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Trade balance deterioration explains industry's modest growth

Manufacturing is expected to grow by only 2.6% in 2011, below the GDP growth rate (3.8%) for the year. This situation is opposite to that observed in 2010, when those figures stood respectively at 9.7% and 7.5%.

The fact that manufacturing is not leading growth in Brazil any longer is not a result of the economic slowdown. Domestic demand for both consumption and investment continues to increase at a significant rate and may allow GDP to grow by nearly 6%. The net contribution of the foreign trade sector, however, will be negative by 1.2 percentage points.

The inflection in the industrial sector's foreign trade is the key to understanding this change, as shown in the graph below. In 2006, manufacturing registered a significant surplus in its foreign transactions (R$ 30.4 billion), which translated into a deficit amounting to R$ 33.5 billion in 2010. This deficit is expected to exceed R$ 50 billion in 2011.

Taking higher added-value products altogether – identified as manufactured products in SECEX's foreign trade classification – this deterioration was even more pronounced. The deficit totaled R$ 71 billion in 2010 and may exceed R$ 100 billion in 2011.

Shifts in the world economy owing to the financial crisis and to the shift of the dynamic axis to Asia explain this downturn only partly. This scenario resulted mainly from a continued appreciation of the Brazilian currency, which jeopardizes the competitiveness of Brazilian products in international markets and fosters a strong entry of imported products into the domestic market.

From December 2005 to June 2011, the Brazilian currency exchange rate fell from 2.30 real per dollar to the current level of less than 1.60. It is impossible for companies to absorb this appreciation – in excess of 30% – through efficiency gains. No improvements were observed during this period in the Brazilian competitiveness – in terms of taxation, capital and logistics costs, among other systemic aspects – which would mitigate this effect.

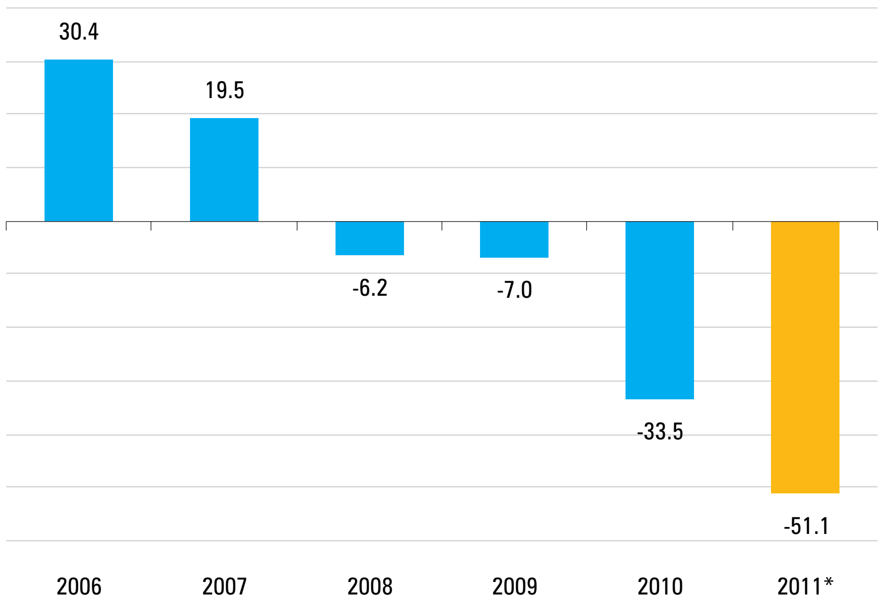
It is pressing to implement effective and robust mechanisms to make up for this loss of competitiveness of Brazilian products. Sporadic measures will be insufficient to make manufacturing more attractive. The sector will continue to lose importance if the current scenario persists, thus significantly jeopardizing the upward trend experienced by the Brazilian economy and its production framework.

