CNI BRAZILIAN ECONOMY

Special Edition of the Economic Report

Year 24 • Number 4 • december 2008 • www.cni.org.br

The challenge lies in developing new sources of financing

The scenario for the Brazilian economy changed radically as a result of the world crisis. After breaking out in the world's largest economy, the crisis has spread intensely, contaminating economies throughout the world. It led to lower economic growth at global level, affecting the Brazilian economic expansion cycle.

The crisis was brought about by a gap between the growth pace of financial assets and that of the real economy. However, a strong financial leverage and a high international liquidity enabled the world economy to experience a long growth cycle which benefitted Brazil. Despite the increasing contribution of domestic demand to economic growth, the major role played by international leverage in the recent growth cycle of the Brazilian economy should not be minimized.

Brazil has two challenges to face. First, it must reestablish favorable credit conditions, minimize the volatility of financial markets, and avoid any further economic retraction. In other terms, it must buffer the effects of the crisis on household consumption and investments.

Second, once the critical phase of the global crisis is over, the main challenge to be faced is developing a new standard to fund economic growth in a world economy marked by lower liquidity and higher risk aversion. For high economic growth rates to be preserved, higher investment rates are required and, consequently, higher domestic savings.

The role played by the State in this new phase is crucial. Indispensable emergency actions to overcome the crisis should be complemented by long-term actions designed to build a better-quality economic environment. As a key measure, the State should play a more active role in providing an appropriate infrastructure, giving priority to public investments. Special mention should also be made of the importance of regulatory mechanisms capable of attracting private investments.

However, warding off fiscal risks is necessary. It is a must to keep the focus on ensuring balanced public accounts in the long term by controlling current spending to make it possible to reduce the tax load. This is a key condition to increase investment rates and resume a virtuous economic growth cycle.

PROSPECTS FOR 2009 4

Changes in the international economic scenario impose restrictions on the growth cycle of the Brazilian economy

THE BRAZILIAN ECONOMY IN 2008

economic activity 8

Global crisis slows down economic activity at last year's end

jobs and wages 12

Despite heated labor market, growth pace is expected to be moderate

inflation, interest rates and credit 15

World deflation and lower growth ease pressures on domestic inflation

fiscal policy 19

Cut down on spending made it possible for fiscal target to be exceeded

foreign trade sector 23

Need for resources increases in a world affected by lower liquidity and higher risk aversion

2008 overview

Economic growth is still high, despite the impacts of the international economic crisis

Prospects are that the Brazilian GDP will have grown by 5.7% in 2008, despite the increasing economic crisis faced in developed countries. The Brazilian economy was not immune to the changes that took place in the world scenario. With a certain lag, the effects of the global crisis began to be felt in Brazil in the last quarter of the year. As a result, the economic activity experienced two quite different periods in 2008. During the first three quarters of the year, the economic growth pace was quite significant, namely, 6.4% in relation to the same period in 2007. On the other hand, the economy was strongly impacted in the fourth quarter by credit restrictions and a drop in foreign demand caused by the world crisis. As a result, the economic activity is expected to decline by 1.5% in relation to the third quarter, as seasonally adjusted for the period.

The fact that it took a while for the effects of the international economic crisis to be felt in the country will enable the Brazilian economy to grow at rates in excess of those of the world economy, which might grow by 3.7% in 2008. This difference is expected to be attributed to the significant growth pace registered in domestic demand. Household consumption, the main factor driving domestic demand, is expected to close the year with a growth in excess of 6.0%. Moreover, the significant growth registered in investments deserves special mention, as gross fixed capital formation is expected to increase by 14.4% in relation to 2007.

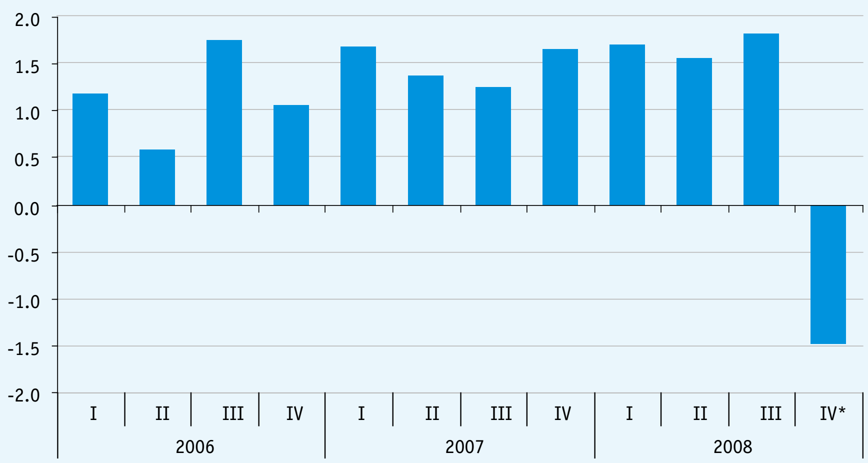
Foreign demand, in turn, dropped significantly. The drop in exports can be explained by a strong exchange rate appreciation in the third quarter of 2008. This appreciation, which took place during much of the year, combined with a high growth pace of domestic economic, led imports to grow sharply. The contribution of the foreign trade sector to GDP growth was once again negative by -0.2 percentage points.

Another striking feature of economic growth in 2008 was its relative homogeneity among the economy's sectors. As in 2007, the industry will be the sector marked by the highest growth, with a production increase of 6.0% in relation to the previous year. It can also be seen that that there was a widespread production increase within

Evolution of the Gross Domestic Product

Seasonally adjusted variation (%) between the quarter and the previous quarter

With a certain lag, the effects of the global crisis are beginning to be felt



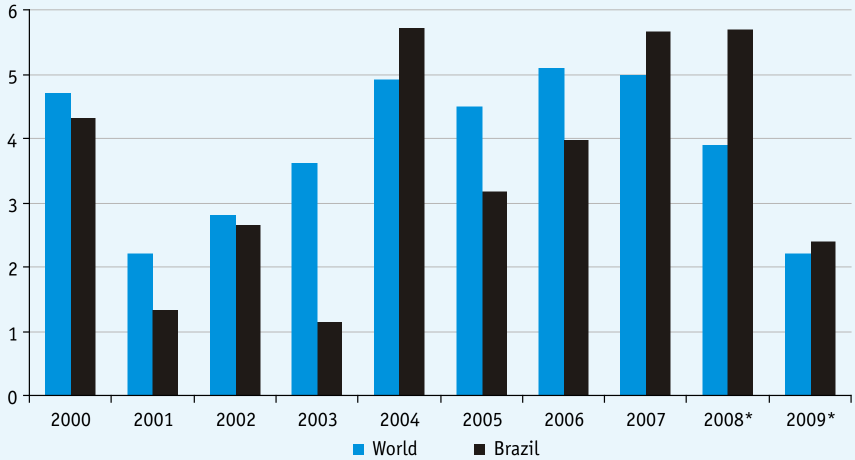
* CNI Projection

Source: National Accounts/IBGE

Evolution of the Gross Domestic Product: World and Brazil

Annual variation (%)

For the second year in a row, the Brazilian GDP grew more than the world GDP



* CNI Projection

Source: National Accounts/IBGE (Brazilian GDP) and World Economy Outlook/IMF (world GDP)

the industrial sector. However, the 9.1% increase registered in the civil construction production chain deserves special mention.

The strong increase observed in domestic demand, which led to the significant and widespread growth of the economic activity in the country, can be basically explained by two factors: the increases observed in total earnings and in total credit outstanding.

Positive developments in the labor market in the past two years became more intense in 2008. The industry played a key role in generating jobs, as it created 533,000 new jobs in the manufacturing industry and another 301,000 in the civil construction industry. The increase registered in total earnings was also favored by a higher real average income, after having grown by 3.3% between January and October 2008 as compared to the same period in 2007. The higher number of employed people and higher average income led to a real increase of 8.5% in total earnings in 2008.

Similarly to what was observed in the labor market, the granting of credit continued to grow in 2008 as in 2007. Longer repayment deadlines and lower interest rates charged from final borrowers in the first months of the year ensured an increase of 26.8% in total credit outstanding in 2008 until October.

Although they played a major role in boosting domestic demand in 2008, increases in total earnings and in total credit outstanding were negatively impacted by the acceleration of the inflation rate in the first half of the year. In the case of total earnings, a higher inflation rate reduced real income gains. As for credit, the effect was felt as a result of the increases in the basic (Selic) interest rate determined by the Central Bank since the second quarter.

The IPCA (Broad Consumer Price Index), which closed 2007 at 4.5%, rose by up to 6.4% in the 12-month period ending in July. As a result, the Central Bank began to tighten the monetary policy in April, leading the selic rate to rise to 13.75%, the level at which it will close 2008. In response to this tighter monetary policy, and mainly to the effect of lower commodity prices, the inflation rate decelerated in the second half of the year and the IPCA is expected to close 2008 with a hike of 6.2% – within the highest inflation band target.

Finally, the positive developments observed in the economic activity in the first nine months of 2008 reflected positively on public accounts. The public-sector tax revenue growth pace exceeded the growth of the economy as a whole by a large margin, mainly due to higher corporate profits and total earnings. As a result, and relying on efforts being made by the federal administration not to turn every increase in the tax revenue into expenditures, the public sector is expected to have a primary surplus of 4.25% of GDP. Since the spending with interest payments in relation to GDP will be lower and considering the net debt-reducing effect of the exchange rate depreciation in the second half of 2008, the net public-sector debt in relation to GDP is expected to decrease significantly.

PROSPECTS FOR 2009

International economic crisis will cause economic activity slowdown

GDP is expected to grow by 2.4% in real terms in 2009. The pace of economic activity will slow down as a result of a set of factors that will affect domestic and foreign demand components negatively:

- **Domestic consumption:** household consumption is expected to grow at a significantly lower pace as a result of less favorable conditions in the credit market and, at a second moment, due to the effect of a deteriorating labor market on total earnings. For this reason, household consumption might increase by 3.0% in 2009, a growth level close to half the one observed in 2008.

- **Investments:** this component of domestic demand will be the most affected by the more pronounced deceleration of the economic growth pace. Investments will drop due to the expectations of a lower domestic and foreign demand in a context of stocks that are already high. This scenario takes into account the maturing of investments still under way in 2008, the higher costs and lower availability of financing and the depreciation of the Brazilian currency. Therefore, investments are expected to grow by only 3.0% in 2009, while in 2008 they grew by 14.4%.

- **Foreign demand:** recession in the world's largest economies might have a strong impact on international trade, which is projected to grow by 2.1% in 2009, contrasting with the marked increase of 4.6% registered in 2008. As a result, Brazilian exports will decline in 2009 and contribute negatively to GDP growth. This effect will be buffered by a decrease in imports caused by the domestic economic slowdown.

