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INDUSTRIAL COST **INDICATOR**

ECONOMIC INDICATORS CNI

CNI
Brazilian National Confederation of Industry
THE FUTURE OF INDUSTRY

Input prices rise, but industrial costs fall due to measures to reduce the effects of the pandemic

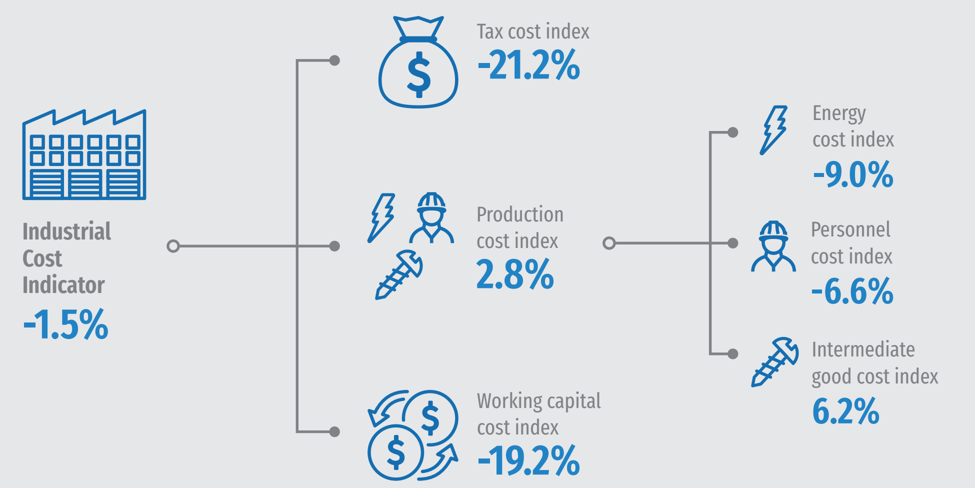
The Industrial Cost Indicator fell by 1.5% in the second quarter of 2020, during the economic crisis caused by the Covid-19 pandemic. There was a decrease in energy costs (-9.0%), in working capital costs (-19.2%), in tax costs (-21.2%) and in personnel costs (-6.6%). On the other hand, the price of inputs – both domestic and imported – increased by 6.2%.

It is noteworthy, however, that all declines in costs are of an extraordinary nature, as they were brought about not only by the recession but, above all, by the set of measures adopted by government to mitigate the economic effects of the pandemic.

In the case of the cost of fuel oil, the drop was due to a lower demand for fuels resulting from a less intense circulation of people and lower economic activity; in the case of the cost of working capital, it declined due to measures taken by the Central Bank to increase liquidity; in the case of tax costs, they dropped due to a postponement of tax payments; and in the case of personnel costs, the decline was brought about by agreements to reduce working hours and wages.

Change in the second quarter of 2020 compared to the first quarter of 2020

Seasonally adjusted



These declines in costs will be reversed as economic activity is resumed, as the measures taken to by the central bank to increase liquidity are lifted, as postponed tax payments are resumed and as the agreements to reduce working hours and wages expire.

Costs with intermediate products increased significantly, by 17.1% for imported products and by 4.1% for domestic products, resulting in a 6.2% increase in the indicator for total intermediate good costs. The increase in the costs of imported products is due to the depreciation of the Brazilian currency, which dropped by 20.9% against the US dollar in the second quarter of 2020.

As a result, the price index of products manufactured in the USA in Brazilian reais also increased by 17.3%. Thus, the price competitiveness of products manufactured in Brazil increased in relation to imported products in the domestic market and in relation to foreign products in the international market.

Costs fell more sharply than the prices of the goods produced, denoting a gain in profitability for Brazilian industry in the second quarter. While costs fell by 1.5%, the prices of produced goods fell less: by 0.1%.

