO GDP

PERCENTAGE OF GDP (%)

Lower spending with interest rates and economic growth ensure a further reduction in the public debt



* CNI Projection

Source: BCB

In this scenario, the primary spending of the Federal Government would be reduced by 0.36 p.p. of GDP and it would amount to 17.50% of GDP in 2008. It should be mentioned that investments could be maintained at the same level registered in 2007, that is, about R$ 26.0 billion, of which R$ 13.8 billion would be included in the Pilot Investment Project (PPI).

Based on the projections for revenue and expenditures, the primary surplus of the Federal Government is expected to amount to R$ 44.9 billion. Therefore, it would not be possible to achieve the primary surplus target, which is R$ 60.4 billion. However, the result would be very close to the target if PPI investments were excluded, bringing the target down to R$ 46.6 billion.

For the other components of the primary result of the consolidated public sector, that is, federal state enterprises and regional governments with their enterprises, achieving the surplus targets of R$ 17.8 billion and R$ 26.1 billion, respectively, is feasible. Therefore, the consolidated public sector primary surplus anticipated for 2008 amounts to R$ 88.8 billion, which are equivalent to the rate of 3.15% of GDP projected by CNI.

Therefore, since we expect to see interest payments drop to 5.45% of GDP, there would be a deficit of 2.30% of GDP in the nominal result. Although the nominal deficit will be very close to the one registered in 2007, the expected economic growth will allow for a reduction in the debt/GDP ratio to 41.3% of GDP. Therefore, despite a significant reduction in the primary surplus, the main solvency indicator for the public sector will be marked by the same positive trend observed in recent years.

Foreign Sector

Import growth pace exceeds that of exports

High supply of foreign currencies sustains appreciation of the real

The high supply of foreign currencies in Brazil in 2007 sustained the appreciation of the real throughout the year. Since December of last year, the real appreciated by 14% (as deflated by the IPA) in relation to 13 currencies of the countries with which Brazil has most business transactions. Various factors account for the significant entry of foreign currencies in the Country:

a) *Entry of short-term capital.* The difference between domestic interest rates and those adopted internationally is still high. The high profitability of investing in Brazilian bonds and the lower investment risks are stimulating the entry of capital.

b) *High foreign direct investments.* Net foreign direct investments in 2007 amounted to US$ 31 billion up to October. The annual figure will certainly exceed the US$ 32-billion record registered in 2000 – when a high percentage of the resources was allocated to privatization actions.

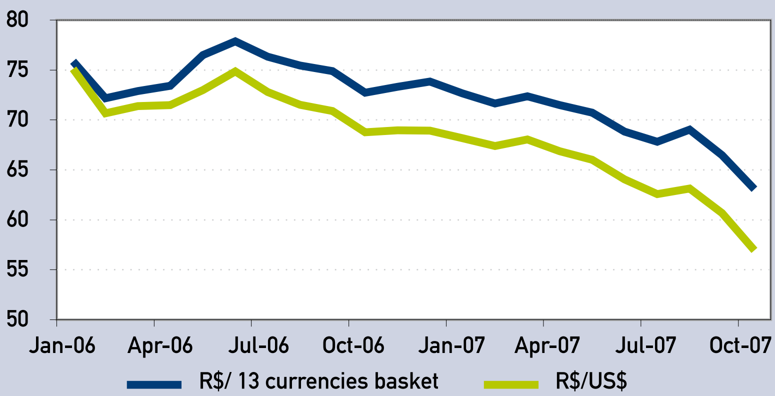
c) *Foreign trade surplus.* Although it is decreasing, the Brazilian trade balance is still significantly high. We expect to have a balance of US$ 40 billion in 2007.

d) *Arbitration.* Expectations of a continued appreciation of the real stimulate additional foreign currencies to the country. Importers postpone the foreign currencies conversion into reals, while exporters do the opposite, converting their reals quickly. As a result, the difference between

REAL EXCHANGE RATE INDEX – 13-CURRENCIES BASKET AND THE US DOLLAR

DEFLATOR: IPA - BASE: DECEMBER 2003 = 100

Real appreciation of the domestic currency becomes more intense at the end of 2007



Source: Caged/MTE Prepared by: CNI

the exchange operations up to October 2007 amounted to US$ 36.4 billion – a figure twelve times higher than the one registered in 2004.

