ECONOMIC REPORT

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Economic growth is slowing down

Exchange rate appreciation and strong economic growth led to deterioration in foreign accounts

The first half of the year was marked by solid economic expansion. GDP grew by 2.7% in the first quarter of 2010 as compared to the previous quarter. This result represents an expansion rate higher than that expected by CNI. As a result of the economy's positive performance, CNI revised its GDP growth estimates upward from 6.0% to 7.2% in 2010. In this scenario, the economy will grow by 6% in the last quarter in annualized terms.

The growth pace has already slowed down and this trend is expected to continue in the next quarters. The end of fiscal and tax incentives in March brought about an atypical consumption pattern during the period, above the historical average. Household consumption is likely to continue to slow down as a result of higher interest rates.

A positive aspect is that the quality of economic growth has improved since the second half of last year. The current pattern is leveraged by the increase in investments, which have grown at a rate in excess of 7.0% in the past three quarters against the immediately preceding quarter, in seasonally adjusted terms. Therefore, the gross formation of fixed capital has returned to pre-crisis levels. If CNI estimates of a 24.5% growth in are confirmed, investments will account for 19.4% of GDP in 2010.

A robust economic growth rate, albeit less intense that early this year, is expected to be sustained on account of the strong increase in investments. The resumption of investments will probably lead to a slowdown trend in industry's capacity utilization level over the next few months, sweeping away fears of a gap between demand and supply.

Even though inflation remains above the central target, it no longer shows signs of acceleration. In fact, some of the pressure observed in the first months of the year has already eased, allowing the monetary tightening cycle to be shorter and less intense than initially expected.

Total trade is expected to reach pre-crisis levels, hitting the mark of US$ 370 billion. However, imports continue to increase at a much higher rate than exports. Imports are projected to exceed the 2008 level and hit the mark of US$ 180 billion, while exports are likely to amount to US$ 190 billion, below the figure registered in 2008. As a result, we still estimate that the trade balance will hit the mark of US$ 10 billion.

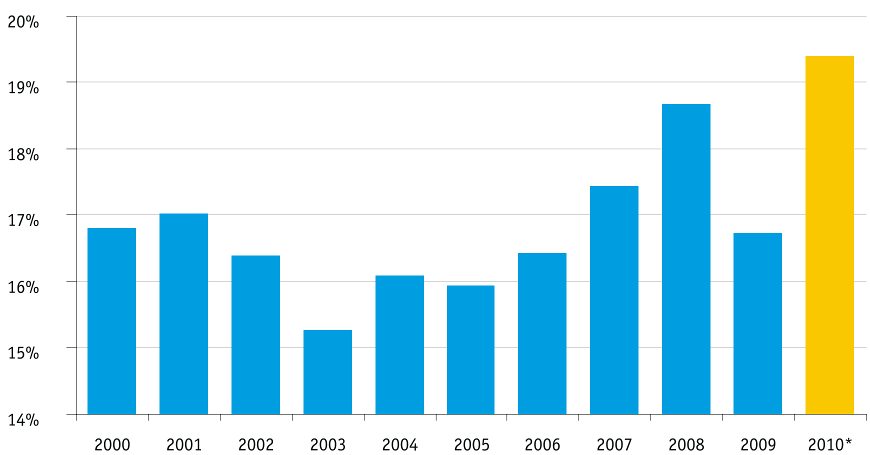
We project that the current account deficit will be the highest ever registered, amounting at US$ 54 billion in 2010. The higher current account deficit is a result of the country's accelerated growth, particularly due to the lack of domestic savings. It should be stressed, however, that the current account deficit is already close to 3% of GDP.

Foreign accounts have deteriorated because of the gap between the strong Brazilian economy growth rate and that of advanced economies. However, there is no doubt that this issue is aggravated by the fact that an appreciated exchange rate affects the competitiveness of Brazilians products and leads to an increase in imports.

Gross fixed capital formation

As a percentage of GDP

Investment rates are above pre-crisis levels



Source: IBGE *Projection for 2010: CNI

Brazilian economy in the 2st Quarter of 2010

CNI

economic activity

Growth is accompanied by more investments

Industry leads economic growth

As GDP increased by 2.7% in the first quarter of 2010 in relation to the previous quarter, CNI revised its GDP growth estimates for 2010 upward from 6.0% to 7.2%.

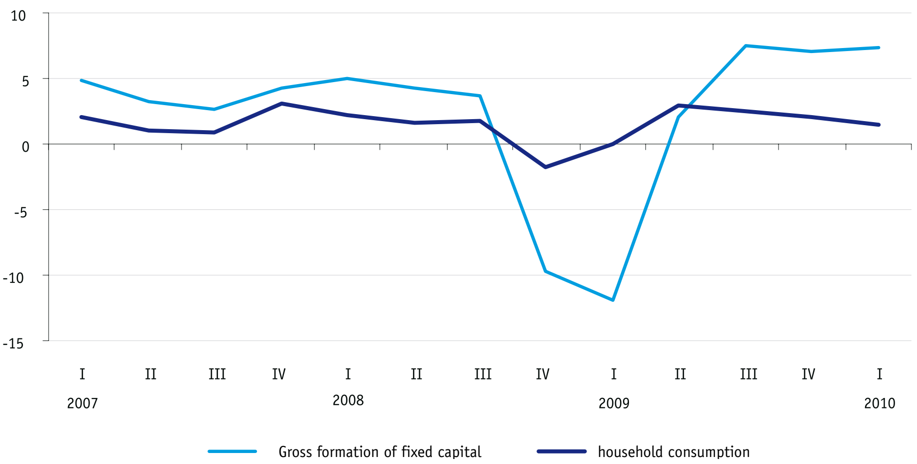
The economic growth in this first quarter was very much influenced by increased investments, which allowed for the gross formation of fixed capital to return to pre-crisis levels. Investments have grown at a rate in excess of 7.0% for three consecutive quarters (National Accounts/IBGE), according to the seasonally adjusted indicator against the previous quarter.