Inflation close to the target and lower interest rates from January on

Inflation as measured by the IPCA index is expected to remain at a level of 4.8% in 2009. As a result, the inflation rate will converge toward near the center of the target proposed for the year, namely, 4.5%. On the one hand, a decreasing domestic demand and international commodity prices on the decline are having the effect of reducing the pressure for price hikes. On the other hand, the strong exchange rate depreciation observed in recent months will bring about direct pressures for import price hikes and indirect pressures on the prices of domestic products and services via higher costs in the production chain. However, the effect of the exchange rate depreciation on the inflation will be softened by decreasing commodity prices and by the lesser likelihood of its transfer to prices due to the economic slowdown.

The behavior of inflation in 2009 will pave the way for the Central Bank to begin to loosen the monetary policy from January on. A reduction of 0.5 percentage points in the first two meetings in 2009 is expected, followed by less intense reductions to be decided upon in the other meetings to be held throughout the year. As a result, CNI projects an 11.25% Selic rate in December 2009, accumulating a 12.2% average in the year.

Trade surplus is expected to decrease once again

Exports in US dollars might drop by 20% in 2008 and hit the mark of US$ 170 billion. Three factors will have a negative impact on sales abroad. The first one is the slowdown in global trade growth caused by the global economic crisis. The second one will be the impact of lower international commodity prices, considering that they make up much of the Brazilian exports. Finally, the protectionism boosted by the global economic slowdown is expected to escalate.

Imports are projected to drop by about 13% and to close 2008 at US$ 155 billion. The slowdown in the growth pace of domestic demand and the hike in the relative prices of imported products in response to the exchange rate depreciation will play a major role in reducing imports.

Based on projections for exports and imports, the trade balance surplus is expected to drop again, from U$ 25 billion in 2008 to US$ 15 billion in 2009. Despite a lower trade balance, the exchange rate depreciation will prevent further deteriorations in the current account balance, as remittances of profits abroad and international trips will lose momentum. The current account gap is expected to remain at US$ 35 billion, against US$ 29 billion in 2008, meaning that it will remain virtually unchanged as a percentage of GDP.

Lower revenues and possible use of anti-cyclical measures make fiscal outcomes uncertain

The impacts of the economic slowdown on the public-sector tax revenue and the likelihood that the Federal Government will adopt a more expansionist fiscal policy than the one contemplated in the budget bill make fiscal outcomes in 2009 very uncertain.

The Executive Branch's proposal to Congress to cut down expenditures in the budget bill – by only R$ 8 billion – and recent measures to relieve the tax burden suggest that the government will be adopting a strongly expansionist fiscal policy in 2009 as a means to mitigate the effects of the crisis on the economic activity. Therefore, it is likely to use the reduction in the Pilot Investment Project to achieve the primary surplus target, namely, 3.35% of GDP in 2009. As a result, the nominal deficit is likely to increase from 1.5% to 1.9% of GDP and the debt/GDP ratio to remain stable at about 37.0%.

Alternative scenarios

The evolution of the world crisis and policy actions will enable GDP growth paths to materialize differently from the path projected in our base scenario. There are two possibilities.

A more favorable scenario may take shape in which policies to tackle the crisis – both in Brazil and in other countries –, stabilizing the economy and allowing for economic growth to be gradually resumed. A significant set of tools and resources are being made available throughout the world to revert the current scenario of recession and recover liquidity.

In this scenario, international recession would be less intense and would have lesser impacts on international trade and on emerging countries. In Brazil, the effects of policies to tackle the crisis would be enhanced by domestic measures designed to stimulate consumption and recover credit. Domestic demand, consumption and investments would drop less than anticipated in the base scenario and, if so, GDP growth would hit the mark of 3.2%.

On the other hand, the possibility of a longer and more lasting global recession has not been discarded. Should this be the case, confidence levels would remain low in industrial countries, which would have to deal with pending asset imbalances and the inability of policies to boost the economy. The negative effects of such a situation on global trade and international liquidity would protract an unfavorable scenario for emerging economies – marked by depressed commodity prices, less exports, and low international liquidity. In this scenario, domestic policies to revive the economy would have limited effects and a more intense economic slowdown would be inevitable. In this case, GDP growth would not exceed 1.8%.

CHANGES IN THE WORLD SCENARIO

The end of a cycle

Between 2004 and 2007, the world economy experienced an unprecedented growth period. Global economic growth and the foreign trade have, year after year, exceeded the most optimistic expectations. During this period, the average growth of the world GDP varied, in real terms, from 3.5% to 5%, and international trade in products and services grew by 8% a year in average. Additionally, the inflow of direct foreign investments increased by more than 170% as compared to the 1990s.

2008 marks the interruption of a virtuous growth cycle

The year of 2008, however, marked the end of this period. The international financial crisis led to a global stock exchange slump, dragging down age-old banks and rippling throughout the real economy, causing the economic activity to slow and creating difficulties for different economic sectors. The Euro Zone experienced a retraction of 0.2% in the third quarter. For the first time since the birth of the European common currency, the region made up of the 15 countries that use the Euro as currency experienced an economic recession. The US is already facing economic recession; data for the third quarter suggest that the US GDP has shrunk by 0.5% and that a further decrease is likely in the fourth quarter. In Japan, economic recession hit in the second quarter of 2008. However, despite the significant changes in the economic scenario late last year, the world GDP is expected to grow by 3.7% in 2008 (IMF), which is still a quite high percentage.

However, it will be impossible to repeat this performance in 2009. Lack of credit, combined with a widespread confidence slump, is leading the industrial, agricultural and service sectors – in many different countries – to suspend investments and to focus on cutting expenditures down. As a result, cost reductions and dismissals, which were initially restricted to financial sectors, have spread to the rest of the economy. With dismissals on the rise, consumption will decline more intensely.

The credit crunch, brought about by pressures on the financial sector, will be felt throughout 2009. As a matter of fact, commercial banks may face greater difficulties than in 2008 as the pace of dismissals and, consequently, default rates become more intense.

Emerging countries will not repeat their performance in 2009

During much of 2008, emerging countries had not experienced the effects of the economic slowdown in developed countries as intensely as the latter did. In most of those countries, including in Brazil, economic growth in 2008 was sustained by domestic demand on the rise and high revenues from commodity sales. However, rapid economic growth brought inflation and most emerging countries decided to tighten their monetary policy. Consequently, their financial losses in stock exchanges were more pronounced than in developed countries.

In 2009, the forces that ensured economic growth in emerging economies lost momentum. Exports to the United States, Europe and Japan will drop even more when imports to those large markets begin to shrink. Commodity prices will continue to fall and major exporting countries, such as Brazil and many emerging countries, will see their export earnings drop sharply. China, for example, saw its exports falling in November in relation to the same month in 2007; for first time in seven years, Chinese exports have not increased in relation to the same period in the previous year. Domestic demand will also lose momentum in these countries. Food products will remain expensive, and less money will be left to buy other consumer goods. The huge inflow of foreign currencies that flooded emerging markets will become less abundant, albeit still high.

Gross Domestic Product and trade volume evolution

Percentage variation

The world scenario in 2009 will be very different from the one in 2007

	2007	2008*	2009*
World	5.0	3.7	2.2
United States	2.0	1.4	-0.7
Developed Economies	2.6	1.4	-0.3
European Union	3.1	1.5	-0.2
Emerging and Developing Economies	8.0	6.6	5.1
World Trade Volume (goods and services)	7.2	4.6	2.1

* Projection

Source: IMF

Continuing to ensure coordination among policies is a must

This change in the economic scenario will slow down the growth pace of the world economy by – at least – two-thirds. It will be the worst year for the world economy since 1982. And it should be borne in mind that this scenario assumes that economic policy agents in developed economies, such as in the United States and in the European Union, will remain as active and coordinated in their measures as in 2008. This is likely to happen: a lower inflation rate in 2009 will make it possible for interest rates to drop further; otherwise, more severe impacts on the economic activity can be expected. Pessimistic estimates suggest that a protracted world economic recession is likely.

However, one aspect should be stressed. An opportunity was lost to agree on a free-trade agreement in the Doha round. As no agreement was reached, some economies may take protectionist measures – even though they are the last thing the global economy needs.

In emerging economies, doubts prevail as to their ability to promote anti-cyclical policies successfully and finance their growth. Direct foreign investments will decrease in 2009 – but more intensely so among large economies. Softening the monetary policy, which has been more restrictive in response to inflation surges led by commodity price hikes, has been the solution adopted by many emerging economies. Brazil is one of the few countries that have not resorted to this alternative so far.

In addition, many emerging countries are announcing packages to boost their economies. It should be highlighted, however, that – except for China – these packages are relatively mild as compared to measures taken in developed countries. The latter have no room in their fiscal policies to adopt packages designed to boost their economic growth without threatening their fiscal balance. An exception is Chile, which has accumulated a fiscal surplus of 8.8% of GDP in 2007 from copper export price gains.

economic activity

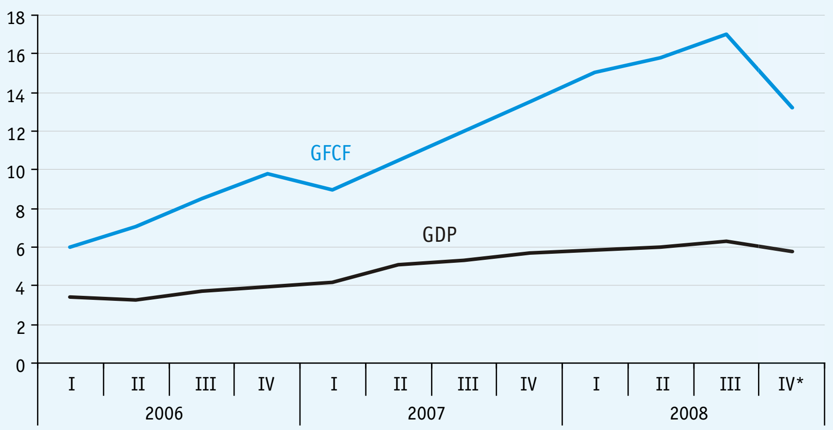
Abrupt interruption of economic growth

The year of 2008 was marked by two different periods in terms of the dynamics of economic growth in Brazil. In the first one, comprising the first three quarters of the year, economic growth evolved intensely and was widespread. In the second one, restricted to the last three months of the year, there was a sudden inversion in economic growth caused by the global financial crisis, which spread rapidly. However, despite the economic slowdown observed late last year, the strong economic growth pace registered until the third quarter will still ensure a robust GDP growth in 2008. CNI estimates that GDP will grow by 5.7% in 2008, more than projected earlier this year.

GDP and gross formation of fixed capital

Variation (%) accumulated in 4 quarters in relation to the 4 previous quarters

Gross fixed capital formation has been growing at least at twice the GDP growth pace for 10 consecutive quarters



* Projection

Source: IBGE

In the average of the first three quarters of the year as compared to the same period the year before, GDP grew at the rate of 6.8%. The acceleration of all domestic demand components in this inter-temporal comparison deserves special mention. Gross formation of fixed capital (FBKF) rose by 19.7% – the highest growth in 12 years. Apart from intense, FBKF growth has been steady: this indicator has been growing at least at twice the rates registered for GDP growth for 10 quarters in a row. Household consumption, however, continued to account for most of the economic growth, having increased by 7.3% in the third quarter in relation to the same period in 2007.