Brazilian economy in the second quarter of 2011

Manufacturing trade balance

In US$ billion

Manufacturing trade deficit grows rapidly



Source: Prepared by CNI based on Funcex data.
Projection for 2011: CNI

economy activity

Economic slowdown in the second quarter

Economic measures imply lower demand growth

GDP is projected to expand by 3.8% in 2011. The upward revision in CNI's estimate (as compared to the previous forecast of 3.5% in March) results mainly from the fact that GDP grew more than expected in the first quarter of this year. During that period, the Brazilian economy posted growth of 1.3% in relation to the previous quarter, above CNI's estimate of 1.0%. The outlook for the next quarters, however, remains the same.

The strong economic growth observed in the first quarter of this year will not be seen in coming quarters. CNI is expecting to see an increase of 0.6% of GDP in the second quarter in relation to the previous one. In the following quarters, the economy is expected to increase by no more than 1.0% per quarter in the seasonally adjusted data. The seasonally-adjusted economic activity index calculated by the Central Bank (IBC-BR/Central Bank) confirms a downturn in activity in the second quarter. While the index rose by 1.3% in the first quarter as compared to the last quarter of 2010, it grew by only 0.9% between April and May against the first three months of the year.

Several factors explain the slowdown in economic activity as of the second quarter: a) measures to restrict credit adopted by the Central Bank; b) increase in the Selic rate (basic interest rate); c) rising household and business default; d) lower growth rate of public sector expenditures; e) slower job creation pace in the labor market; and f) decrease in consumers' optimism, which has been falling since October 2010, and in business confidence, on a downward path since January of last year.

These factors have led to a reduction in demand mainly via less intense credit growth, both for individuals and corporations, and a lower inclination to consume. The main GDP component affected on the demand side is household consumption, whose growth pace has dropped sharply from 2.3% in the fourth quarter of 2010 to 0.6% in the first quarter of 2011.

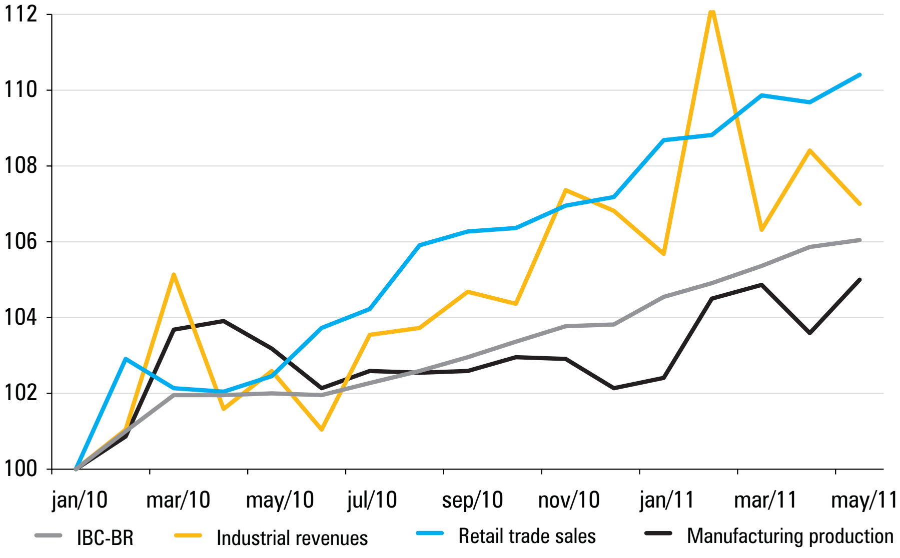
Household consumption is expected to grow at the same rate observed in the first quarter until the end of the year. For this reason, CNI is projecting that household consumption will increase by 4.5% in 2011. Even though it will grow less than in 2010, when it recorded growth of 7.0%, household consumption will be the component that will influence GDP growth the most on the demand side.

The expected slowdown in the growth pace in the second quarter in relation to the figure registered in the first quarter will be determined by an increased negative contribution of the foreign trade sector. Imports, which dropped by 1.6% in the first quarter, are once again expected to experience the uptrend registered throughout 2010. CNI is expecting imports to increase by 7.9% in the last three quarters, amounting to 17.0% in 2011.

EIndustrial production evolution, industrial sales, trade sales, and economic activity index (IBC-BR)

Base Jan/10 = 100

Manufacturing production does not keep up with increased sales in the sector



Source: CNI, Central Bank and IBGE

Increase in imports causes industry to grow less

The decline in economic activity shown by the IBC-BR/Central Bank in the second quarter was more intense when industrial data are considered.