Despite a lower manufacturing production in April, production of capital goods (PIM/IBGE) kept growing (by 2.4% in relation to March) and is now up for 12 consecutive months as compared to the previous month. Production of capital goods for industrial and serial industrial purposes have grown at increasing rates throughout the year and hit the mark of 34.2% and 42.9% in April, respectively, as compared to April 2009. Apart from the fact that domestic production led to an increase in investments, imports of capital goods also rose significantly: by 46.6% in May against the same month last year.

In this regard, the increase in capacity utilization (CU/CNI) in recent months is not to be seen as a trend that will last throughout the year. This indicator, which hit pre-crisis levels, is expected to stabilize over the second half of this year due to the expansion of the industrial park with the increase in investments. The Industrial Survey - Manufacturing and Mining in May pointed out that the actual CU indicator remained at usual levels for May in relation to previous years, showing that the industry's installed capacity has been keeping pace with demand growth.

Gross formation of fixed capital and household consumption
Variation against the previous quarter - seasonally adjusted

Investment growth rate is more than four times higher than household consumption growth rate



Source: IBGE

Even on the assumption that the GFFC will stop growing by the end of the year, this GDP component has already ensured a growth of 17.6% in 2010, given the dragging effect. As investments have grown at a stronger pace, CNI revised its estimates for the GFFC growth upward from 18.0% to 24.5% in 2010. If this estimate is confirmed, investments' share as a percentage of GDP will increase to 19.4%.

Household consumption was essential for the Brazilian economy to recover from the crisis. The rapid recovery of employment led to higher total earnings which, in a scenario of continued credit expansion, allowed the population to increase consumption. However, this trend is losing steam not only due to the end of tax exemptions on some products, but also to the deceleration of the growth rate over the past three consecutive quarters as compared to the previous quarter (seasonally adjusted data). Retail trade sales (PMC/IBGE) reflect this scenario, as their growth rate fell in relation to the same month the year before, from 15.7% in March to 9.1% in April.

Despite the lower growth in household consumption, the fact that the result in the first quarter of the year brought about a dragging effect of 5.0% in 2010 caused CNI to revise its growth estimates for this GDP component upward from 6.2% to 7.3% for 2010.

The recovery in investments and a higher household consumption boosted domestic demand and therefore had an impact on Brazilian imports. This GDP component is expected to grow by 31.0% in 2010, contrasting with growth estimates of only 10.9% in exports. While industrialized economies linger to show a positive reaction, particularly the European ones, foreign demand continues to recover slowly. For this reason, the foreign trade sector is expected to contribute negatively, by 2.3 percentage points, to GDP growth.

On the supply side, industry has experienced an almost continuous growth, which has already ensured a 9.5% dragging effect for the sector's GDP in 2010. The slowdown in manufacturing production in April, which came after an upward trend over the past 15 months, will not continue in coming months. The indicator for production evolution (Industrial Survey - Manufacturing and Mining/CNI) hit the mark of 54.9 points in May (figures above 50 points suggest increased production) and, according to the June survey, the evolution of demand and purchases of raw materials are expected to grow over the next six months: the demand index was calculated at 63.4 points and the indicator for purchases of raw materials amounted to 61.1 points.

CNI estimates that the GDP for manufac-turing and mining and quarrying will increase by 13.0% and 7.0%, respectively.

The construction industry is the industrial sector with the greatest ability to recover after the crisis. An increased demand for real estate leads to a growth in the sector. The total stock of credit operations in the housing financial system has increased at an accelerated rate in recent months and hit the mark of 50.5% in May in relation to the same month last year. The Industrial Survey for the Construction Sector also indicates the sector's positive performance: the indicator for construction activity amounted to 55.8 points in May (figures above 50 points suggest an increased activity). CNI estimates that the GDP for the construction sector will grow by 14.0% in 2010.

A strong overall manufacturing activity and domestic demand are also expected to increase GDP growth for public-utility industrial services to 8.5% in 2010. By considering all four industrial sectors together – mining and quarrying, manufacturing, construction, and public-utility industrial services –, CNI estimates that the industrial GDP growth will total 12.3% in 2010.

Growth in the second quarter of the year will be less pronounced

Despite the slowdown in economic activity in April, the previous indicators for May indicate that the economy continues to grow, albeit at a slower pace. The indicator for corrugated paper production grew by 22.5% in May over the previous month. On the same comparison basis, electricity consumption also rose (7.5%) in May. Believing that economic activity will increase in May and June, CNI estimates that GDP will grow by 0.8-1.0% in the second quarter, according to seasonally adjusted data, as compared to the previous quarter.

GDP Estimates - Percentage variation and components' contribution to GDP

	GDP components	2010 Growth rate (%)	2010 Contribution (p.p.)
Demand side	Household consumption	7.3	4.6
	Government consumption	4.1	0.9
	Gross formation of fixed capital	24.5	4.1
	Exports	10.9	1.2
	(-) imports	31.0	3.5
Supply side	Agriculture/livestock	6.0	0.4
	Industry	12.3	3.1
	Mining and quarrying	7.0	0.1
	Manufacturing	13.0	2.0
	Construction	14.0	0.7
	Public administration, health, and public education	8.5	0.3
	Services	5.1	3.5
	GDP mp	**7.2**	

jobs and income

Labor market sustains increase in domestic consumption

Labor market sustains increase in domestic consumptiot

Economic activity has been increasingly boosting the labor market. The solid upward trend experienced by formal jobs leads to higher real incomes and raises consumer confidence about future purchases.

After January, employment grew in the six largest metropolitan regions (Monthly Job Survey/IBGE) in all subsequent months as compared to the previous month. In May, jobs grew by 4.3% in relation to the same month the year before. This growth rate – which means that 894,000 jobs were created in the last 12 months – is the highest one since January 2004.

Job growth is driven by the increase in formal employment (this trend has prevailed since April 2007). In other words, despite the strong negative impacts of the crisis on economic activity, the labor market kept absorbing a higher number of formal jobs.