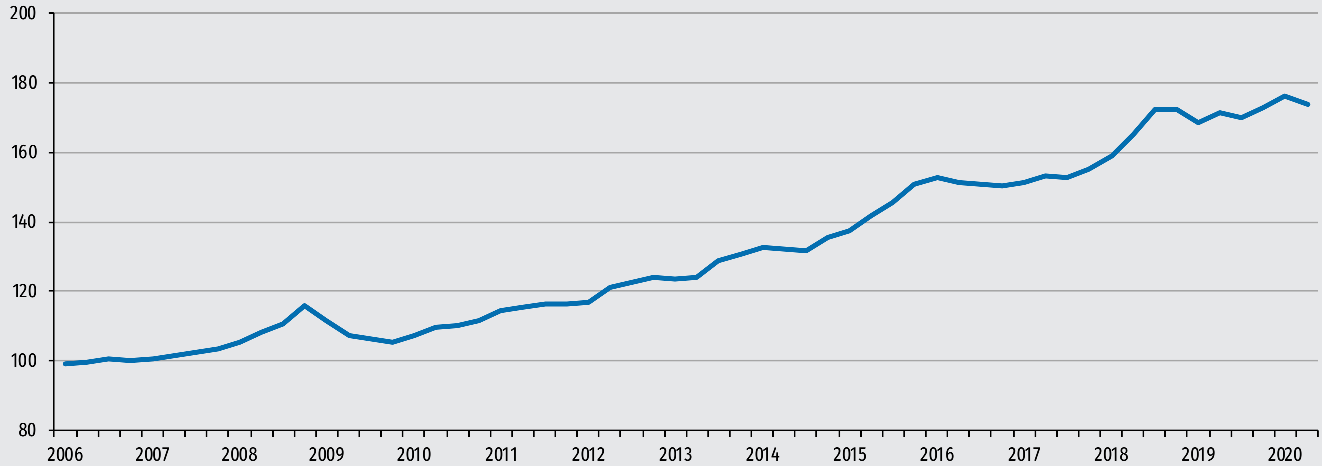
INDUSTRIAL COST INDICATOR AND ITS COMPONENTS

Recession pushed industrial costs down, but inputs became more expensive due to the exchange rate

Comparing the Industrial Cost Indicator for the second quarter of 2020 with that for the first quarter, all components fell or remained stable, except for the cost of intermediate goods. As a result, the industrial cost indicator dropped by 1.5% in total in the second quarter of 2020 in the seasonally adjusted series.

Industrial Cost Indicator

Seasonally adjusted - Base: 2006 average = 100



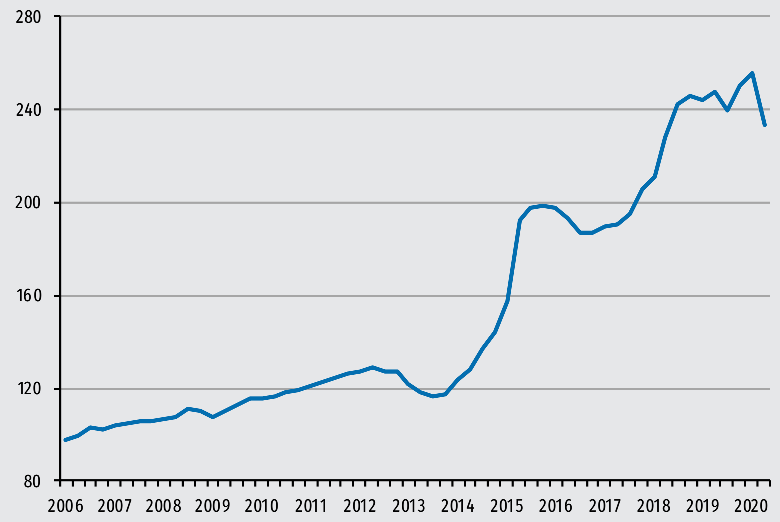
Energy costs declined as a result of a lower demand for fuel oil

Energy costs for industry fell by 9% in the second quarter of 2020. While the electricity cost component increased by 0.5%, the cost of fuel oil for industry decreased by 38.2% over the period.

This drop in the price of fuel oil was brought about by a lower demand for the product in the period due to lower economic activity. The Covid-19 pandemic forced many economic activities to shut down both due to the lack of appropriate sanitary conditions for their operation and to the lack of demand from consuming sectors. In addition, the lower circulation of people and goods resulting from the social isolation measures adopted in the second quarter also reduced the circulation of motor vehicles.