Manufacturing production (PIM-PF/IBGE) rose by only 0.4% when comparing the average figure registered from April and May to that observed in the first quarter. In the first three months of the year, manufacturing production had advanced by 1.2% in relation to the fourth quarter of 2010.

Furthermore, it should be noted that the expansion in manufacturing production in the first two months of the second quarter was only possible due to the growth experienced by mining and quarrying (1.1%), as manufacturing recorded a drop of 0.3%. The CNI Industrial Indicators survey also points to a decrease of 0.3% in manufacturing's real revenues on the same comparison basis.

Over the same period, retail sales rose by 0.8%. This gap between the evolution of trade sales and manufacturing production resulted from a sharp increase in imports. In average, imports of durable goods grew by 6.9% and of non-durable goods by 1.5% from April to May in relation to the first quarter of the year, according to Funcex data seasonally adjusted by CNI.

In addition, industrial stocks are above desired levels. Data from the June issue of the Industrial Survey - Manufacturing and Mining (CNI) show that the actual-planned stock indicator hit the mark of 53.0 points – indicators above 50 points suggest that stocks are above planned levels. Seventeen sectors registered excessive stocks in the month, including, among others, the Machines and equipment, Electronic and communication materials, Apparel, and Textiles sectors.

In this scenario, industrial GDP will probably begin to grow at a slower pace in the second quarter. CNI projects that industrial GDP will grow by an average of 0.6% in the last three quarters, while in the first quarter it expanded by 2.2% against the fourth quarter of 2010. Therefore, CNI's expectations are that industrial GDP will rise by 3.2% in 2011, representing less than one-third of the growth rate observed in 2010.

Moderate activity leads to a reduction in investments

Investments kept increasing early in 2011, up by 1.2% in the first quarter in relation to the three last months of 2010. Nevertheless, a moderate economic activity and a decline in business confidence will cause investments to grow much less in 2011 than in 2010. As a result, CNI revised its growth projections for gross fixed capital formation downward from 9.0% to 8.5% in 2011.

It is worth mentioning that these investments have been largely met by imports. While domestic production of capital goods grew, in average, by 1.1% from April to May in relation to the first quarter of the year, imports of these same products rose by 5.6%, according to Funex data seasonally adjusted by CNI.

GDP Estimate

Percentage variation and components' contribution to GDP growth

	GDP components	2011 Growth rate (%)	2011 Contribution (p.p.)
Demand side	Household consumption	4.5	2.7
	Government consumption	3.0	0.7
	Gross formation of fixed capital	8.5	1.6
	Exports	10.0	1.1
	(-) imports	17.0	-2.3
Supply side	Agriculture/livestock	4.3	0.2
	Industry	3.2	0.9
	Mining and quarrying	4.5	0.1
	Manufacturing	2.6	0.4
	Construction	3.8	0.2
	Public administration, health, and public education	4.0	0.2
	Services	4.0	2.7
	GDP mp	**3.8**	

employment and income

Employment loses momentum in 2011

Industrial and trade sectors create less jobs

In the second quarter of 2011, the labor market experienced a downtrend in relation to the previous quarter. The job creation pace slowed down as compared to the same period in 2010. However, the fact that labor continued to be formalized, that the unemployment rate declined and that real earnings remained on the rise in the period deserves special mention.

Metropolitan employment (Monthly Job Survey/IBGE) increased, in average, by 2.4% in the first six months of this year in relation to the same period the year before. This rate was much below that observed in mid-2010 (3.6%) on the same comparison basis. The labor market has been naturally trending downward as jobs lost owing to the crisis are being recovered.