The General Registry of Employed and Unemployed Persons (CAGED/MTE) – which measures the flow of new jobs throughout Brazil – also indicates a strong growth in formal employment. The number of jobs created in the last 12 months ending in May is already above 2 million (1.26 million jobs were created in the first five months of the year alone). Industry was the sector in which the highest number of workers were employed in 2010 – until May –, accounting for 45.3% of all jobs created. By disaggregating the industrial sectors, manufacturing created 350,000 jobs; the construction industry hired 205,000 workers; 9,000 jobs were created in the public-utility industrial services; and mining and quarrying hired 7,000 workers.

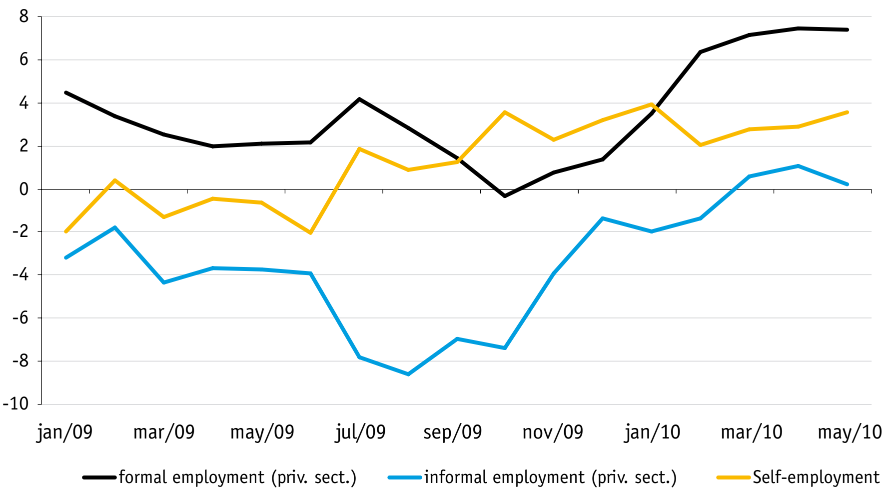
In parallel to the dynamic growth of formal jobs, informal employment in the private sector and self-employment (both indicators are measured by the Monthly Job Survey/IBGE) grew by 0.2% and 3.6% in May also as compared to the same month last year, which represent significantly lower rates than that registered for formal jobs.

The higher number of jobs created encourages more people to enter the labor force (EAP), as there is a feeling that it is easier to succeed in getting a job. The labor force, which dropped by 2.9% in October 2009 against the same month last year, reversed this trend and grew at an accelerated rate for seven months in a row until it increased by 2.7% in May, on the same comparison basis. This percentage means that 622,000 people entered the labor market, including both employed persons and people looking for a job.

The higher growth rate of the labor force, however, does not entail upward pressures on unemployment rates. Since employment has grown at rates higher than that of labor force, the unemployment rate has experienced a year-on-year down-

Formal and informal employment in the private sector and self-employment
Variation against the same month last year - in (%))

Formal employment has grown more than informal employment for more than three years



SOURCE: IBGE

ward trend since 2007. From January to May 2010, this indicator reached its lowest levels as compared to the same months in previous years.

The unemployment rate rose by 0.2 percentage points in May in relation to the previous month, denoting relative stability, given the survey's margin of error. This indicator is still 1.3 percentage points below the one calculated in the same month last year. Even if the labor force increases even more strongly, CNI expects that the unemployment rate will continue to drop in coming months and therefore will end the year at about 6.0%, accumulating a 7.0% average in 2010.

As a result of the recent acceleration of inflation, the real average incomes usually received by metropolitan workers dropped by 0.9% in May against April and amounted to R$ 1,417.30. However, as compared to the same month in the previous year, the indicator is up by 2.5%, on this comparison basis.

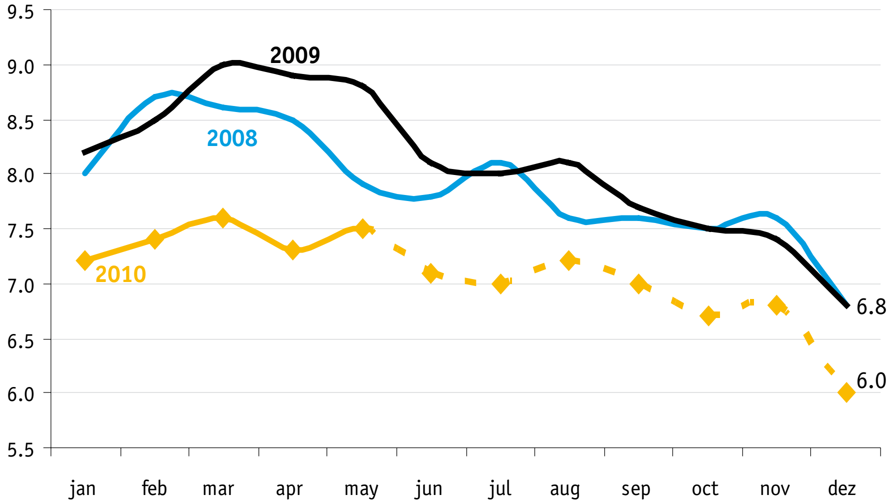
By disaggregating income by the different employment categories, one can see that the highest wage gains are that of informal workers in the private sector. In May, the real average incomes for this group of workers grew by 7.7% in relation to the same month the year before. On the other hand, the real average income of formal workers in the private and public sectors and of self-employed individuals grew, respectively, by 1.1%, 3.6% and 0.3% also against the same month in the previous year.

As a result of higher employment and income levels, real total payroll actually received by metropolitan workers in April (last data available) rose by 6.9% in relation to the same month last year. As CNI believes that employment will keep growing at the same pace, total earnings are expected to continue to benefit from this trend, thereby sustaining an increase in household consumption, albeit at a lower rate in the next few months.