Energy cost index

Seasonally adjusted - Base: 2006 average = 100

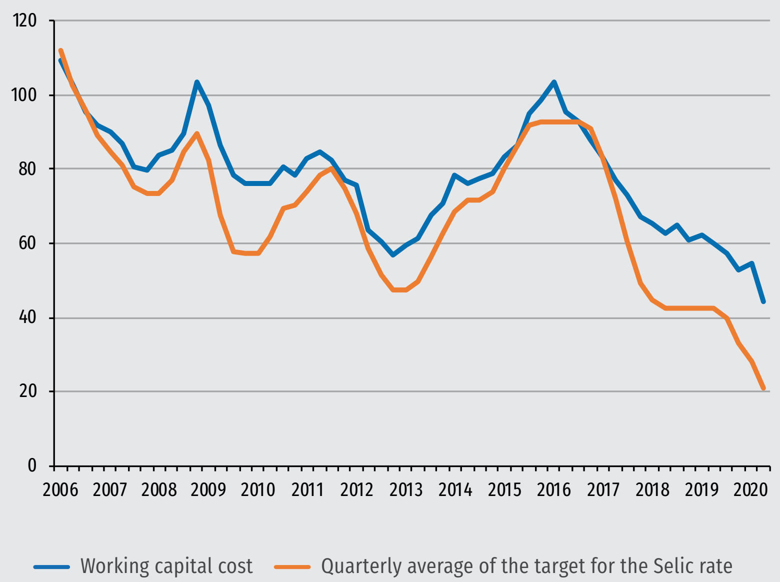


Working capital cost falls in response to measures taken by the Central Bank

The cost of working capital also decreased: it declined by 19.2% in the second quarter of 2020. The decline in working capital costs was caused, first, by a reduction in the monetary policy interest rate, the Selic rate, decided upon by the Monetary Policy Committee. The rate dropped from an average of 4.2% per year in the first quarter of 2020 to 3.1% per year in the second quarter of 2020. In addition, the Central Bank took a set of measures to increase liquidity as a result of changes in credit guarantee systems, lower capital requirements, etc. as a way to mitigate the effects of the Covid-19 pandemic on the economy.

Working capital cost index and quarterly average of the Selic rate

Base: 2006 average = 100



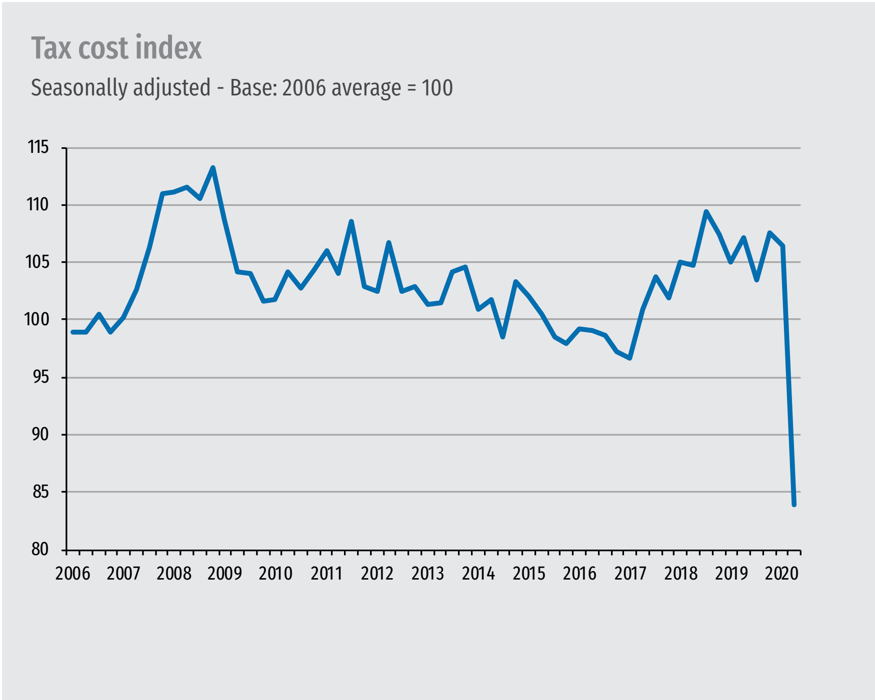
Tax cost shows that its drop will be transitory

Tax costs decreased by 21.2% in the second quarter of 2020, but several observations should be made about this result. Tax costs dropped in part due to a postponement of tax payments and extraordinary conditions offered by government. Once these measures are lifted, regular tax payments will be resumed and tax arrears will be settled, resulting in an increase in tax costs.

All tax cost components considered declined significantly: social security contributions, the value-added tax (ICMS) and the Tax on Industrialized Products (IPI).