There is also an additional incentive to the appreciation of the real in relation to the dollar: the persistence of high trade deficits in the US and the fact that its economy is cooling down are pushing the dollar down in the world. Between December 2006 and October 2007, the domestic currency appreciated by 17% (as deflated by the IPA).

Export growth pace in 2007 is the same as in 2006

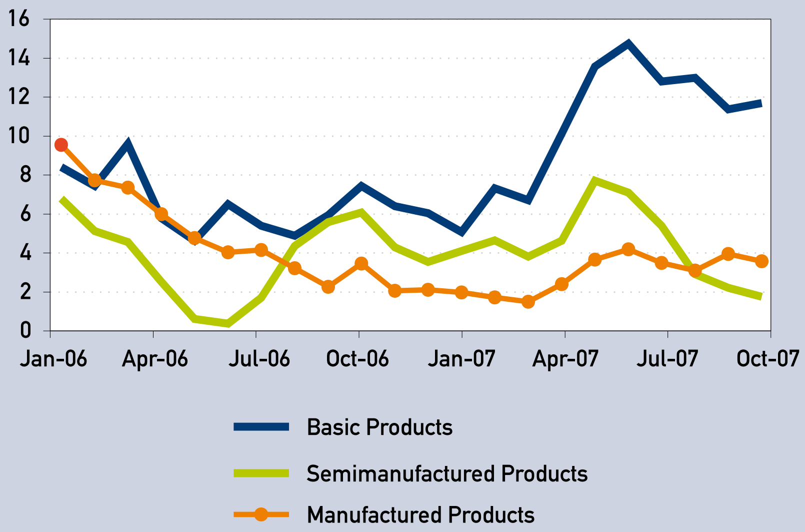
The exported value in 2007, up to November, hit the mark of US$ 146 billion, a figure 17% higher than the one observed in the same period in 2006. CNI believes that exports will total US$ 160 billion in 2007, meaning that they will grow by 16% in relation to 2006. The export growth pace in 2007 is the same one observed in 2006 – despite the continuous exchange rate appreciation.

As opposed to 2006, when price gains accounted for almost three quarters of the increase observed in exports, the growth registered in 2007 is also explained by an increase in exported volumes. Despite

QUANTUM OF BRAZILIAN EXPORTS, BY PRODUCT CATEGORY

GROWTH RATE ACCUMULATED IN 12 MONTHS IN RELATION TO THE PREVIOUS 12 MONTHS (IN %)

Sales of basic products lead increase in exported volumes

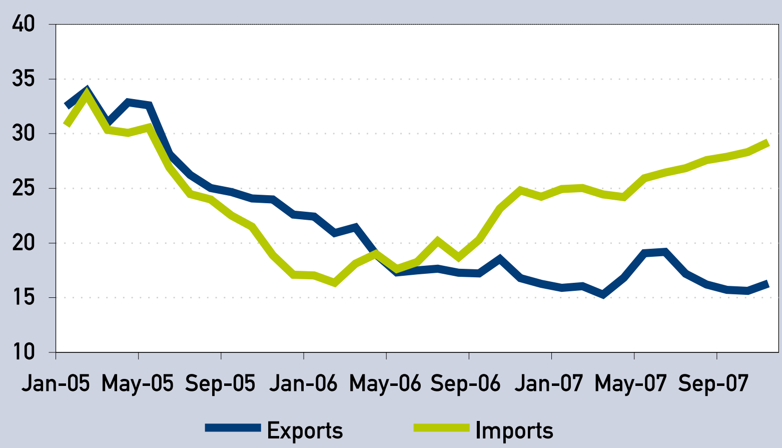


Source: Funcex Prepared by: CNI

BRAZILIAN EXPORTS AND IMPORTS

VARIATION ACCUMULATED IN 12 MONTHS IN RELATION TO THE SAME MONTH IN THE PREVIOUS YEAR (IN %)

Import growth pace is increasingly intense



Source: Funcex Prepared by: CNI

the continued exchange rate appreciation and consequent drop in the profitability of exports, the exported quantum increased by 7%, while prices rose by 9% up to October in relation to the same period in 2006.