Metropolitan unemployment rate

In (%)

Downward trend in the unemployment rate over the years allowed the indicator to achieve a 7.0% average in 2010

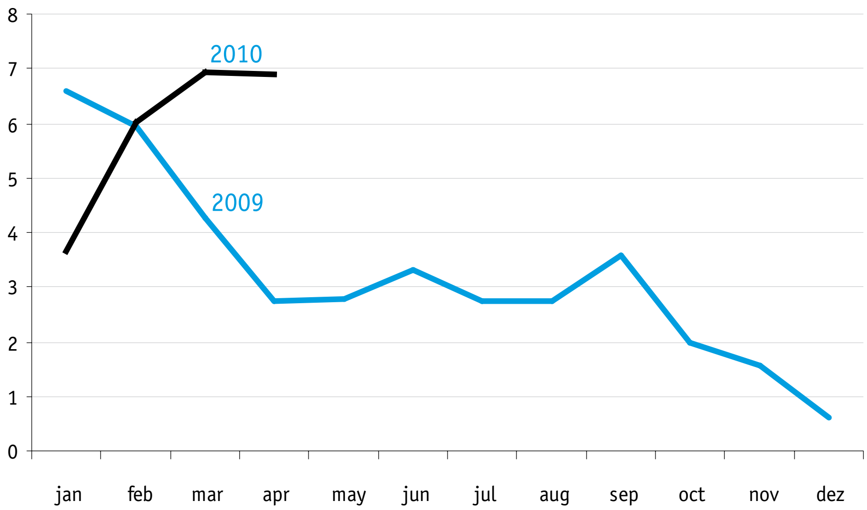


Source: IBGE. Projection: CNI

Actually received real total payroll

Variation against the same month last year - in (%)

As opposed to 2009, total earnings have grown more strongly early this year



Source: IBGE Calculation : CNI

inflation, interest rates and credit

Increase in the Selic rate had the expected impact on prices and credit

Industrial prices slow down

The Extended Consumer Price Index (IPCA), which measures the official inflation rate in Brazil, remains above the central target of 4.5% per year set out by the National Monetary Council (CMN). In the 12-month period up to May (last given available), the index was calculated at 5.22% per year and has been above 4.5% per year for five months in a row.

This scenario has been sustained mainly by the continued increase in service and food prices. The 12-month accumulated figure for services amounted to 6.7% per year, while the one for the food and beverages group totaled 6.8% per year.

Inflation in services remains close to its historical average (about 6% per year). This component has been above the general IPCA since late 2008, and there are no signs that this trend will be significantly reversed. This factor contributes to the higher increase in the IPCA experienced in recent months.

Food products, in turn, behaved differently: prices increased up to mid-2008 (even amounting to 15.8% per year in twelve months) and, as a result of the international crisis, this trend was reversed and a downtrend was experienced until late 2009.

The improvement in the global scenario – which stimulated the recovery in foreign demand for food products – and unfavorable weather conditions caused commodity prices to grow again in 2010. However, this trend is not expected to be experienced in the same way as in 2008. Signs that food price hikes are not likely to be as intense over the next few months had already been observed in May, when this group increased by only 0.26% in relation to the previous month. As a comparison, the average monthly variation from January to April amounted to 1.27%.

The main factor leading to this slowdown in price hikes in the sector was the normalization of weather conditions. Excessive rainfall, which led to major crop failures, is no longer a problem and the supply of these products is returning to normal. This trend is expected to be observed in the next few months, mainly in June.

On the opposite side, industrial product prices have contributed less to the IPCA being above the central target. Since 2007, these prices have always been below the global IPCA, with an average close to 3% per year.

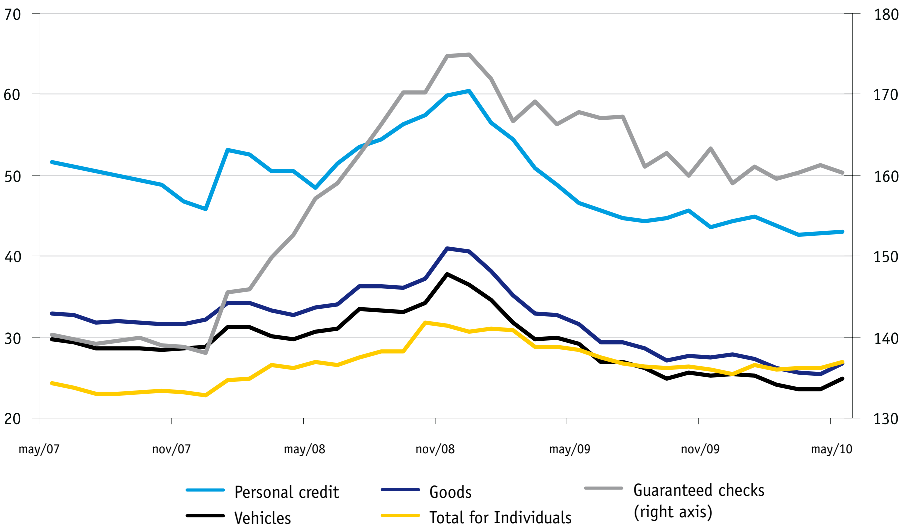
However, as anticipated in the last Economic Report, industrial prices are the most affected by Copom's decisions to increase interest rates. Since February, the 12-month accumulated figure for industrial prices has been dropping, hitting the mark of 3.3% in May. If these prices were already unlikely to increase significantly before decisions to raise interest rates were made, the likely drop in demand for credit by individual borrowers and higher financing costs are expected to curb this increase even further.

Under this scenario, IPCA variations up to the end of the year are likely to be less significant that those observed in the first months of 2010. CNI estimates

Evolution of interest rates for individuals

Percentage per year

Interest rates on the rise



Source: Central Bank of Brazil Prepared by: CNI that the average of these variations will amount at 0.32% per month. Therefore, the projection presented in the previous Economic Report – of a 5.4% per year IPCA in 2010 – has been maintained.