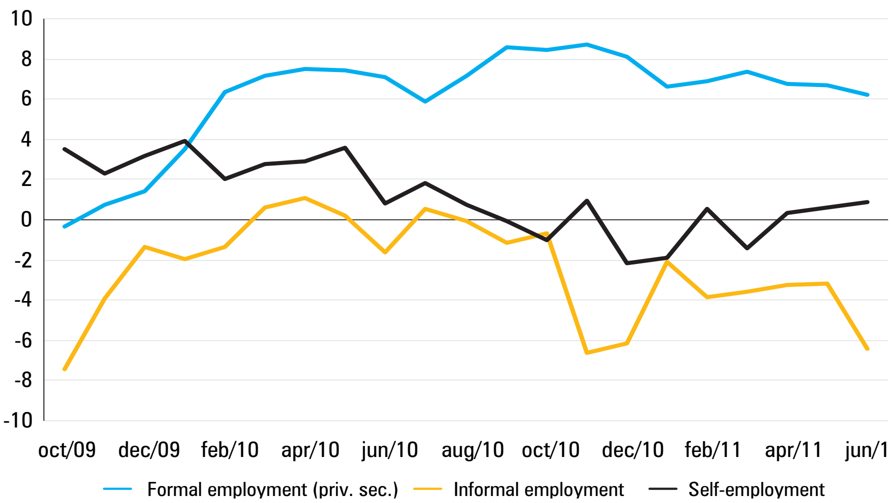
Despite the fact that new jobs are being created at a slower pace, labor continues to be formalized. Formal metropolitan jobs in the private sector have grown to the detriment of a decrease in informal employment. The figure for formal jobs accumulated from January to June advanced by 6.8% in relation to the same period a year earlier. On the other hand, Informal employment dropped by 3.7% and self-employment shrank by 0.2% over the same period.

Data from CAGED, of the Ministry of Labor and Employment, indicate that 1.7 million new jobs were created in the last 12 months up to June. In 2011 alone, 1.3 million formal jobs have been created already.

Employment by occupational category

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

Formal employment has grown more than self-employment since February 2010



Source: IBGE

Among the five sectors considered by CAGED (industry, trade, services, public administration, and agriculture/livestock), the services sector was the one in which employment grew the most from January to June 2011, creating 507,000 jobs. Comparatively to the same period last year, the number of jobs created by the sector is 3.5% higher.

Agriculture/livestock generated 224,000 jobs during the period and was the sector that experienced the sharpest growth as compared to the same period in 2010 (27.7%). Public administration posted growth of 14.7% on the same comparison basis, with the creation of 24,000 jobs up to June.

Among these sectors, industry and trade are the ones that generated the lowest number of jobs in 2011 in relation to 2010. The trade sector created 92,000 jobs in the year, down by 36% when compared to the same period in 2010.

The four industrial segments – mining and quarrying, manufacturing, construction, public-utility services – created 33% of the total of 1.3 million new formal jobs in the cumulative figure in 2011 up to June, accounting for 418,000 jobs. During the same period last year, however, 643,000 jobs were created – a drop of 35%.

Job search has been growing more slowly than in 2011 and is below the occupation growth rate on a year-on-year basis. This trend has been observed since June 2007. According to the Monthly Job Survey/IBGE, the metropolitan economically active population (EAP) – the labor force – rose by 1.4% in June as compared to the same month last year (PME/IBGE), which represents 340,000 people. At the same time, 515,000 jobs were created over the same period (increase of 2.3%), above the labor force growth rate.

As a result of this movement, the unemployment rate remained systematically below the figure registered in the same months in the previous year. This indicator stood at 6.2% in June, a drop of 0.8 percentage points in relation to June 2010. One can see that, historically, the unemployment rate tends to grow over the first three months of the year. In 2011, however, this indicator has increased less strongly, causing the average annual unemployment rate to decline even further.

If the labor force continues to grow less than employment, the average annual unemployment rate will keep falling. CNI estimates an average annual unemployment rate of 5.9% in 2011. However, the rate of decline of this indicator will lose steam over the year, as a less intense economic activity begin to impact more widely on the labor market.