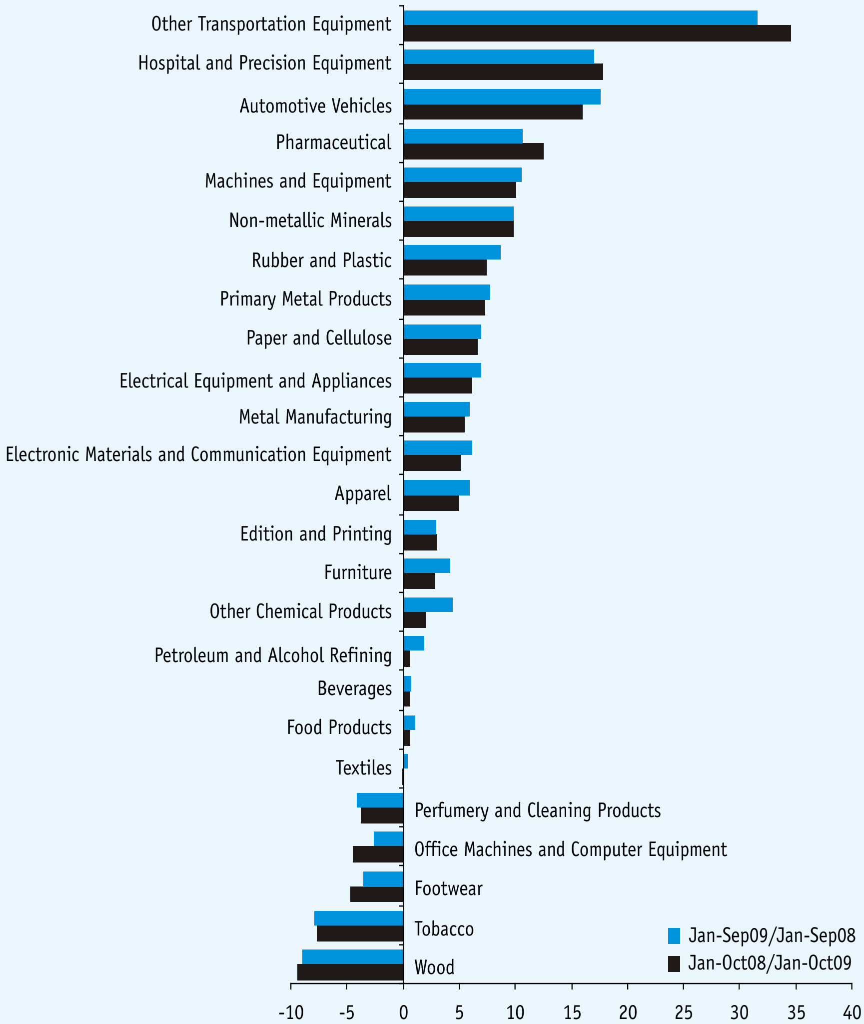
On the supply side, economic growth in the third quarter – as compared to the same quarter in 2007 – was once again led by the industry, which grew by 7.1%. The civil construction industry stood out for having grown at the highest pace (11.7%) since the Real Plan was launched. Production in the manufacturing industry has increased in most sectors: between January and September 2008, it grew in 21 of the 24 surveyed sectors (PIM-PF/IBGE) in relation to the same period the year before – and at two-digit rates in five of them.

This greater dynamism of the manufacturing production led the capacity utilization rate to hit the mark of 83.4% in September, the highest rate in the historical series of the seasonally adjusted indicator – initiated in January 2003. Pressures on capacity

Manufacturing production by activity sector

Variation (%) accumulated in the year in relation to the same period the year before

Drop in manufacturing production in October decelerates economic growth in the year as a whole in 18 sectors of the manufacturing industry



Source: PIM/IBGE

utilization have even led to a debate on possible supply restrictions to meet demand, which had been showing signs of a solid growth. However, this assumption lost its validity in the fourth quarter of 2008, when the economic growth process was abruptly interrupted – in October, the capacity utilization rate dropped by 0.5 percentage points, to 82.9%, and this trend is likely to continue over the next few months.

The industrial slowdown observed in the period from September to October was sufficient to decelerate growth in 18 of the 24 manufacturing industry sectors in the variation accumulated during the year as compared to the same period in 2007.

Fourth quarter of 2008 marks inflection in economic growth

The international crisis rippled to the real economy by reducing credit liquidity instantly, making it difficult for enterprises to raise working capital. As a result of a likely credit collapse, interest rates, which were already on an upward path in response to a restrictive monetary policy, rose even more.

Although no consolidated data are available so far on the path of domestic demand in the fourth quarter of 2008, there are clear signs that household consumption and investments have lost momentum.

It should be mentioned that CNI's Industrial Survey - Manufacturing and Mining detected an increase in stocks in the industry at large in the third quarter of 2008 for the first time in nine quarters. Considering only large enterprises, stocks have accumulated above planned levels for three consecutive quarters.

As credit became more expensive and scarce in a scenario marked by a rapid deterioration of consumer trust – the confidence index calculated by the Fundação Getúlio Vargas (FGV) was the lowest one in October since the survey began to be carried out, in 2005 – and by undesired stock accumulation, there was a sharp slowdown in the productive activity.

Manufacturing production decreased by 1.7% in seasonally adjusted terms (PIM-PF/IBGE) in October in relation to the previous month. This decrease was so sharp that, as compared to the same month the year before, manufacturing production dropped from 9.6% in September to 0.8% in the following month. A positive calendar effect was the only reason why this slowdown was not more intense – October 2008 had one production day more than October 2007.

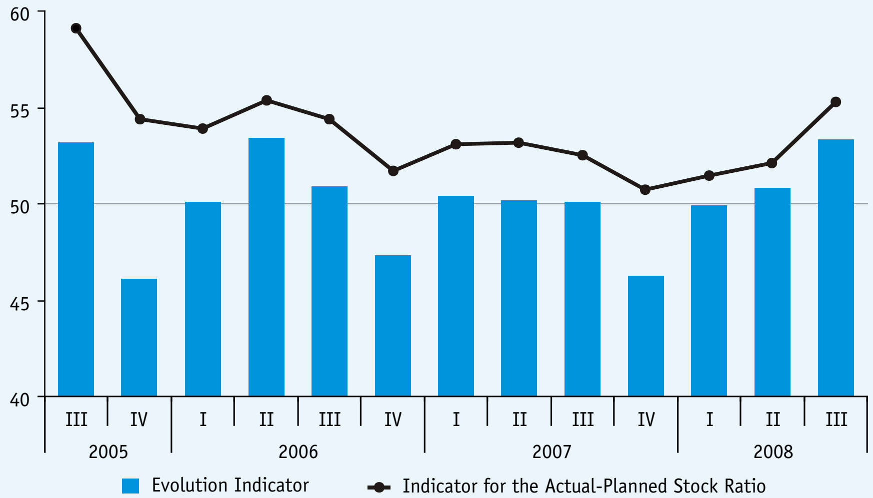
Other manufacturing activity indicators, such as turnover and worked hours in the industry (CNI Industrial Indicators) also declined sharply as compared to the same month in the previous year. Turnover dropped from 11.8% in September to 6.9% in October, while worked hours, which had been increasing at a rate of 9.6% in September, decreased to 4.9% in the following month.

An emblematic industrial sector and one which felt the impact on sales most was that of Automotive Vehicles. This sector, whose production had grown by 20.2% in September, experienced a drop of 4.1% in October (PIM-PF/IBGE) in relation to the same month the year before. Data for November confirm that this scenario has worsened, as vehicle production decreased by 34.4% in November in relation to October and by 28.6% as compared to the same month in the previous year (Anfavea data). This production slowdown even led assembly plants to send their workers on collective vacation before the due date, suggesting that production in this sector may decrease even further in December.

Stocks of large companies

Diffusion index*

Stocks are growing above planned levels



* The indicators vary in the 0-100 interval . Figures above 50 suggest a positive evolution (growth) or stocks above planned levels.

Source: CNI's Industrial Survey - Manufacturing and Mining

GDP is expected to decrease in the fourth quarter

According to preliminary data, the current economic slowdown suggests that GDP might drop by 1.5% in the fourth quarter of the year in relation to the immediately preceding quarter, according to data without seasonal influences. If confirmed, it will be the most pronounced decrease registered on this comparison basis since the first quarter of 1998, a year in which the economy experienced zero growth.

Significant decrease in economic growth rates: in 2009, the economy is expected to grow by only 2.4%

GDP drop in the fourth quarter of 2008 will be sufficient to virtually annul the 2009 dragging effect (projection of only 0.2%). That is, economic growth next year will not rely on any statistical impulse from the growth registered in 2008. Due to the significant impacts of the international crisis on the domestic economy, CNI estimates that GDP will remain on a downward path in the first quarter of 2009, when it will drop by a further 1.1%, in relation to the previous quarter in seasonally adjusted terms. If confirmed, this downward path will characterize a scenario of economic recession in the Brazilian economy (in technical terms, such a scenario is defined by two consecutive quarters with a negative GDP as compared to the previous period).

CNI projects GDP growth in 2009 at 2.4%. Although economic growth is still being led by household consumption, this component of domestic demand is expected to decrease to half the growth rate registered in 2008, meaning that it will increase by 3.0% in 2009. Government consumption, in turn, is expected to grow by 3.7% over the same period.

However, gross formation of fixed capital (FBKF) will be the main element that will slow down domestic demand in 2009. Because it is more sensitive to economic fluctuations, FBKF is expected to grow by only 3.0% in 2009, as opposed to the 14.4% increase projected for 2008. Four factors explain this behavior:

a. **Maturing of investments already under way:** investments made in 2008 will enhance the productive capacity of the industry even more;

b. **Lower demand:** a strong deceleration in domestic demand is expected in 2009, as well as a lower foreign demand – for Brazilian exports –, which will put even more pressure on stocks that are already above planned levels;

c. **Depreciation of the real:** As a result of the depreciation of the Brazilian currency in relation to the US dollar, machinery and equipment imports have become more expensive;

d. **Higher prices and increased difficulties to access credit:** interest rates on the rise – as a result of both the restrictive monetary policy adopted in 2008 and of the international crisis – have increased risk aversion and financing costs, increasing the opportunity cost of investing in production schemes.