Upward cycle of the *Selic rate* to end in September

The Copom meeting in June repeated the same decision made at the previous meeting: increase the *Selic* rate by 0.75 percentage points (p.p.). As a result, the economy's basic interest rate was calculated at 10.25% per year. It has already accumulated a 1.5% hike in the year.

According to the Central Bank, this decision was essentially due to a higher-than-usual activity, which could lead to more significant inflationary pressures in the future. However, what has been observed so far is that the rise in prices in the first months of 2010 was a result of sporadic and seasonal features, such as an increase in the food group. Considering how essential these goods are, food prices are little influenced by changes in the interest rates.

Nevertheless, Copom believes that it is crucial and necessary to increase interest rates with the aim of keeping the IPCA in line with the inflation target. This political orientation is also expected in the next two meetings. For this reason, CNI estimates two further increases, by 0.75 p.p. in July and by 0.5 p.p. at the following meeting, with the upward cycle ending in September 2010. If these estimates are confirmed, the *Selic* rate would end the year at 11.5% per year, with average real interest rates of 4.8% per year.

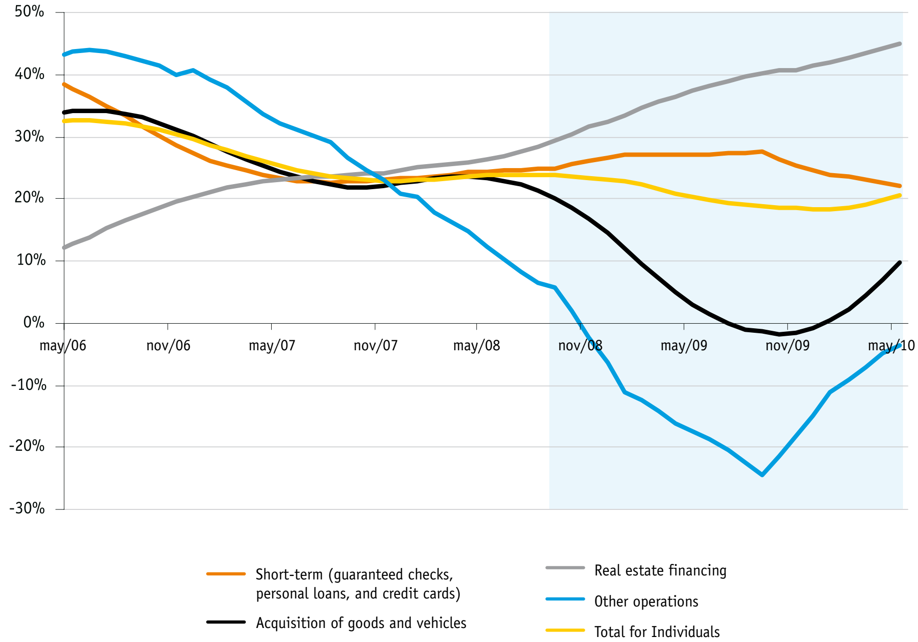
Lower short-term credit and higher interest rates

The effects of the increase in the *Selic* rate began to be observed in the credit market. The alternative to grant loans to the private sector to the detriment of government bonds, which are remunerated at the *Selic* rate, becomes less attractive with rising interest rates. This scenario leads naturally to higher rates charged to borrowers and lower credit availability.

Evolution of balance of loans to individuals

Average for the last 12 months against the 12 previous months

Short-term credit is contracting



Source: Central Bank of Brazil Prepared by: CNI

If the aim of this increase is to slow down domestic demand (which has been the growth engine after the crisis), this is likely to happen in the next few months. Data from the Central Bank on interest rates and balance of loans to individuals in May (last data available) begin to point to this reality.

Interest rates for personal loans had been on a downward path since early 2009. This trend is expected to be reverted in the next few months. In May, there was an increase in interest rates charged on personal credit lines, vehicle financing, and acquisition of goods. As a result, the consolidated interest rate for individuals rose from 26.3% per year in April to 27% per year in May.

This effect had already been observed in the granting of short-term loans. While real estate financing has grown at a sustained pace and the financing of goods and vehicles shows a strong recovery from the effects of the crisis, the granting of guaranteed checks, personal loans, and credit cards has declined since late 2009.

This situation corroborates the IPCA results. The decrease in short-term loans results in a lower demand for industrial products, mainly for non-durable consumer goods.

Even though these are only the first signs of this new trend, the monetary policy adopted leaves no room for a continued drop in interest rates and for a vigorous credit expansion.

fiscal policy

Fiscal expansion is expected to be lower in the second half of the year

Public spending will contribute less to the economic activity growth rate

The increase in public spending was lower in the second quarter and this trend is likely to intensify over the two next quarters. For this reason, the fiscal policy will contribute less to boosting economic activity. In addition, a strong growth in tax revenue and a lower increase in public-sector spending will allow for better fiscal results.

The Federal Government's primary spending grew by 12.8% in real terms between January and April 2010 in relation to the same period the year before. This is still a high rate, but it is worth mentioning that, up to May, the increase amounted to 13.7%. Defrayal and capital expenses, which grew by 28.1% in the first four months of the year, are still the main factor leading to an increase in spending. Most of this increase was related to discretionary spending, with investments growing by 80.4% and defrayal rising by 17.5%.