Workers' income still on the rise

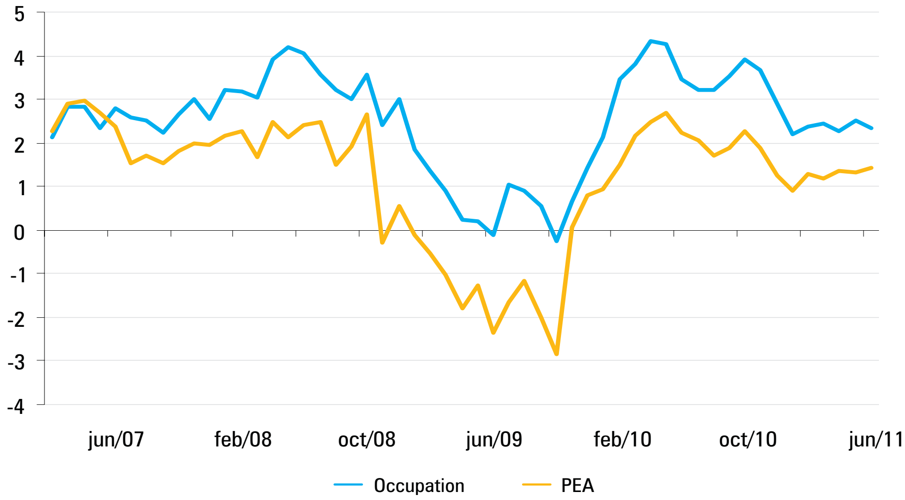
The growth pace of metropolitan workers' income (Monthly Job Survey/IBGE) slowed down in the first four months of the year as compared with the same month a year ago. In May and June, however, this indicator grew more strongly again (by 4.6% and 4.2%, respectively), compared to a 1.9% increase in April.

While the increase in inflation in the 12-month accumulated figure caused income to grow at a slower speed, wage negotiations have led to an increasingly homogeneous movement in the labor market. According to the Inter-Union Department for Statistics and Socioeconomic Studies (DIEESE), the percentage of higher-than-inflation wage negotiations has been increasing systematically each year.

Occupation and Labor Force

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

Employment has grown at a stronger rate than labor force since June 2007

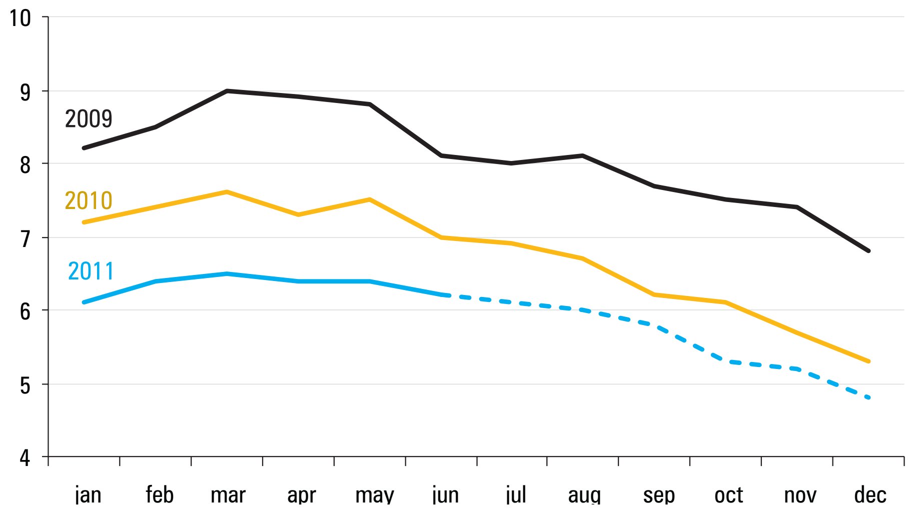


Source: IBGE

Unemployment rate

In % of the labor force

Average unemployment rate will keep falling in 2011



Source: IBGE. Projection: CNI

inflation, interest rates, and credit

Inflation exceeds target ceiling for the first time since 2005

The 12-month Extended Consumer Price Index (IPCA) may hit the mark of 7%

The IPCA recorded growth of 0.15% in June in relation to May. This result represents a decrease as compared to the previous months and was pushed by two components: fuels and food products. Gasoline dropped by 3.9% and ethanol by 8.8%, while food prices shrank by 0.26%.