GDP Estimate

Percentage variation and contribution

Gross fixed capital formation will be the component of domestic demand that will reduce the economic growth rate most in 2009

	GDP Components	2008 Growth Rate (%)	2008 Contribution (in p.p.)
Demand	Household consumption	3.0	1.8
	Government consumption	3.7	0.7
	Gross Fixed Capital Formation	3.0	0.6
	Exports	-4.3	-0.5
	(-) Imports	-2.1	-0.3
Supply	Agriculture and Livestock	1.6	0.1
	Industry	1.8	0.5
	Services	2.8	1.8
	Taxes	2.0	
	GDP	**2.4**	

Prepared by: CNI

The volume of exports of goods and services (according to the methodology of the National Accounts) is expected to decline by 4.3% in 2009. Although the depreciation of the real in relation to the US dollar enhances the competitiveness of Brazilians products on the international market – in terms of price –, the scenario of economic recession in developed countries and the slowdown observed in emerging economies will affect the sale of Brazilians products abroad significantly. In a context of depreciation of the Brazilian currency and deceleration of domestic demand, CNI estimates that the volume of imports of goods and services will decrease by 2.1% in 2009. As a result, the contribution of the foreign trade sector to GDP will decrease from the projected -2.2 percentage points in 2008 to -0.2 percentage points in 2009.

jobs and wages

Labor market in 2009 will not repeat its positive performance in 2008

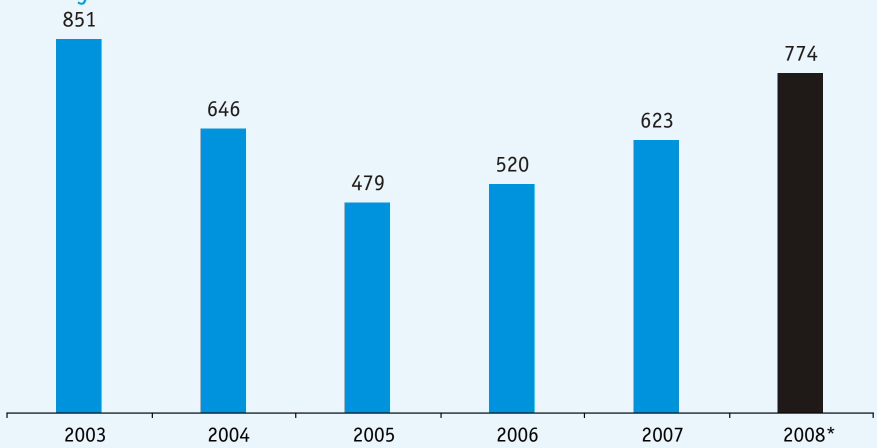
The dynamism of the labor market over the past two years became even more intense in 2008. From January to October of this year, 774,000 jobs were created in the six largest Brazilian metropolitan regions (Monthly Job Survey/IBGE). This growth was second only to the one registered in 2003, when 851,000 jobs were created in all its 12 months.

It should be stressed that, taking into account the outcomes for November and December – which have not been announced so far –, it is likely that more jobs will be created in 2008 than in 2003. It should be noticed that the quality of the new jobs created in 2008 is higher than of those created in 2003. This is so because while almost all jobs created in 2003 were informal jobs, most of those created in 2008 were formal ones.

Jobs created in metropolitan regions

In the year as a whole (thousands)

2008 will be marked by the highest number of new jobs in metropolitan regions since the beginning of the Monthly Job Survey historical series – in 2002



* Until October

Source: Monthly Job Survey/IBGE

Formal jobs stand out in 2008

It is unquestionable that more quality jobs were created in 2008. While the occupation rate grew by 4.0% in October in relation to the same month in the previous year, the number of formal jobs – made up of jobs occupied by registered, statutory and military workers and employers – grew by 6.6% on the same comparison basis. At the same time, the informal occupation rate, represented by informal and self-employed workers, grew by only 0.2% over the same period. On this comparison basis, formal jobs have been growing more than informal jobs since April 2007.

In absolute figures, 832,000 formal jobs were created and 54,000 informal jobs were closed down in the first ten months of 2008. This is the highest number of new formal jobs in six years - considering the public and private sectors.

Considering only the private sector, the job formalization trend is even more apparent. We have witnessed 45 months in a row in which formal jobs grew more than informal ones – except in August 2008, when both grew at virtually the same rate.

As this trend continued, the labor market formality index rose to 56.6% in October. This indicator, which represents the sum of all formal, military and statutory jobs in relation to all occupations, grew by 1.6 percentage points as compared to October 2007.

The only reason why the formality index did not increase continuously throughout 2008 was that it was an election year, when the supply of temporary – and usually informal – jobs increases as people are hired to work in electoral campaigns. After the electoral period, that is, after September, the formality index continued to rise and hit the highest mark in the series since the survey began to be carried out, in March 2002.

Formal jobs were not created in metropolitan regions only, but also throughout the national territory. The total number of formal jobs created throughout Brazil from January to October 2008 (Caged/MTE) hit the mark of 2.1 million, characterizing the highest net flow of new formal work opportunities in similar periods in all the country's history. As a comparison, 1.9 million formal jobs were created in the same period in the previous year.

Jobs grow in all sectors of the manufacturing industry

The manufacturing industry created 533,000 jobs in the period from January to October 2008, virtually the same number of jobs created in the same period in 2007 (540,000).

Of the 12 sectors of the manufacturing industry surveyed by Caged, six hired more workers in 2008. The Food and Beverages sector stood out, as it accounted for 34% of all new jobs in the manufacturing industry during that period.

The Civil Construction industry also deserves special mention, as it created 301,000 jobs from January to October, representing twice the net flow registered in the previous year (155,000).

Lower labor force growth pushes unemployment rate up

While the occupation rate in metropolitan regions grew intensely in 2008 (by 3.9% in average in the monthly comparison against the same month the year before), the labor force – made up of employed people and unemployed individuals looking for a job – did not grow at the same pace (2.1% in average over the same period). In fact, the occupation rate has been growing at a substantially higher pace than that of the labor force since June 2007. As a result, the average difference between the annual occupation and labor force growth rates increased from 0.8 percentage points in 2007 to 1.8 percentage points in 2008.

This behavior led the unemployment rate to fall more sharply during 2008 than in previous years. In 2008, the unemployment rate went on a downward path as early as in the first quarter of the year, while in 2007 and 2006 this indicator began to rise as of the mid second quarter. Therefore, the unemployment rate remained, in average, 1.6 percentage points below its level in the same months in the previous year. According to CNI's projection, the unemployment rate will close the year at 6.9%, with an average annual rate of 7.9% – the lowest rates in the Monthly Job Survey historical series.

Total earnings grow at a two-digit rate

The acceleration of inflation since the second half of the year reduced gains in the purchasing power of workers, resulting in a lower income. The usually earned real income grew by 3.3% in average in 2008 as a whole as compared to the same period in 2007.

However, since jobs continued to grow substantially, mainly in the second half of 2008, the real total payroll increased by 10.2% in September in relation to the same month in the previous year. It should be stressed that total earnings have been growing at two-digit rates for three consecutive months.

In the first nine months of 2008, in turn, total earnings increased by 8.5% in relation to the same period in 2007.

Prospects of a less dynamic labor market

Although the international crisis has not affected the labor market as a

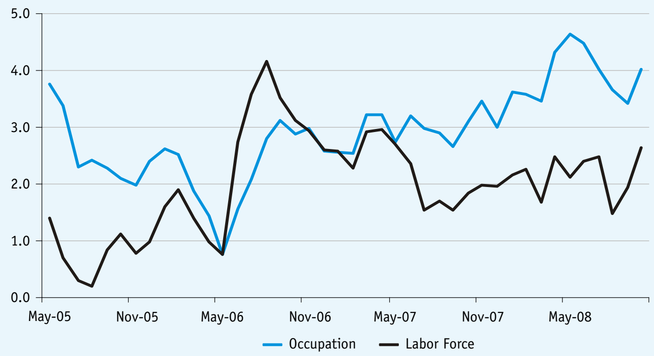
jobs and wages

whole so far – according to the data available until October –, it very likely that it will lose momentum in relation to 2008. The lower economic growth anticipated for 2009 will result in less jobs being created in the year. Therefore, CNI estimates that the labor market formalization process will not be as intense as in 2008. In other words, if the labor market formality index continues to rise, it will increase at a significantly lower pace than the one registered in 2008.

In this context, the labor force will grow more intensely in 2009. This assumption is based on the greater chances for secondary family members to try and find a job to help balance household income gains. With more people looking for a job, the unemployment rate will rise more rapidly early in 2009 than in the same period in 2008. As a result, the average unemployment rate in 2009 is expected to remain at 8.2%, or 0.3 percentage points above the average registered in 2008. In the wake of this scenario, the slowdown in job generation will have negative effects on real total payroll gains.

Labor Force and Occupation

Variation (%) in relation to the same month the year before

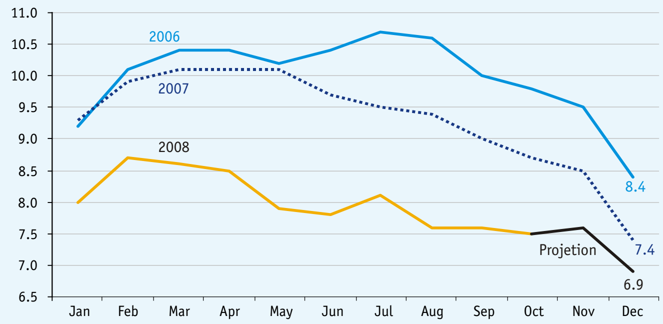


Source: Monthly Job Survey/IBGE

Labor force has been growing at a lower pace than that of jobs since June 2007

Unemployment rate in metropolitan regions

In % of the labor force

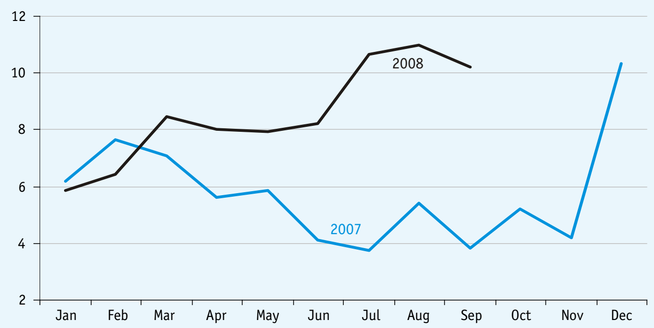


Source: Monthly Job Survey/IBGE

The unemployment rate began to drop earlier than observed in previous years

Real total payroll

Variation (%) in the comparison with the same month in the previous year



Source: Monthly Job Survey/IBGE

Higher job growth rate led to higher total earnings inflation, interest rates and credit

Deceleration of the economic activity and scenario abroad reduces inflationary pressures

General price indices (IGP-DI/FGV) point to an accelerated inflation throughout the first half of 2008. Wholesale inflation as measured by the Wholesale Price Index hit the mark of 18.9% in July in the 12-month accumulated indicator. Following this trend, the inflation rate for consumers (as measured by the IPCA) rose at a faster pace in the first seven months of the year, reaching the peak mark of 6.4% in July, virtually the upper limit of the inflation target.

This phenomenon was experienced not only in Brazil. The steady hike observed in international commodity prices in recent years has increased the pressure on inflation throughout the world. In fact, the index making up the IMF's commodity aggregate experienced a growth of 40% from January to July 2008, when reached the historical peak of the series.