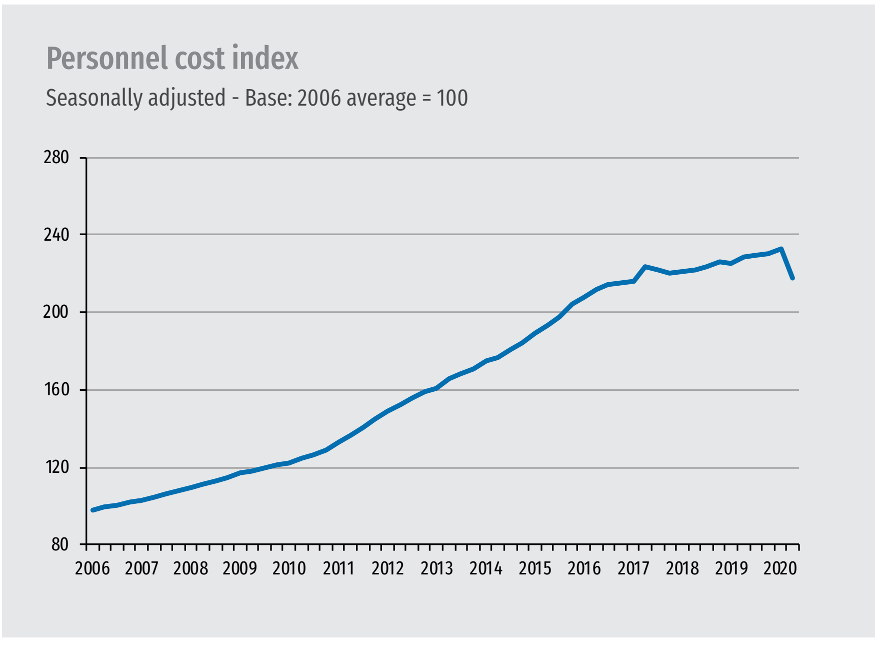
The drop in social security contributions was caused by agreements to reduce or suspend working hours and wages. The social security contribution to be paid when wages are reduced is also lower or, when employment contracts are suspended, it is suspended. In addition, companies operating under the Simple Taxation Regime (Simples Nacional) were also allowed to postpone their second quarter's social security contribution.

The drop in revenues from the ICMS and IPI taxes is mainly related to the permission granted to companies operating under the Simple Taxation Regime (Simples Nacional) in all states to postpone their tax payments due in the second quarter. In the case of the IPI tax, the decline may also be related to Decree 10,285, which reduced tax rates to zero for certain health and medical-hospital products as a means to fight the pandemic. It should be highlighted that this drop in tax revenues may also be partly due to the fact that some companies lost the capacity to pay taxes due to a sharp drop in their revenue.



Personnel costs fall due to agreements to reduce or suspend working hours and wages

Personnel costs fell by 6.6% in the second quarter of 2020. This drop was also brought about by agreements to reduce or suspend working hours and wages, as government offered companies the alternative of entering into individual agreements with their employees instead of terminating their employment contracts. This measure was highly adopted by industry.



The cost of intermediate goods is significantly pushed up by the exchange rate depreciation

As opposed to all other costs, the cost of intermediate goods increased by 6.2% in the second quarter of 2020 compared to the first quarter.

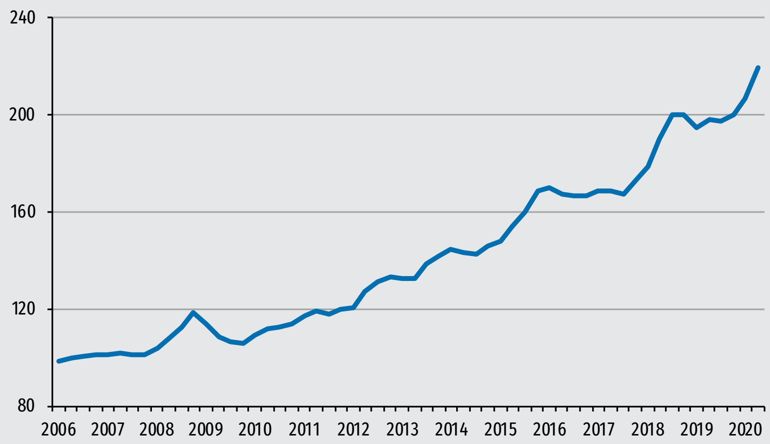
The cost of imported intermediate goods rose by 17.1%. The increase in the costs of imported products is explained by the depreciation of the Brazilian currency, which amounted to 20.9% against the US dollar in the second quarter of 2020.