However, this result should be seen cautiously. Since the IPCA did not vary at all in June last year, the 12-month accumulated figure – based on which the inflation target is set – has increased. The official inflation index (IPCA) has remained above the upper limit of the target established for the year (6.5% per year) for the third month in a row (6.71% in the 12-month figure).

In the same month last year, the IPCA had accumulated a 4.84% growth and was already above the central inflation target of 4.5% per year. As the indicator also held largely steady in July and August 2010 (up by 0.01% and 0.04%, respectively), the 12-month figure may reach 7% in the next months.

Recent price hikes have raised concerns about inflation in the year. Inflation is no longer simply reflecting a seasonal situation – as observed in previous periods with regard to food products –, but rather a more structural issue. In June 2011, the 12-month figure for the four main IPCA price groups (regulated, industrial-product, food and service prices) remained above that observed in the same month a year earlier.

Food prices experienced high volatility in the first six months of the year, as is usual for this type of good, and continue to contribute the most to push the IPCA up. In June 2011, the group accumulated a 12-month increase of 8.9%, against 5.1% in June 2010, and has been on the rise for the past two months.

Service prices are still rising and there are no signs yet that this trend will change in the short run. The 12-month accumulated inflation in the group, which stood at 6.7% per year in 2010, is getting close to 9% per year already. Since its weight in the IPCA is about 25%, it plays a major role in sustaining the index at high levels.

Regulated prices experienced a marked upward trend in the beginning of this year, mainly between February and April. In June, the 12-month figure amounted to 5.6%, up by 1.37 percentage points (p.p.) in relation to the same month the year before. The fact that a large number of indexed prices remains has sustained this trend.

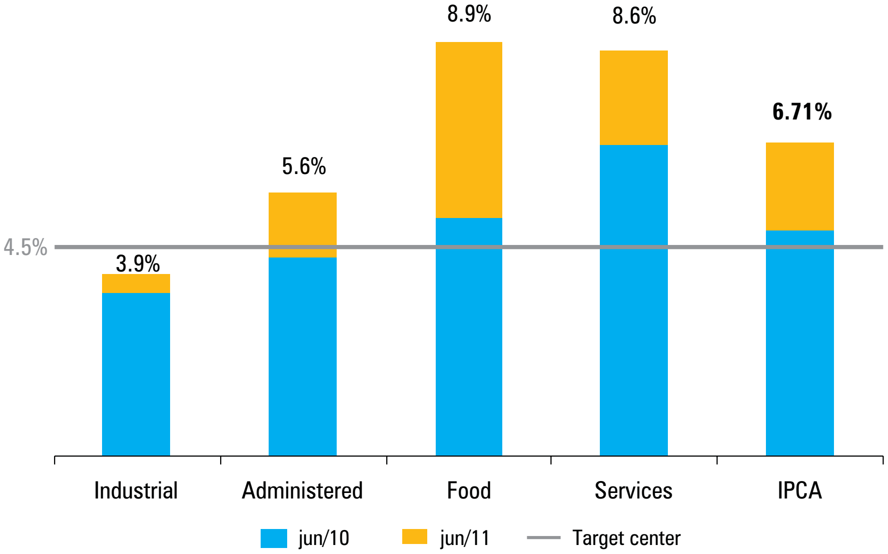
Among the different groups making up the IPCA, industrial products are the only ones that remain below the central target of 4.5% per year. Owing to their tradable characteristics, industrial-product prices are those most directly influenced by the policy of increasing interest rates adopted in recent months and by an overvalued exchange rate. These prices accumulated a 12-month growth of 3.9% up to June 2011, up by only 0.4 p.p. in relation to the figure observed in the same month in the previous year.

In the last months of 2011, the 12-month figure for inflation will decline. As a result of measures taken in recent months to

IPCA by groups

12-month accumulated percentage

Services and food prices push IPCA above target center



Source: IBGE Elaboration: CNI

restrict credit and increase interest rates, the inflation scenario for the end of the year will likely be relatively better than that observed in the first half of the year.

However, it takes longer for these measures to produce effects on service and regulated prices, which tend to sustain the high level observed in June. This situation prevents inflation from dropping more sharply. In this context, CNI maintains an inflation forecast of 6.0% per year for 2011.