However, the second half of the year was marked by a reversion in this trend, when commodity prices began to drop sharply as a result of a decreasing global demand. In the following four months – from August to November – the commodities aggregate IMF index decreased by 47.4%. There was a widespread decrease in commodity prices, particularly in those of energy and industrial inputs and, more

International commodity prices

Annual variation (%)

Evolution of international commodity prices in 2008 contrasts with their path in previous years

	2004	2005	2006	2007	2008*
Total	18.4	29.3	14.3	29.4	-26.4
Energy (Petroleum, Gas and Coal)	30.2	41.1	7.1	44.0	-29.9
Petroleum	30.5	44.5	8.0	46.6	-39.6
Edibles	1.2	5.2	15.0	25.6	-14.8
Industrial Imputs	9.9	21.1	37.5	-5.7	-24.6
Agricultural Raw Materials	-3.6	6.7	12.9	-0.3	-16.8
Metals	23.3	32.3	53.0	-8.2	-28.6

* November 2008 in relation to December 2007

Source: IMF

specifically, of metallic ores. This behavior led the average commodity price to drop by 26.4% year in the year as a whole until November.

This change in scenario slowed down the upward trend of the General Price Index from a 14.8% growth in July to one of 11.2% in November in the 12-month accumulated indicator. It should be stressed, however, that the inflation rate for consumers (IPCA) has not followed the slowdown trend and remained above a 6.0% variation during all the second half of the year. CNI estimates a 6.2% IPCA in 2008.

The greater rigidity of the inflation rate for consumers was caused by a significantly high domestic demand – resulting from higher total earnings, greater credit availability and governmental social programs such as the Bolsa Família (Family Grant) program –, which made room for wholesale inflation to be transmitted to the retail market and kept service prices under pressure.

Although is has a weight of 22% in the IPCA index, at one point the Food group accounted for 54.9% of all price variations in the indicator accumulated in the 12-month period ending in

June. The pressure on this group also decreased gradually, in pace with the downward trend of international commodity prices. As a result, the participation of the Food group in the inflation accumulated in the 12-month period ending in November 2008 declined to 44.1%.

Lower pressure on the IPCA core

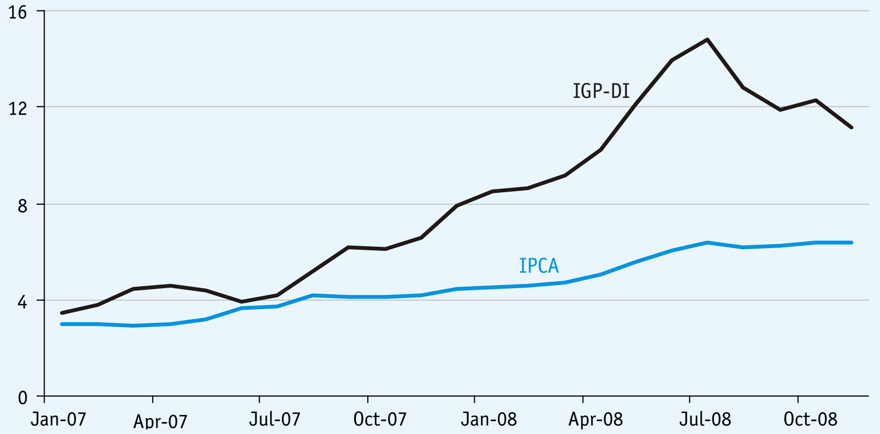
The upward trend of the core inflation – characterized by a more rigid evolution path – in the 12-month accumulated indicator was interrupted in November. The smoothed trimmed mean core stabilized at 4.8% in the October-November period and the core inflation calculated without taking into account food products and monitored prices decreased slightly over this period (from 5.1% to 5.0%).

Pursuant to the last calculations of price variations and as a result of the marked slowdown in the domestic and international economy, risk factors for future inflation have decreased significantly. The exchange rate depreciation is the only factor with a potentially destabilizing effect on the inflation rate in Brazil right now. Historically, depreciation of the Brazilian currency in relation to the US dollar causes significant inflationary pressures domestically. However, the real depreciated concomitantly with decreasing international commodity prices. For this reason, the negative

General Price Index (IGP-DI) and Broad Consumer Price Index (IPCA)

Accumulated in 12 months

Deceleration of the wholesale inflation rate has not affected inflation for consumers so far

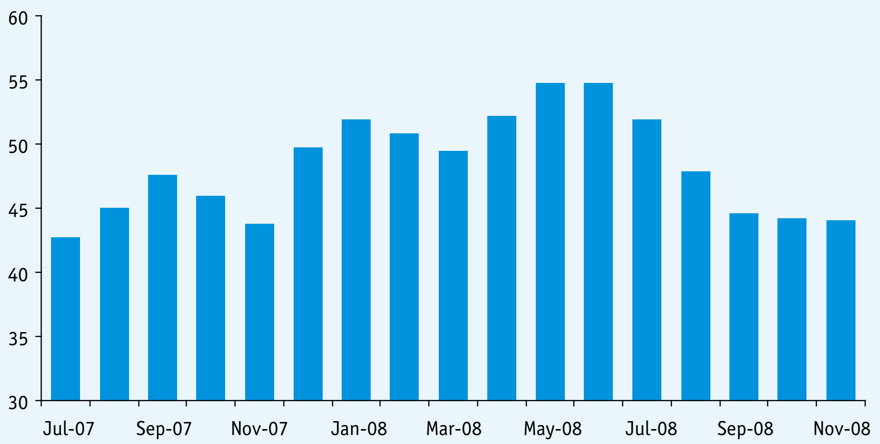


Source: IBGE and FGV

Contribution of the Food and Beverages group to the IPCA

In % of the 12-month accumulated IPCA

Drop in commodity prices causes contribution of the Food group to drop significantly in the inflation rate for consumers

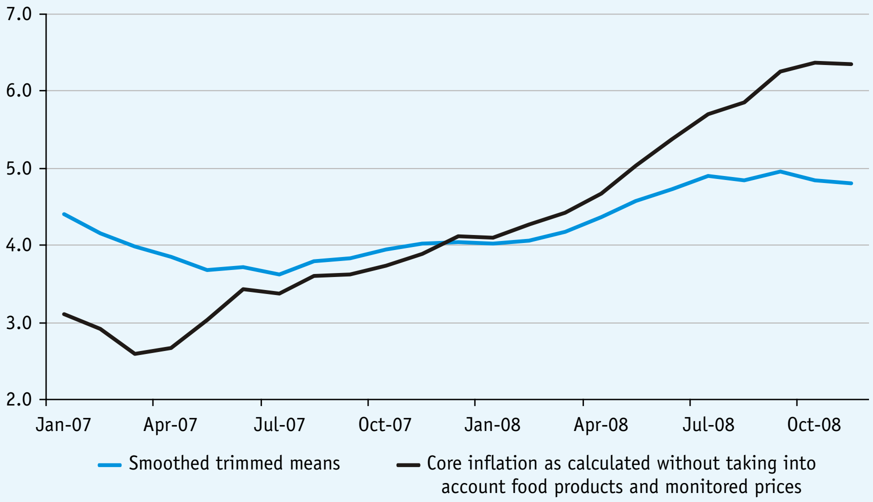


Source: IBGE

IPCA cores

12-month accumulated variation (%)

Acceleration of core growth loses momentum

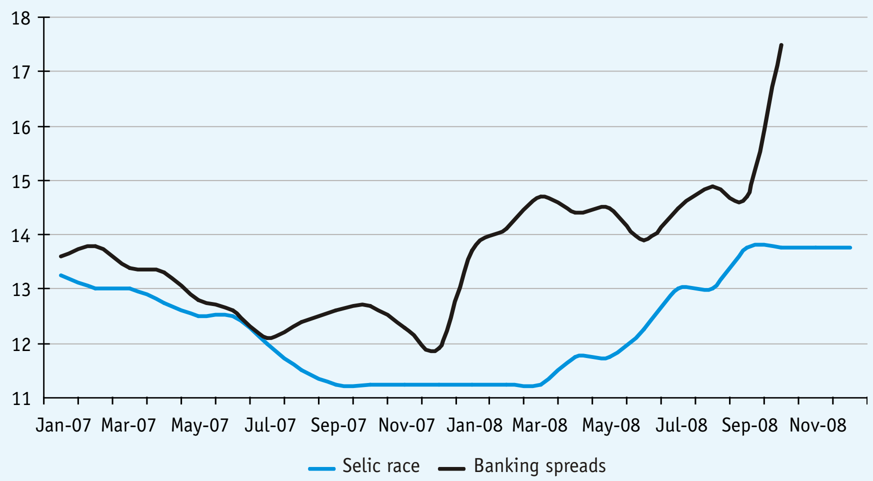


Source: IBGE

Evolution of the Selic rate and banking Spread for individuals

In % a year

Banking spread rises to the second highest rate in the Central Bank historical series, moving apart from the Selic rate path



Source: Central Bank

impact of this depreciation on the inflation rate is likely to be significantly lower than in the past. CNI estimates that the rigidity of the IPCA path will continue in the first quarter of 2009 and that the index will only decelerate in following months, closing the year at 4.8% – slightly above the center of the inflation target, which is 4.5% for the year.

International crisis changes posture of monetary policy in Brazil

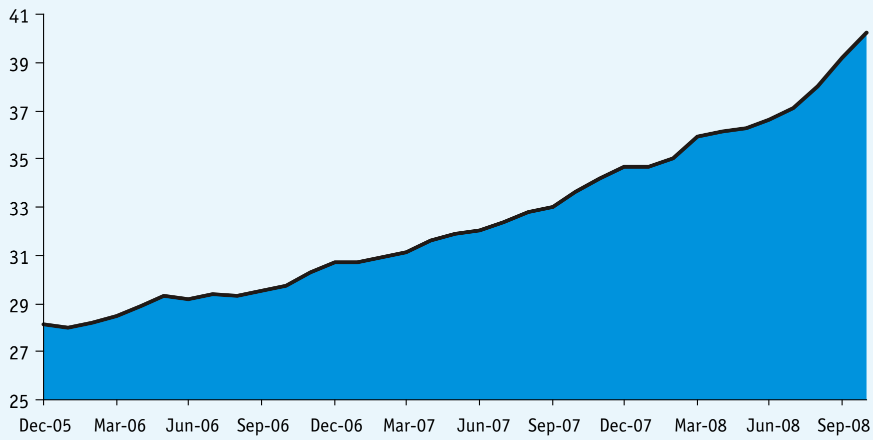
After the Central Bank increased interest rates by 2.5 percentage points – from April to September 2008 (to 13.75% a year) –, the international crisis spread rapidly and intensely through reduced credit liquidity. Due to a higher risk aversion, the liquidity crunch pushed reference interest rates for credit operations up even further, to such a point that they hit the mark of 42.9% a year in October (last data available).

Banking spreads, which are defined as the difference between capital raising and lending rates, more than reverted their drop in 2007. Average spreads for legal persons rose from 13.7% in January 2008 to 17.5% in October. This movement led the Selic rate to move apart from banking spreads for the individual. It should be stressed that the average banking spread for legal persons only exceeded the current rate

Total credit outstanding

As a percentage of GDP

Total credit outstanding hit the mark of 40.2% of GDP, the highest level in the Central Bank historical series



Source: Central Bank of Brazil

on one occasion – in October 2002 – since the beginning of the Central Bank historical series (June 2000).