The cost of domestic intermediate goods increased by 4.1%. This result may also be indirectly related to the exchange rate, as the depreciation of the Brazilian real makes it attractive to export of domestic intermediate goods, pushing up the price of what remains to meet domestic demand. Domestic intermediate goods can also include imported components to some extent, and because they became much more expensive, they may have had an impact on the final price. This result may also be related to the partial stoppage of production chains during the second quarter, which reduced the availability of some industrial inputs in the market.

Comparing the second quarter of 2020 with the second quarter of 2019, the prices of imported intermediate goods are up by 27.1% and those of domestic intermediate goods rose by 8.1%, resulting in a total increase of 11% in the costs of intermediate goods.

Intermediate good cost index

Base: 2006 average = 100



Industrial cost indicator and its components

	Q2 2020/ Q1 2020*	Q2 2020/ Q2 2019**
Industrial Cost Indicator - ICI	**-1.5**	**1.5**
Production cost index	**2.8**	**6.9**
Personnel cost index	-6.6	-4.7
Intermediate goods cost index	6.2	11.0
Domestic intermediate goods price index	4.1	8.1
Imported intermediate goods price index	17.1	27.1
Energy cost index	-9.0	-5.5
Working capital cost index	**-19.2**	**-26.2**
Tax cost index	**-21.2**	**-21.9**

Source: CNI.
Note: * seasonally adjusted results. ** original results.

PROFITABILITY AND COMPETITIVENESS

The exchange rate increases costs, but it also increases the price competitiveness of Brazilian industry

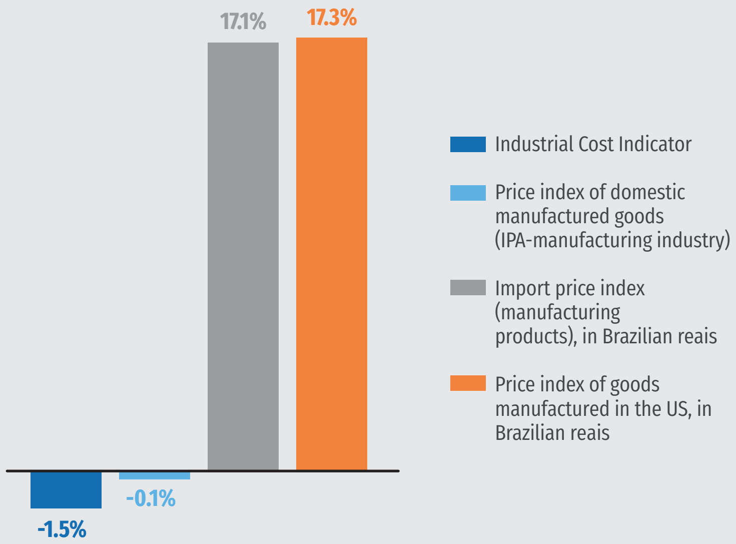
Despite the decline in costs, the prices of goods produced by industry remained stable, varying by -0.1%. At the same time, the 20.9% depreciation of the Brazilian real against the US dollar led the prices in Brazilian reais of products manufactured in the United States and of imported manufactured products to increase by 17% each.

Thus, it increased the competitiveness, in terms of price, of products manufactured in Brazil in relation to imported products and products traded internationally.

Comparing the second quarter of 2020 with the second quarter of 2019, the price in Brazilian reais of products manufactured in Brazil rose by 2.8%. The price in Brazilian reais of products manufactured in the United States are up by 30.9% and the price in Brazilian reais of imported products, which compete with those manufactured in Brazil in the domestic market, are up by 27.1%.

Profitability and competitiveness

Percentage change in the second quarter of 2020 against the first quarter of 2020



Industrial cost indicator and price indices

	Q2 2020/ Q1 2020*	Q2 2020/ Q2 2019**
Industrial Cost ndicator	**-1.5**	**1.5**
Price index of domestic manufactured goods (IPA-manufacturing industry)	-0.1	2.8
Import price index (manufacturing products), in Brazilian reais	17.1	27.1
Price index of goods manufactured in the US, in Brazilian reais	17.3	30.9

Source: CNI.
Note: * seasonally adjusted results. ** original results.

Learn more

For more information on the survey, including previous editions, methodology and historical series, visit: *www.cni.com.br/e_ici*

Document closed by September 18, 2020.

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Subscriptions: Customer Service - Phone: +55 (61) 3317-9992 – email: sac@cni.com.br

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