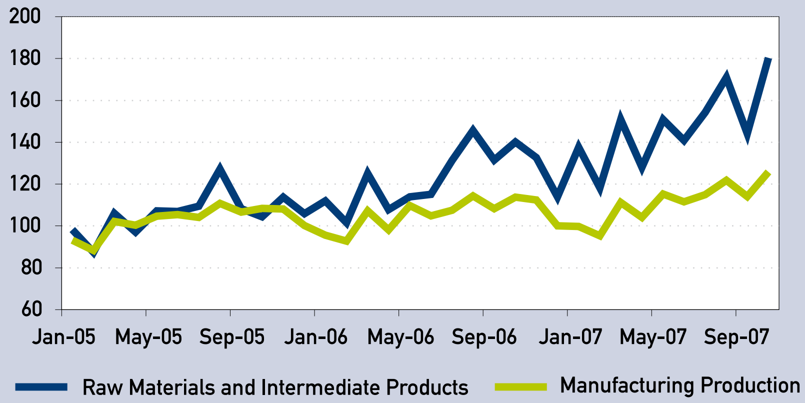
The highest growth rate was registered in the exported volumes of basic products, while a slight recovery was observed in the exports of manufactured products. It should be highlighted that while four products account for over half of the growth observed in the exports of basic products, almost two-thirds of the growth registered in the sales of manufactured products can be explained by products that are not included in the list of the 20 most exported ones in this category.

Special mention should be made of the fact that the growth pace of the foreign demand index, released by FUNCEX, (which measures variations in the imports of the main partners of Brazil) increased by 18% in 2007 up to October. This growth pace has been consistently exceeding that of world imports (12% in the same comparison), meaning that Brazilian share in the international trade is increasing. On the other hand, the growth pace observed in the foreign demand index is higher than that of Brazilian exports, indicating that the country lost space in its main destination markets.

IMPORTS OF INTERMEDIATE PRODUCTS AND PRODUCTION OF THE MANUFACTURING INDUSTRY

BASE: AVERAGE FOR 2004 = 100

Growth in imports of raw materials suggests that domestic goods are being replaced by similar imported materials



Source: PIM-PF/IBGE and Funcex   Prepared by: CNI

Imports increase stimulated by a higher domestic demand and production

The pace of imports continues to grow. The continued appreciation of the real enhanced the purchasing power of the domestic currency and encouraged the replacement of domestic goods with imported goods in a scenario marked by a stronger domestic demand. Up to November, imports had totaled US$ 110 billion this year. We expect imports to end 2007 at US$ 120 billion altogether, which would represent a growth of 31% in relation to 2006.

The growth observed in imports was mainly determined by an increase in imported volumes. Taking into account the growth rate in the 12-month period ending in October, the quantum increased by 23%, while prices rose by only 5%.

The increase in imported volumes was observed in all categories, but it is particularly high for consumer durables: 54% as compared to the same period in 2006. This robust growth is also explained by the appreciation of the real, but this effect is additional to the higher purchasing power derived from the recovery of household income and from a higher availability of credit. The imported volume of capital goods grew by 35% in the comparison with 2006. This increase in imports of capital goods is good news, as it shows that the industry has been investing to meet the demand.

Imports of raw materials and intermediate goods increased by 21% in the comparison between the first ten months of 2006 and 2007. This pace is much higher than the growth pace of the manufacturing production, showing that domestic raw materials are being replaced by similar imported materials.

Trade balance is dropping, deficit in services is rising

Although it is still significantly high, the trade balance is dropping. The balance registered up to November is US$ 36.4 billion – 12.1% lower than the one observed in the same period in 2006 (12.5% based on the daily average). We expect the accumulated trade balance in 2007 to total US$ 40 billion – a drop of almost 14% in relation to 2006.