Despite higher interest rates and spreads, the total volume of credit available in the financial system increased significantly in 2008, from 34.7% of GDP in January to 40.2% in October – this was the highest share of credit in GDP in history.

Effective measures to loosen the monetary policy

Amidst this scenario, in which the government took measures to reduce the tax load, the Central Bank promoted, in an unprecedented effort, a set of expansionist monetary measures designed to unleash credit. These measures are focused on increasing monetary liquidity and include reductions in compulsory time and sight deposits (followed by changes in the requirement to make deposits in cash for government bonds) and the creation and expansion of credit lines for exports and sectors where the lack of credit liquidity has become particularly dramatic.

These measures are aimed at partially buffering disseminated impacts of the international crisis by promoting liquidity in the monetary market. It should be stressed that in order to enhance the impact of the measures taken so far, changes will have to be made in the exchange rate-interest rate relationship which will require a monetary policy softening – that is, lower interest rates than those that prevailed in 2007.

Prospects for the Selic rate

Despite the seriousness of the credit crunch and of the economic activity deceleration in the fourth quarter of 2008, it was agreed that the Selic rate would be kept at 13.75% a year at the last Copom meeting of the year, which was held in December.

CNI believes that in the first monetary policy meeting of 2009 – on January 20 and 21 – the Copom will begin to loosen the monetary police by aligning the path of the Selic rate with that of the monetary policy in force. Interest rates are expected to be reduced by 0.5 percentage points and once again by the same percentage at the following meeting, in March, so that the Selic rate may decrease to 12.75% a year. Interest rates will continue on a downward path through the six remaining monetary policy meetings to be held during the year, in the form 0.25 percentage point reductions at each meeting. As a result, CNI projects a Selic rate of 11.25% in December 2009, accumulating an average of 12.2% in the year – 0.3 percentage points below the average interest rate registered in 2008.

fiscal policy

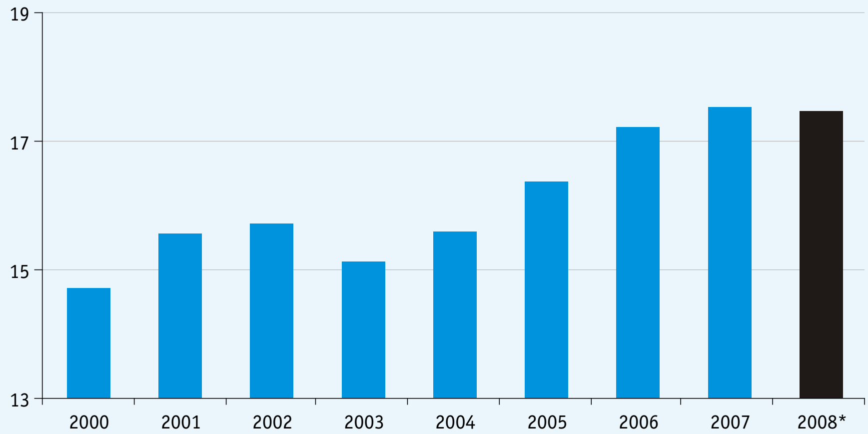
Higher primary surplus target prevents a new surge in spending in relation to GDP

An inflection was observed in the fiscal policy in 2008. Federal Government primary spending will not increase in relation to GDP for the first time in the past five years. Two factors played a major role in bringing about this inflection. The first one was a positive GDP growth pace, which made up for a nominal increase in spending. The second one was a decision to increase the primary surplus target to 0.5% of GDP, which prevented a remarkable revenue growth pace from being converted into additional expenditures.

Federal Government Primary Spending

Accumulated in the year (% of GDP)

Primary spending should will not increase for the first time since 2003



* CNI Projection

Source: STN/MF

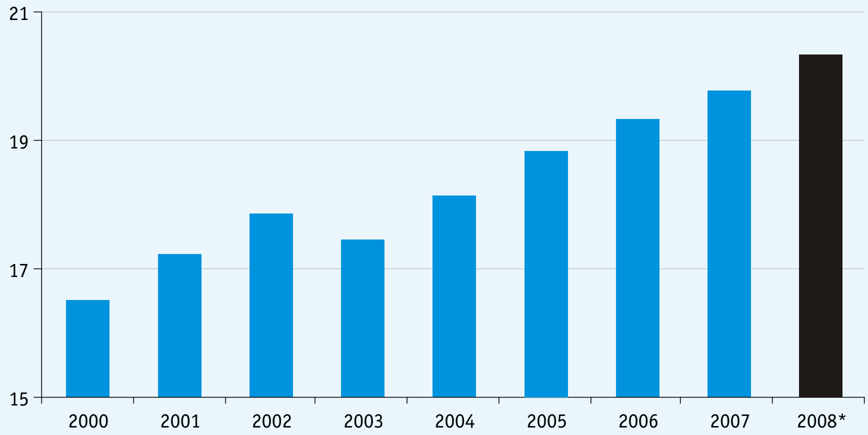
Federal Government primary spending increased by 5.1% in real terms (IPCA deflator) between January and October 2008 in relation to the same period in 2007. However, because the growth pace of these expenditures has accelerated in recent months, real growth should be higher considering the data for November and December. Nevertheless, the primary spending of the Federal Government is likely to close 2008 at 17.5% of GDP, the same level observed in 2007.

Apart from the stability of total primary spending in relation to GDP, another relevant fact should be mentioned in connection with the composition of the increase observed in expenditures. Current spending grew by 3.75% in real terms between January and October 2008 as compared to the same period the year before. On the other hand, investments had a real growth of 42.5% on the same comparison basis. As a result, the 12-month accumulated volume of investments grew from 0.75% of GDP in December 2007 to 0.9% of GDP in October 2008.

The net revenue of the Federal Government grew by 11.4% in real terms between January and October 2008 in relation to the same period in 2007. As in 2007, the revenue growth pace widely exceeded the real GDP growth rate, which hit the mark of 6.4% in the first three quarters of 2008. Since amendments in tax laws were generally aimed at reducing the tax revenue (end of the Provisional Contribution on Financial Transactions (CPMF) against an increase in rates of the Tax on Financial Operations (IOF) and of the Social Contribution on Net Income (CSLL)), the increase observed should be mainly attributed to a better bottom line of enterprises and

Evolution of the Federal Government net revenue

Accumulated in the year (% of GDP)



* CNI Projection

Source: STN/MF

Tax revenue increases more than GDP for the fifth consecutive year

higher total earnings. This way, despite the impacts of the economic slowdown in the last quarter, the net revenue is likely to amount to 20.3% of GDP in 2008, against 19.8% at the end of 2007.

Like the Federal Government, state and municipal administrations also saw their revenue grow significantly. Their main revenue sources grew by 14.0% in real terms between January and October 2008 in relation to the same period in 2007. On the other hand, the expenditure growth pace of regional governments widely exceeded the one observed for the Federal Government. Considering the primary result achieved up till October, we estimate that expenditures had a real growth of 16.3% between January and October 2008 in relation to the same period in 2007. Two factors explain this behavior of regional governments: the fact that municipal elections were held in 2008 and their little propensity to save any revenues in addition to those defined in their debt renegotiation agreements with the Federal Government.

Primary surplus is likely to exceed the target set for 2008 by a large margin

Given the growth pace of the tax revenue at all governmental levels and the curtailing of additional expenditures by the Federal Government, the public sector is expected to exceed the primary surplus target of 3.8% of GDP established for 2008 by a large margin. CNI estimates that the federal, state and municipal governments and their enterprises will close the year with a primary surplus of 4.25% of GDP. Therefore, there will be a significant increase in the primary surplus in relation to the 3.9% of GDP increase registered in 2007.

The Federal Government will account for most of the positive difference in the actual primary surplus in relation to the target. It expects to have a surplus of 2.85% of GDP, exceeding the target of 2.2% of GDP set for the year and the 2.3% of GDP target achieved in 2007. For states and municipalities, the expected primary surplus will amount to 1.05% of GDP. Therefore, although they exceeded the target of 0.95% of GDP set for 2008, regional governments are expected to have a lower primary result than the one registered in 2007, which amounted to 1.15% of GDP.

The primary surplus of federal government-owned enterprises should in turn amount to 0.35% of GDP, much lower than the target set for the year (0.65% of GDP) and than the one registered in 2007 (0.45% of GDP) as well. This low primary surplus of federal state enterprises can be mainly explained by a significant increase in their investments. In the ten first months of 2008, the investments of state enterprises grew by 17.9% in relation to the same period in the previous year. Although these investments are important for these enterprises and for ensuring economic growth, they jeopardize the current primary surplus generating capacity.

Apart from a higher primary surplus, lower spending with interest payments is another positive factor of the fiscal variables observed in 2008. Interest payments in the year are expected to amount to 5.7% of GDP, against 6.15% of GDP in 2007. Although the average basic interest rate (Selic) was higher this year than in 2007, two additional factors more than made up for the impact of the Selic rate hike. The first one was the lower interest charged on pre-fixed bonds. The second one was the effect of the exchange rate depreciation on the exchange rate-indexed domestic debt.

The combination of a higher primary surplus and lower interest spending will lead to a significant reduction in the nominal deficit, which is expected to drop from 2.25% of GDP in 2007 to 1.45% of GDP in 2008. As a result, we will see a significant decrease in the public debt in relation to GDP, from 42.7% in 2007 to 36.4% in 2008. Besides the lower pressure from the nominal deficit and the reducing effect of a greater GDP, the impact of the exchange rate depreciation on reducing the net debt of the public sector deserves special mention. Because the external assets of the public sector exceed the foreign public debt by a large margin, the exchange rate depreciation led to a higher increase in external assets than the one observed in the foreign public debt when they are denominated in reals

Slower revenue growth pace makes it imperative to cut down expenditures programmed for 2009

In 2009, the effects of the international economic crisis on the Brazilian economy entail great uncertainties for the fiscal policy. On the one hand, there are doubts about their impact on the economic activity and, consequently, on the public sector tax revenue. On the other hand, there is the possibility of adopting a more expansionist fiscal policy to lessen these effects on the economic activity. This scenario became more likely after the Executive Branch submitted a proposal to Congress to cut down expenditures provided for in the Annual Budget Bill (PLOA) – by only R$ 8 billion – and announced measures to reduce the tax load – estimated at R$ 8.4 billion – in December.