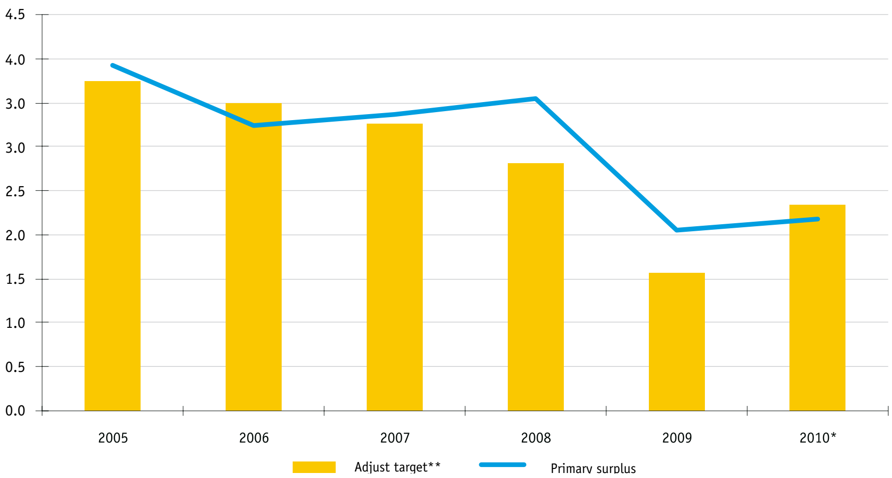
Albeit at a much lower rate, social security and staff expenses also rose in real terms in the first four months of 2010. Expenditures on social security benefits grew by 9.2% as compared to the same period in 2009. Apart from a systematic increase in the number of beneficiaries, this result is explained by real adjustments to the minimum wage and to benefits above the minimum wage – still 6.14%.

Staff expenses rose by 2.0% in real terms from January to April 2010 against the same period in 2009. The increase in staff expenses was curbed by a reduction in condemnation expenses, which amounted to R$ 4.9 billion in the first four months of 2009 and dropped to R$ 3.5 billion in 2010.

Primary surplus for the public sector and fiscal targets

As a percentage of GDP

Primary surplus in the 12-month period up to April is 0.2 p.p. of GDP below the 2010 target



Source: Central Bank of Brazil and Ministry of Planning, Budget and Management
Prepared by: CNI

* 12-month period ending in April 2010.
** Without considering Petrobras, PAC, PPI and payments due in the accrual regime of public accounts for extraordinary credits granted in previous years

Expenses in states and municipalities have risen at an accelerated pace. We estimate that these governments' expenses will grow by 9.4% in real terms in the first four months of 2010 in relation to the same period in 2009.

Revenues increase driven by a boost in economic activity and by the end of tax incentives

Public-sector revenues also grew significantly in the first four months of 2010 due to positive effects resulting from the boost in economic activity, to the end of certain tax incentives and to high tax credit compensations in 2009, which reduces the comparison basis.

In the Federal Government, the net revenue rose by 13.6% in real terms between January and April 2010 as compared to the same period in 2009. This increase was led mainly by the collection of value-added taxes on goods and services (PIS - Social Integration Program, Cofins - Contribution to Social Security Financing, IPI - Tax on Industrial Products) and total earnings (Social Security Contribution), which were positively affected by the resumption of growth. In addition, tax credit compensations for the PIS, Cofins, and CIDE-Fuels (Contribution for Intervention on the Economic Domain) in the first quarter of 2009 (R$ 3.7 billion) reduced the comparison basis. Finally, the increase in IPI, IOF, and CIDE-Fuels collection was driven by the fact that rates are higher than those observed in the first quarter last year.

Based on preliminary data, state and municipal revenues grew by 10.8% in real terms in the first four months of 2010 over the same period in 2009. Most of this increase was due to a higher ICMS (Value-Added Tax) collection, which rose by 13.2% in real terms on this comparison basis, and may be explained by the boost in economic activity.

Fiscal results are closer to the targets set for 2010

As a result of the accelerated growth rate of public sector revenues and lower increase rate in the Federal Government's spending, the Federal Government's and regional governments' primary surplus are now closer to the 2010 targets.

In the Federal Government and its state-owned enterprises, the primary result for the twelve-month period ending in April 2010 hit the mark of 1.32% of GDP, against an adjusted target of 1.4% of GDP – without considering costs related to the Growth Acceleration Program (PAC) and payments due in the accrual regime of public accounts for extraordinary credits granted in previous years. The primary surplus amounted to 1.15% of GDP in the period ending in March 2010.

In regional governments and its state-owned enterprises, the primary surplus for the last 12 months rose from 0.8% of GDP in March to 0.84% of GDP in April. The target set for 2010 is 0.95% of GDP.

Lower spending growth and strong increase in revenues allow for the fiscal target to be achieved

The Federal Government's spending growth rate is expected to continue to decline in the next months. Since the Federal Government's and regional governments' revenues are likely to keep growing significantly, the adjusted fiscal target (2.34% of GDP) will probably be exceeded. However, it seems unlikely that the non-adjusted target (3.3% of GDP) will be achieved, as this would require cuts in expenses provided for in the federal budget amounting to R$ 25 billion. This cut is very unlikely, as a financial programming of R$ 31.8 billion of expenses budgeted for 2010 has already been made.

The Federal Government's spending growth rate is estimated to fall by the end of the year, down from the current 12.8% to 6.6% in real terms. This reduction is likely to result from a lower increase in defrayal and capital expenses. As the net revenue is expected to increase by 8.8% in real terms by the end of the year, we estimate that the Federal Government's primary surplus will amount to 1.7% of GDP. We believe that the federal state-owned enterprises' primary deficit will be close to that observed in 2009 (-0.05% of GDP). Therefore, the Federal Government and state-owned enterprises are estimated to achieve a primary surplus of 1.65% of GDP in 2010.