Better inflation prospects point to an end of the rising interest rate cycle

Even though the IPCA is above the inflation target, prospects that it will end the year on a downward path suggest that the cycle of rising interest rates is probably coming to an end. The decision taken in the five Copom meetings held this year was to increase the Selic rate. The rate was initially increased two times by 0.5 p.p. and then three times by 0.25 p.p., hitting the mark of 12.5% in July.

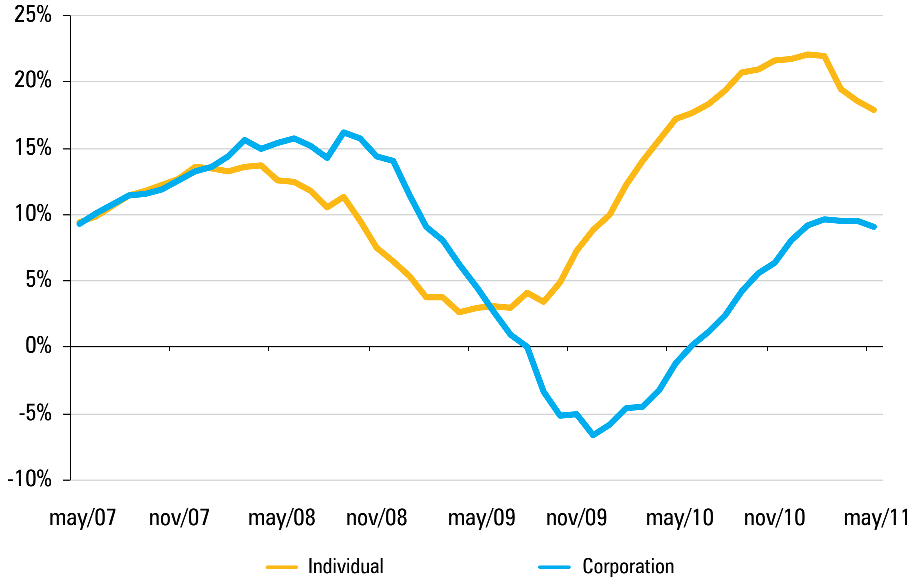
It takes time for the effects of rising interest rates to be felt on prices. The increases made early this year are likely to contribute to slowing down the IPCA. Nevertheless, the monetary policy based on increasing interest rates has impacted only some components of price indices and has proven not to be the most effective measure to control inflation.

Measures to restrict short-term credit, which have been adopted together with the monetary policy, have already affected the availability of this type of credit and tend to produce more direct effects on inflation control by reducing domestic demand. Within this context, CNI believes Copom will not increase the Selic rate in its next meetings, keeping it

Free credit loans to individuals and companies

Average percentage (%) in the last 12 months against the 12 previous months

Credit slowdown affects both individuals and corporations



Individuals / Corporations

at 12.50% per year until the end of 2011. Under this scenario, the average real interest rate in the year would total 5.2% per year.

Slowdown in lending rates contributes to control inflation

Lending to individuals and corporations has declined. The number of loans to individuals in the last 12-month period ending in May is 17.9% higher than in the 12 previous months. In January, this indicator registered growth of 22.1%. For corporations, however, the downtrend was less intense, down from 9.7% in February to 9.1% in May on the same comparison basis.

Loans with non-earmarked resources (mainly short-term resources funded by the financial institutions themselves) expanded strongly throughout 2010, as measures to encourage lending taken after the crisis were still in place.

Early in 2011, measures were taken in the opposite direction, such as that of increasing the Tax on Financial Operation (IOF) for loans to individual borrowers and of raising the risk factor for loans to individuals with a maturity greater than 24 months (which increases reserve requirements). The objective of this policy was to push lending rates down with the aim of contributing to the purposes of inflation control policies. These measures affected mainly car loans for individuals.