Services and Income deficit, in turn, continue to rise – the deficit up to October increased by 7% in the comparison with the same period in 2006. The increase observed in the purchasing power of the real stimulated expenditures with services, which grew by 23% in the period. A higher deficit in international trips accounted for one one-fourth of this increase, particularly owing to credit card expenses. The increase registered in remittances of profits and dividends abroad also deserves special mention (47% increase). Foreign companies operating in Brazil are speeding up remittances of profits and dividends abroad based on expectations of appreciation of the real.

The current account surplus (accumulated up to October) was US$ 5.6 billion, less than half the one registered in the same period in 2006. We expect 2007 to end with a balance of US$ 4.5 billion.

Brazil will once again experience a current account deficit in 2008

In 2008, the path of the exchange rate will be determined by factors acting in opposite directions. Three factors are stimulating the exchange rate appreciation: the high difference between domestic and international interest rates, continued foreign direct investments, and the possibility that Brazil will achieve an investment-grade ranking in 2008, since the country risk is apparently on a downward path and external solvency indices remain robust. During the year, however, a lower current account surplus and a higher deficit in services will tend to devaluate the real. Therefore, we expect the exchange rate to close the year at about R$ 1.76/ US$ 1, with an average of R$ 1.72 / US$ 1.

We estimate that the trade balance will amount to US$ 25 billion in 2008, much less than the US$ 40 billion registered in 2007. Our projections indicate that the export quantum growth rate will slow down: exports in 2008 may grow by about 9%, totaling US$ 175 billion at the end of the year. While on the one hand the scenario abroad continues to be favorable, allowing for price gains and ensuring markets to Brazilian commodities, on the other hand the appreciated exchange rate will make it increasingly difficult to step up the exports of manufactured products.

The exchange rate appreciation and the resulting higher purchasing power of the real will provide an additional incentive to imports, which will also be stimulated by a higher domestic demand. As a result, we expect to see a 25% growth in 2008, which would lead imports to total US$ 150 billion.

The appreciation of the real will also lead to higher expenditures with services, increasing the deficit in 2008. Thus, the current account surplus is likely to decrease sharply in 2008. As a matter of fact, we expect a deficit of about US$ 6 billion.

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PROSPECTS FOR THE BRAZILIAN ECONOMY IN 2007 - 2008

ECONOMIC ACTIVITY				
GDP (annual change)	3.2%	3.8%	5.3%	5.0%
Industrial GDP (annual change)	2.1%	2.9%	5.3%	5.0%
Household Consumption (annual change)	4.5%	4.6%	6.0%	6.2%
Gross Fixed Capital Formation (annual change)	3.6%	10.0%	12.8%	14.0%
Unemployment Rate (annual average- % of EAP)	9.8%	10.0%	9.5%	9.0%
FOREIGN SECTOR				
Exports (Billion US$)	118.3	137.5	160.0	175.0
Imports (Billion US$)	73.6	91.4	120.0	150.0
Trade balance (Billion US$)	44.7	46.1	40.0	25.0
Current Account Balance (Billion US$)	13.9	13.6	4.5	- 6.0
INFLATION				
Inflation (IPCA - annual change)	5.7%	3.1%	4.2%	4.1%
PUBLIC ACCOUNTS				
Nominal Public Deficit (% of GDP)	3.0	3.0	2.3	2.5
Primary Public Surplus (% of GDP)	4.4	3.9	4.1	3.0
Net Public Debt (% of GDP)	46.5	44.9	42.9	41.5
INTEREST RATES				
Nominal Interest Rate				
(average annual rate)	19.1%	15.3%	12.1%	11.1%
(end of period)	18.0%	13.3%	11.3%	10.5%
Real Interest Rate (average annual rate and IPCA)	12.7%	11.8%	7.6%	6.7%
EXCHANGE RATE				
Exchenge Rate - R$/US$				
(average annual rate)	2.28	2.14	1.78	1.76
(end of period)	2.44	2.18	1.95	1.72