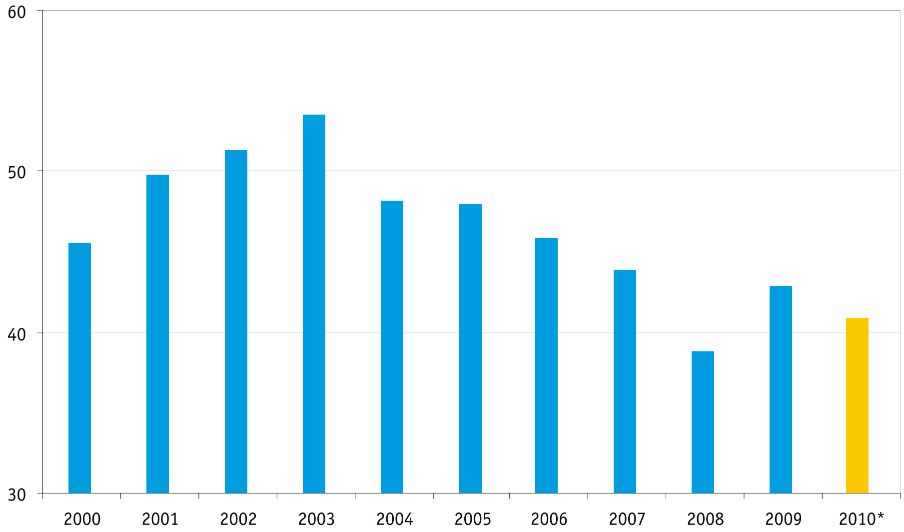
In regional governments and its state-owned enterprises, higher revenues have contributed to improving the primary result since late 2009 and are likely to ensure the achievement of the target of 0.95% of GDP. We project a primary surplus of 2.6% of GDP for the consolidated public sector in 2010 against 2.05% in 2009.

The increase in interest costs – from 5.4% in 2009 to 5.55% of GDP in 2010 – will probably reduce the positive impacts of a higher primary surplus on broader fiscal results. Nevertheless, the nominal deficit is expected to drop from 3.3% of GDP in 2009 to 2.95% in 2010. The debt/GDP ratio, on the other hand, is projected to decrease from 42.8% late in 2009 to 40.9% of GDP in December 2010.

Evolution of the Public-Sector Net Debt/GDP Ratio

As a percentage of GDP

Lower nominal deficit and GDP growth are likely to cause the debt/GDP ratio to drop by 1.9 percentage points



Source: Central Bank of Brazil *Preparation and Projection for 2010: CNI foreign trade sector and exchange rate

Brazilian imports to hit a record high in 2010

Foreign trade will reach pre-crisis levels

Brazilian foreign trade continues to grow and is likely to reach the 2008 figure, amounting to US$ 370 billion. Imports continue to rise much faster than exports and are estimated to exceed the figure for 2008, at US$ 180 billion. Exports, in turn, will hit the mark of US$ 190 billion, below the figure registered in 2008 (US$ 197 billion).

In absolute terms, imports grew more than exports as comparing the figures accumulated up to the third week of June 2010 and 2009: US$ 23.1 billion against US$ 18.1 billion. As a result, trade balance remains on a downward path. The year-accumulated figure for trade balance during the same period amounted to US$ 7.3 billion, a 40% drop in relation to 2009.

Up to the third week of June, exports totaled US$ 83 billion, a growth of 28% as compared to the same period in 2009. This increase is even above that registered in the first three months of the year, which amounted to 26%.

Imports, in turn, are rising much more strongly. Domestic purchases increased by 44% up to the third week of June in 2010 over the same period in 2009. The growth rate has been continually speeding up since early this year: in the first quarter, the rise totaled 36%.

Uncertainties about the foreign market affect recovery of exports

The difference between Brazil's growth rate and that of many of its main trade partners will apparently be even higher than initially anticipated. These issues reduce the ability of Brazilian exports to recover.

Uncertainties about the foreign market have increased. Europe continues to face great difficulties. The high indebtedness of European countries is creating a need for fiscal adjustments, on pain of there being a default that would shake the international financial system. These fiscal adjustments reduce the growth of those countries. Furthermore, the situation faced by this block of countries is pushing for the adoption of protectionist measures.

On the other hand, the United States are afraid of removing tax incentives for fear of another recession. China, in turn, has experienced higher inflation rates and increased the flexibility of its currency. This measure will probably not be enough to significantly influence bilateral trade in the short run, but concerns about inflation are alarming, as China has become one of the driving forces behind the world economy and Brazil's main partner in foreign trade.

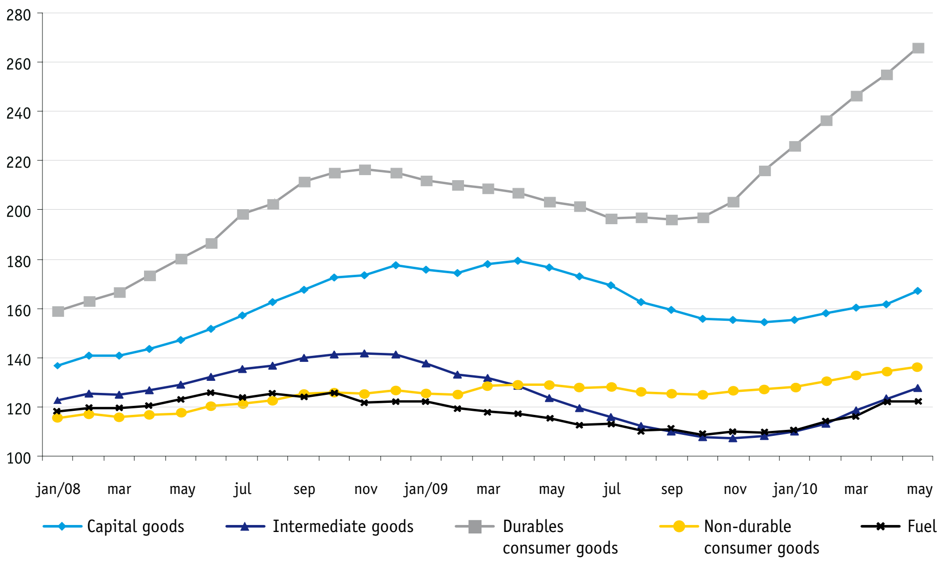
Imported volumes are above pre-crisis levels

The Brazilian economic activity, particularly manufacturing activity, is expected to grow strongly in 2010. Added to the fact that the Brazilian currency will remain at an appreciated level, this growth will continue to boost imports. From January to May 2010, 301 companies stopped export-

Quantum of Brazilian imports

12-month average - in US$ million

Imports of all use categories are strongly up



Source: Secex

ing, while 3,728 began to import. In the first five months of the year, imported volumes increased by 41% as compared to the same period in 2009 and by 10% in relation to 2008, before the crisis hit. Imported volumes of all use categories are up.