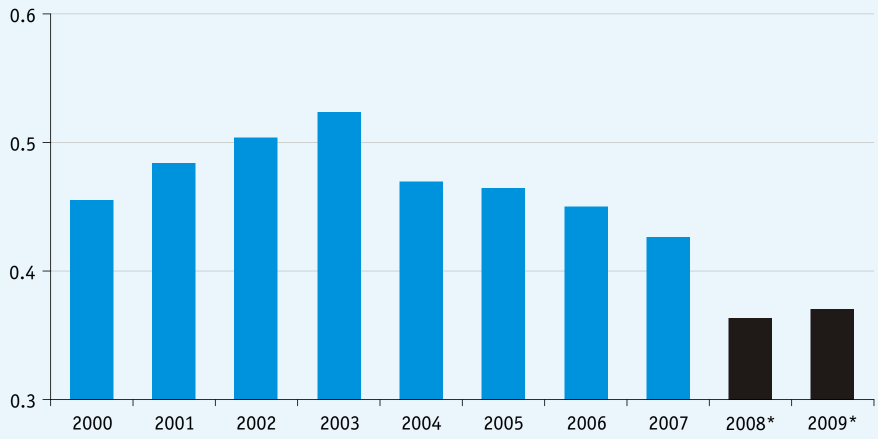
The PLOA was prepared in the light of a completely different economic scenario than the one actually expected for 2009. For this reason, the bill provides for a significant increase in expenditures based on a significant increase in the net revenue. Because estimates for both revenue and spending have increased for 2008, updated variations anticipated for 2009 suggest that spending and the net revenue will increase by 14.1% and 10.1%, respectively, in nominal terms.

CNI expects the Federal Government net revenue nominal growth to hit the mark of 7.3% next year. This projection is based on CNI's estimate of a real growth of 2.4% of GDP in 2009. For this reason, it is assumed that the revenue from taxes and contributions will keep pace with the nominal GDP increase (9.6%), without taking into account the effect of the recent reduction in the tax burden. The lower economic growth pace will also reflect on a lower increase in total earnings and, as a result, on the social security revenue. Finally, a strong impact of the drop in international commodity prices on royalties and dividends received by the Federal Government is admitted. Therefore, the Federal Government net revenue is likely to drop by 0.4 p.p. of GDP, amounting to 19.9% of GDP in 2009.

Considering a new scenario for revenues, the Federal Government will have to reduce the primary spending contemplated in the PLOA in order to achieve the primary surplus target of 2.2% of GDP set for 2009. In this case, we estimate the expenditures to be cut down in the budget at R$ 35.0 billion.

Net public sector debt

Accumulated in the year (% of GDP)



* CNI Projection

Source: Central Bank of Brazil

Reduction of the nominal deficit, economic growth and exchange rate adjustments ensure a marked decrease in the public debt in 2008

However, if it decides to adopt a more expansionist fiscal policy and to use the mechanism of the Pilot Investment Project (which allows for a target of 1.7% of GDP by excluding R$ 15.6 billion in expenditures with investments contemplated in the project), the cut in spending would amount to R$ 19.4 billion.

In our projections, we admit that the Federal Government will implement a strongly anti-cyclical fiscal policy and will cut down spending in the budget at the same percentage as that of the base of programmable expenditures made in 2008 (about 30% of the base, or R$ 22.0 billion). In this scenario, the Federal Government primary spending will increase by 0.6 p.p. of GDP and hit the mark of 18.1% of GDP in 2009. This will happen because, even if discretionary spending is reduced in nominal terms as a result of the budget cutdown, compulsory expenses will grow nominally by 13.5%. This growth will be brought about by a marked increase in expenditures with staff – in response to wage adjustments granted in 2008 – due to the impacts of a higher minimum wage on social security, assistance, wage bonuses and unemployment insurance spending.

Whether federal state enterprises will achieve the 0.65% target is also uncertain. In the past three years, the highest percentage achieved by these enterprises was less than 0.6% of GDP in 2006. In addition, the PLOA provides for a new significant increase (26.7% in nominal terms) in the investments of state enterprises in 2009. For this reason, we admit that federal government-owned enterprises will produce a primary surplus slightly below the target (0.6% of GDP).

As for regional governments and their enterprises, achieving a 0.95% of GDP surplus is feasible. As a result, the consolidated public sector primary surplus anticipated for 2009 is one of R$ 107.5 billion, or 3.35% of CNI's projected GDP.

Therefore, since we expect to see a reduction in spending on interests to 5.2% of GDP in 2009, the nominal result would be marked by a deficit of 1.9% of GDP. With a higher nominal deficit and considering the forecast of a lower economic growth rate, the debt/GDP ratio is expected to increase slightly, to 37.0% of GDP, late in 2009.

foreign trade sector and the exchange rate

Change in foreign account pattern began in 2008

Appreciation path of the exchange rate is interrupted

In 2008 until August, the high inflow of foreign currencies sustained the appreciation of the Brazilian currency, which dropped to R$ 1.55 / US$ 1, the lowest exchange rate since June 1998 – when it had appreciated by 12% in the year's accumulated rate. However, the worsening of the international financial crisis and its consequences changed this scenario. Between August and November, the Brazilian currency accumulated a depreciation of 42%, when the exchange rate hit the mark of R$ 2.42 / US$ 1.

Two main factors led to this rapid depreciation of the Brazilian currency. The first one is closely linked to the crisis faced in the financial sector, which led to a deleveraging process and to risk aversion rise throughout the world. In November, the highest contracted exchange outflow since January 1999 was registered: US$ 7.1 billion. Between January and November, the balance is still positive at US$ 5.4 billion; but in the same period in 2007, the balance was positive at US$ 82 billion. The second one, which explains the expectations of a definitive change in the exchange rate level, is related to the international economic slowdown that reduced the demand for goods exported by the country and the prices of commodities, which account for a major percentage of Brazilian sales abroad.

Exchange rate index (R$/US$)

Nominal Rate (PTAX) – purchase and sale average

Price of the Brazilian currency has become volatile

Source: Central Bank of Brazil

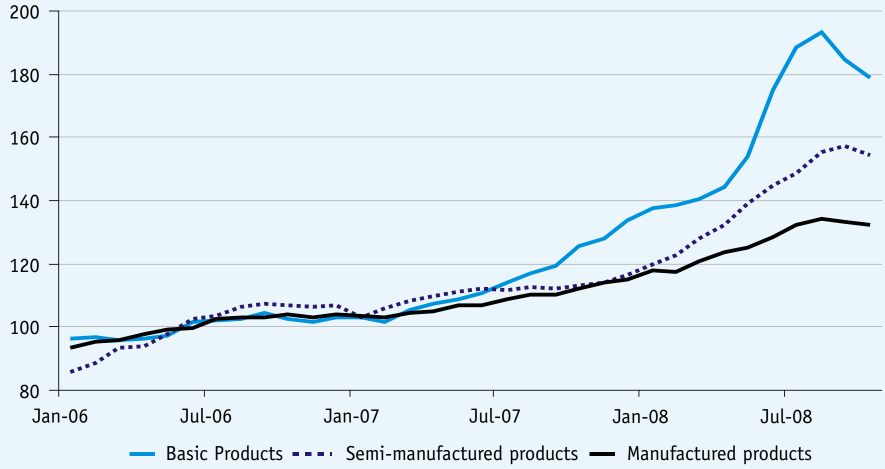
Change in the exchange rate level in 2009, despite a small appreciation

Late in 2008, the US dollar was fluctuating strongly. The domestic US dollar price, which had been varying only slightly until September, began to fluctuate strongly – on many days in October, its daily variation exceeded 5%. Even through the US dollar may resume a depreciation path in relation to other currencies, the domestic US dollar price will remain under pressure, particularly in the short term, due to a high balance of payments deficit. Moreover, at least in the first months of 2009, the current unfavorable financial conditions will continue and, according to our forecasts, Brazil may be facing economic recession, which may drive foreign investments away. As a result, the supply of foreign currencies will remain scarce. In this scenario, the real / US dollar exchange rate will remain at the current level (above R$ 2.40 / US$ 1) in the first months of the year and further depreciation is possible. Throughout the year, it is expected that financing conditions will improve and that the impacts of a more depreciated Brazilian currency on the deficit in the balance of payments will finally let up, allowing for this depreciation to be reverted, albeit partially. We project that the exchange rate will close the year at about R$ 2.25 /US$ 1, with an annual average rate in the order of R$ 2.35 / US$ 1.

Price index for Brazilian exports

Per product category - Base: 2006 average = 100

On the margin, a drop in export prices can be perceived



Source: Funcex

Export growth pace loses momentum late in 2008

In 2008 until November, exports hit the mark of US$ 184 billion, 25% more than the amount registered in the same period in 2007. A significant growth pace was observed between May and September of this year (between 30% and 44% as compared to the same month in 2007). As of October, despite the rapid depreciation of the Brazilian currency and the resulting gains in export profitability, the export growth pace declined. A rapid decrease in international demand, difficulties to contract export credit, and price reductions prevented the previously observed strong growth pace of sales abroad from being maintained. We expect exports to total US$ 198 billion in 2008, up by 23% as compared to 2007.

It should be stressed that price gains account for all the increase observed in exports in 2008. In the year until October, the exported quantum dropped by 2%, while prices rose by 30%. Higher commodity prices have, particularly in the first half of the year, played a major role in ensuring export price gains. Prices are still much higher than those registered in the same period the year before, but a marginal drop in export prices can be perceived already – something that had not been seen since March 2007.

Price gains of basic products have been increasing significantly: 47% in the comparison between the accumulated until October 2008 and 2007. On the other hand, the quantum remained stable. Apart from registering the lowest price increase (18%), manufactured products also experienced the sharpest drop in shipped quantities: 5%. Finally, the prices of semi-manufactured products increased by 28% and their quantities grew by 1% over the period.

Imports lose momentum at the end of 2008

In the year until November, imports totaled US$ 161 billion. Imports grew at a solid rate during much of the year; until September, this growth had exceeded 53% as compared to 2007.

However, the rapid depreciation of the real, added to a significant stability in its exchange price and the drop in the international prices of major import products, has slowed down the growth pace of purchases abroad. It should also be stressed that stock accumulation in enterprises and greater difficulties to get financing for working capital make it expensive for them to keep high stocks of raw materials (which account for almost half of all Brazilian imports). As a result, in November, the increase registered in the imported value in relation to 2007 amounted to only 9%. We are projecting a similar growth in December; as a result, imports in 2008 will total US$ 174 billion.

Increases in the imported value are also determined by increases in imported quantities and prices. In the light of the growth rate in the 12-month period ending in October, the quantum rose by 22%, while prices increased by 23%.

Throughout the year, the increase in the imported value spread to all use categories, but it was more intense for durables (as a result of the expansion of credit). All use categories, however, grew less in November.

It should be highlighted that there is strong evidence of a process of replacing domestic raw materials by imported ones throughout 2008. Imports of raw materials and intermediate goods grew by 24% (in imported volume) in relation to the first ten months of 2007 and 2008, a much higher pace than that of the industrial production growth. Despite the higher imported component in the cost of products, the expected drop in international commodity prices and the economic slowdown will prevent the exchange rate depreciation from pressing the inflation rate up.