Current account deficit grows significantly

Unlike previous years, the exchange rate in 2010 has not yet shown a defined tendency either toward appreciation or toward depreciation. In the second quarter of 2010, the Brazilian currency has oscillated at an appreciated level. The exchange rate has varied as a result of uncertainties about the foreign market and their effects on investments and foreign trade.

The main driving force behind the real's appreciation is still active: the high differential – which is up once again due to the restrictive monetary policy - between domestic and international interest rates. This prevents the current exchange rate from increasing even further.

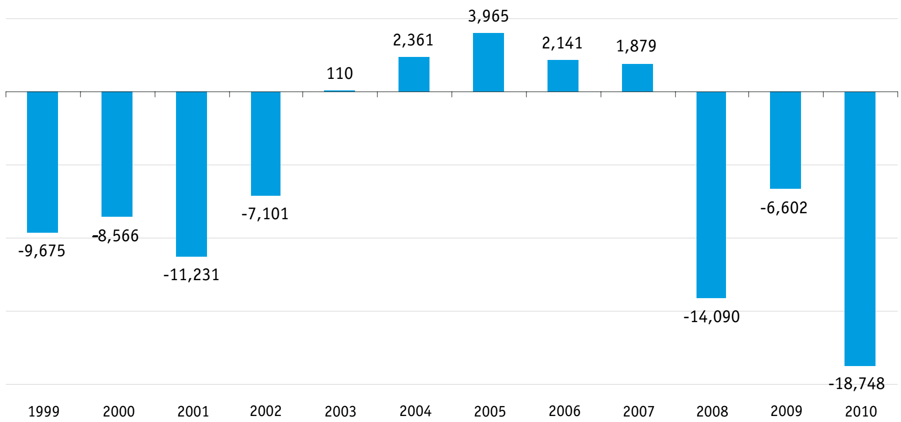
It should be stressed, however, that the Brazilian current account deficit has been growing significantly and rapidly. In May, the current account deficit amounted to US$ 2 billion, the highest figure since 2001. In the first five months of 2010, the deficit hit the mark of US$ 18.7 billion, almost three times higher than the one registered in the same period in 2009 (US$ 6.6 billion).

This higher deficit is explained by the fact that the real remains at an appreciated level and by the strong economic recovery in Brazil. The increase in Brazilian tourists' spending abroad has already amounted to US$ 5.7 billion, 65% above the figure registered

Current account surplus

Year-accumulated figure up to May (in US$ million)

Accumulated deficit up to May is almost three times higher than the one registered in 2009



Source: Central Bank

in the same period in 2009. Expenses related to transport, equipment rental, and the remittance of profits from Brazilian branches to foreign parents have also increased and contributed to increasing the deficit.

Part of this deficit is still financed by direct foreign investments. However, it is worth stressing that there are risks involved in maintaining foreign investments at the current level due to the fact that the international scenario – especially the European one – is still uncertain and affected by crises. Nevertheless, since the economy of emerging countries – particularly Brazil – is expected to increase strongly, these will probably attract more investments and therefore we believe that this risk is small.

We estimate that the deficit in 2010 will be the highest one since the beginning of the historical series, in 1947: US$ 54 billion. The increase in the current account deficit is a natural consequence of the fast growth experienced by Brazil, particularly due to the lack of domestic savings. The current account deficit is close to about 3% of GDP.

Unlike the recent past, Brazil will be able to finance this deficit: international reserves are at about US$ 250 billion and Brazil is seen internationally as a more solid country and one that is more committed to economic stability than in the past. However, foreign creditors may feel uncomfortable if this deficit continues to increase rapidly and for a prolonged period, which could lead to a stronger adjustment in the exchange rate. We continue to exclude this possibility and expect the exchange rate to remain close to the current level until the end of the year, without a defined trend.

prospects for the brazilian economy

	2008	2009	2010 *previous projection May/10*	2010 *projection*
Economic activity				
GDP (annual variation)	5.1%	-0.2%	6.0%	**7.2%**
industrial GDP (annual variation)	4.4%	-5.1%	8.0%	**12.3%**
Household consumption (annual variation)	7.0%	4.1%	6.2%	**7.3%**
Gross fixed capital formation (annual variation)	13.4%	-9.9%	18.0%	**24.5%**
unemployment Rate (annual average - % of the labor force)	7.9%	8.1%	7.2%	**7.0%**
Inflation				
Inflation (IPCA - annual variation)	5.9%	4.3%	5.4%	**5.4%**
Interest rates				
Nominal interest rates				
(average rate in the year)	12.45%	10.13%	10.01%	**10.22%**
(year end)	13.75%	8.75%	11.00%	**11.50%**
Real interest rate (annual average and deflated rate: IPCA)	6.4%	5.0%	4.6%	**4.8%**
Public accounts*				
Nominal public deficit (% of GDP)	2.00%	3.30%	3.20%	**2.95%**
Public primary surplus (% of GDP)	3.70%	2.05%	2.35%	**2.60%**
Net public debt (% of GDP)	38.8%	42.8%	42.0%	**40.9%**
Exchange rate				
Nominal exchange rate - R$/US$				
(average in December)	2.39	1.75	1.77	**1.79**
(average in the year)	1.83	1.99	1.78	**1.81**
Foreign trade sector				
Exports (US$ billion)	197.9	153.0	185.0	**190.0**
imports (US$ billion)	173.2	127.6	175.0	**180.0**
Trade balance (US$ billion)	24.7	25.4	10.0	**10.0**
Current account balance (US$ billion)	-28.3	-24.3	-50.0	**-54.0**

* Excludes Petrobras Group's companies

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