Trade balance accumulated in 2008 will be lower

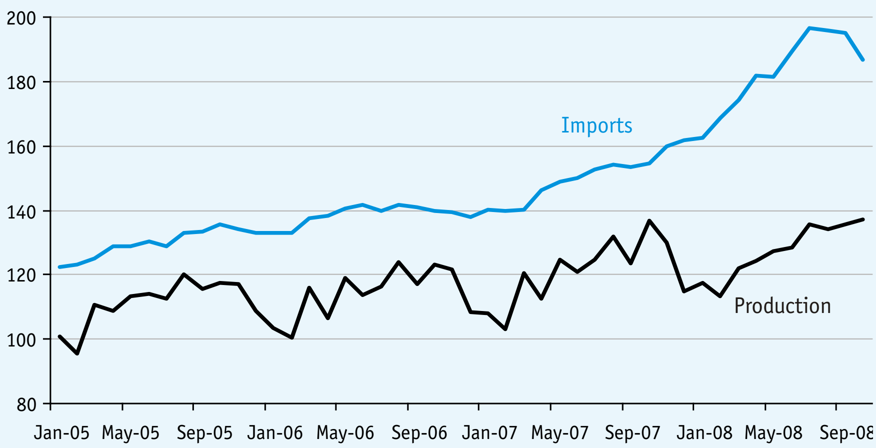
The trade balance in 12 months dropped throughout 2008 as a result of a marked acceleration of the imported value associated with a slower increase in exports. The balance registered until November amounted to US$ 22.4 billion, 38% lower than the one observed in the same period in 2007. We expect the trade balance accumulated in 2008 to amount to US$ 24 billion, 40% less than in 2007.

The Service and Income deficit, in turn, followed an upward path during all the year, particularly in response to

Imports of intermediate products and production in the manufacturing industry

Base: 2002 average = 100

Increase in imports of raw materials exceeds domestic production growth



Source: PIM-PF/IBGE and Funcex

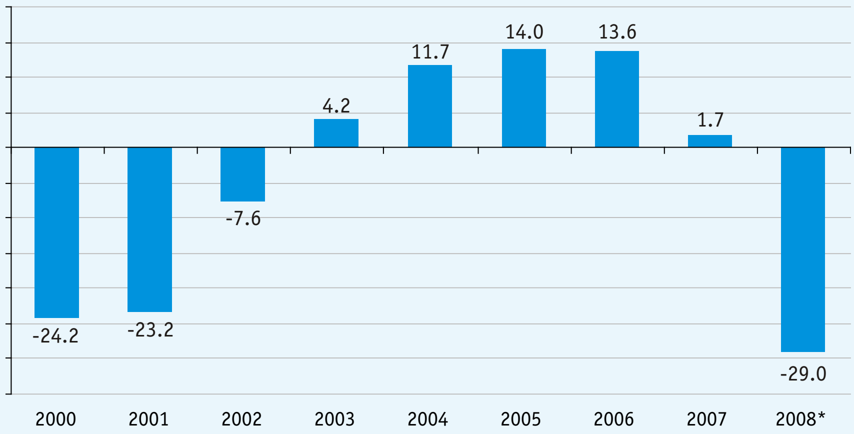
higher expenditures with international trips and remittances of profits and dividends abroad. The deficit accumulated until October totaled almost US$ 49 billion, 43% more than in the same period in 2007.

The higher Service and Income deficit, combined with a lower trade surplus, strongly impacts on the balance in current transactions. As a result, this balance is expected to close the year with a deficit of US$ 29 billion, about 1.8% of GDP

Current account surplus

In US$ Billion

Balance in current transactions will be negative after registering surpluses for five years



* CNI Projection

Source: Central Bank of Brazil

Foreign account scenario in 2009 is unfavorable

For exports, the scenario from 2009 on is unfavorable. In 2009, advanced economies are expected to experience a marked drop in their growth rates and many of them will face economic recession. The world economic growth is estimated at 2%. The main economies in the world are jointly expected to experience a decrease of about 0.5%. The pace of expansion of the global trade growth as a whole – a crucial factor for the performance of Brazilian exports – is likely to slow down significantly in 2009. Estimates point to an increase of 2.1%, as opposed to the 4.6% growth anticipated in 2008.

In 2008, Brazil only increased its exported value as a result of price gains. In a higher-demand scenario, prices tend to drop, particularly commodity prices, which had experienced significant price gains from the solid growth experienced by emerging economies. Commodity prices are likely to decline by 20%-30% in 2009 in relation to 2008. Brazilian exports, in which commodities play a major role, are even more sensitive to this scenario.

This scenario tends to worsen due to more intense protectionist pressures boosted by the global economic slowdown and failed multilateral negotiations of trade agreements. In addition, the inter-block international trade, that is, the trade between different economic blocks, is expected to be more affected than the intra-block trade, that is, the trade within a single economic block. As a result, since much of the growth registered in Brazilian exports resulted from exports to countries out of the Mercosur area, this is another situation that deserves attention.

Considering all of these factors, we expect to see a drop of 20% in the value of exports next year. At the end of 2009, therefore, exports would amount to US$ 170 billion in this scenario.

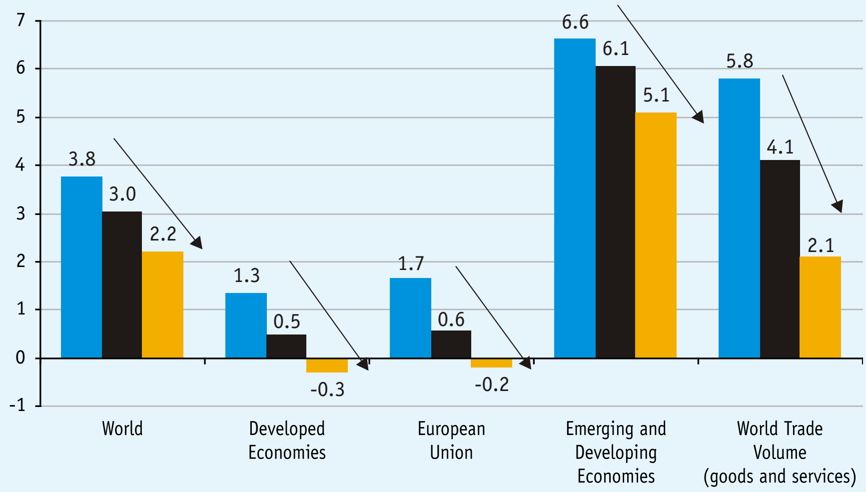
Imports are also expected to decrease. Imports of capital goods and raw materials and intermediate goods, which jointly account for almost 70% of all Brazil's purchases, will drop in response to the domestic economic slowdown and to the interruption of investments. Purchases of consumer goods will also decline, since credit conditions have become less favorable and household consumption will grow less in 2009. Finally, the additional effect of the exchange rate should be mentioned, whose depreciation is expected to more than make up for price decreases. As a result, we expect to see a strong decrease in imports, which are likely to total US$ 155 billion in 2009 – a 13% drop. In this scenario, the accumulated balance would hit the mark of US$ 15 billion.

With the Brazilian currency remaining at a more depreciated level in relation to other currencies, the deterioration of the balance of payments deficit will be interrupted. Greater intensity flows this year, such as those of profit remittances abroad and of international trips on the one hand, and of direct foreign investments on the other, will be less intense. We are projecting a higher deficit in the balance of payments in 2009 than the one expected for 2008, namely, US$ 30 billion.

Evolution of the estimates for 2009

Percentage variation

Estimates for GDP growth and international trade in 2009 dropped during 2008

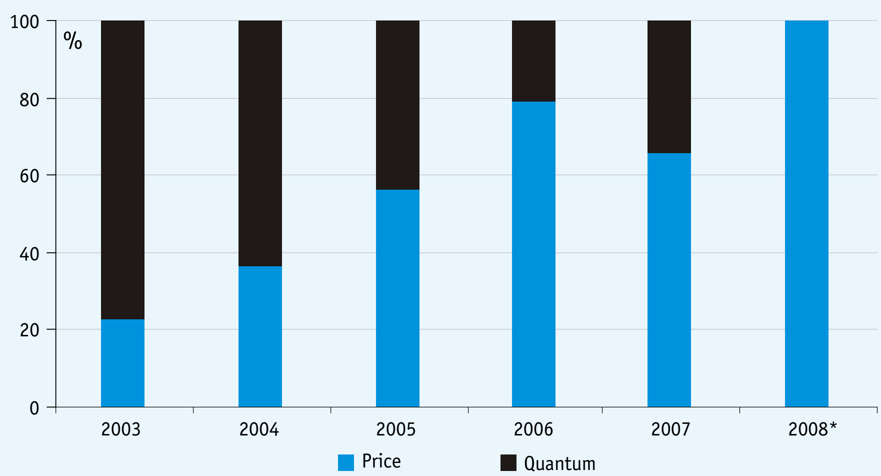


Source: IMF

Participation of increased quantities in export growth

Percentage on total growth in the year

Export growth is explained by price hikes alone



* Until October

Source: Funcex

PROSPECTS FOR THE BRAZILIAN ECONOMY 2008 - 2009

	2006	2007	2008 *Estimate*	2009 *Projection*
Economic activity				
GDP (annual change)	4.0%	5.7%	**5.7%**	**2.4%**
Industrial GDP (annual change)	2.3%	4.7%	**6.0%**	**1.8%**
Household Consumption (annual change)	5.2%	6.3%	**6.1%**	**3.0%**
Gross Fixed Capital Formation (annual change)	9.8%	13.5%	**14.4%**	**3.0%**
Unemployment Rate (annual average- % of EAP)	10.0%	9.3%	**7.9%**	**8.2%**
Inflation				
Inflation (IPCA - annual change)	3.1%	4.2%	**6.2%**	**4.8%**
Interest rates				
Nominal Interest Rate				
(average annual rate)	15.40%	12.13%	**12.50%**	**12.21%**
(end of period)	13.25%	11.25%	**13.75%**	**11.25%**
Real Interest Rate (average annual rate and IPCA)	10.7%	8.2%	**6.5%**	**6.6%**
Public accounts				
Nominal Public Deficit (% of GDP)	3.00	2.23	**1.45**	**1.90**
Primary Public Surplus (% of GDP)	3.86	3.91	**4.25**	**3.35**
Net Public Debt (% of GDP)	44.7	42.7	**36.4**	**37.0**
Exchange rate				
Exchange Rate - R$/US$				
(average annual rate)	2.14	1.78	**2.40**	**2.25**
(end of period)	2.18	1.95	**1.83**	**2.35**
Foreign sector				
Exports (Billion US$)	137.5	160.6	**198.0**	**170.0**
Imports (Billion US$)	91.4	120.6	**174.0**	**155.0**
Trade balance (Billion US$)	46.1	40.0	**24.0**	**15.0**
Current Account Balance (Billion US$)	13.6	1.7	**-29.0**	**-30.0**

Brazilian Economy | Special Edition of the Economic Report - Quarterly Publication of the National Confedaration os Industry - CNI | Economic Policy Unit - PEC | Executive Manager: Flávio Castelo Branco | Technical Team: Marcelo Souza Azevedo, Marcelo de Ávila and Mário Sérgio Carraro Telles | Technical Information: (61) 3317-9468 | Graphic supervision: Editing Center | Bibliographic normalization: Shared Information and Documentation Area - ACIND | Subscriptions: Customer Service Center - SAC: (61) 3317-9989 - sac@cni.org.br | SBN Quadra 01 Bloco C Ed. Roberto Simonsen Brasília, DF - ZIP: 70040-903 www.cni.org.br. | This publication may be reproduced, provided that the source is mentioned.

Document prepared on December 15, 2008.