They also pushed the prices of credit lines up and reduced repayment deadlines. However, the credit slowdown was not brought about by this problem alone. In 2011, we can already notice an increase in payments in arrears for more than 90 days (indicative of default), creating less incentive for banks to grant credit and reducing the number of people entitled to receive loans.

fiscal policy

Public spending grows less in the second quarter

Regional governments have increased their expenditures at a rate higher than that of GDP growth

The behavior of Federal Government expenditures in the first five months of 2011 shows that the fiscal policy has contributed to reducing the growth rate of demand and, therefore, of economic activity. Federal public spending has increased by 2.6% in real terms over the same period in 2010, compared to a real economic growth estimated at 4.0% by the Central Bank.

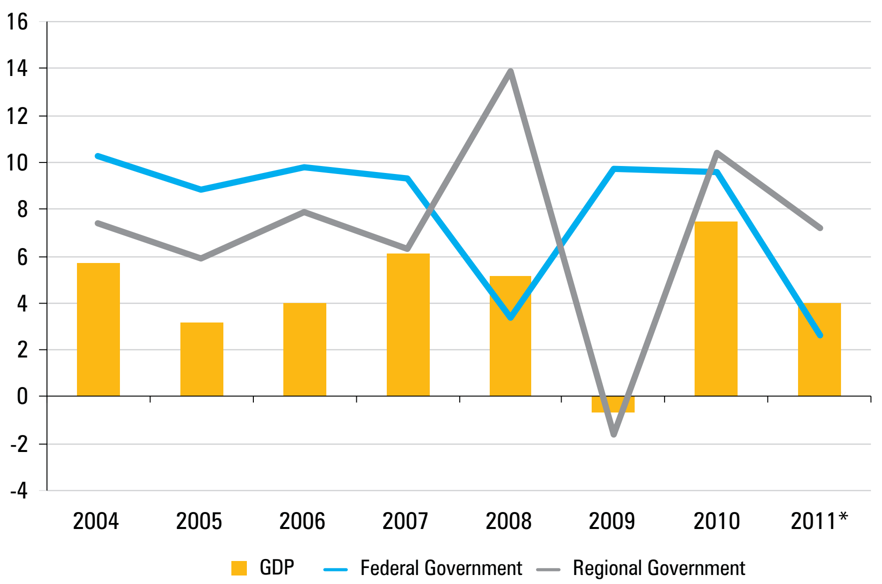
The fiscal policy has contributed less to controlling inflation because expenditures by states and municipalities have risen above the GDP growth rate. We project that regional governments' spending will increase by 7.2% in real terms in the first five months of 2011 in relation to the same period in 2010. However, measures to stimulate demand taken by states and municipalities have been reduced in the second quarter, as the spending growth rate is below the one registered up to February (10.8%) and in 2010 (10.4%).

Although it is an important measure to control the economic growth pace, lowering federal spending is having a negative bearing on investments. This is a consequence of a high budgetary rigidity, which does not leave many options for reducing current expenses. Federal Government's investments recorded a real drop of 4.7% between January and May 2011 as compared to the volume observed in the same period in 2010.

Increase in Federal Government's and regional governments' spending and in PIB

Real growth rate (%)

Real growth of federal expenditures up from 9.8% in 2010 to 2.6% in the first five months of 2011



Source: National Treasury and IBGE – Estimates for spending by states and municipalities: CNI
Deflator: IPCA

On the other hand, current expenditure rose by 3.2% in real terms on the same comparison basis. This growth rate was significantly lower than that registered in 2010 (8.4%), which can be explained by two major factors: lower minimum wage adjustments and a cut in spending on subsidies in housing finance operations.

Marked growth in primary surplus

The reduction in the growth rate of spending and a strong increase in revenues have led primary results to improve significantly. The Federal Government's net revenue experienced a real growth of 9.0% in the first five months of 2011 in relation to the same period in 2010. The main factors behind this behavior are: increased business profitability in 2010, after the effects of the economic crisis subsided, higher total earnings, and higher sales volumes in the domestic market, with emphasis on an upturn in imports.

For regional governments, we expect revenues to grow by 8.6% in real terms up to May as compared to the same period in 2010. Most of this growth resulted from an increase in transfers made by the Federal Government (17.4%).

The primary results have grown strongly since the end of 2010. The 12-month accumulated surplus for the Federal Government and its state-owned enterprises rose from 2.1% in December 2010 to 2.6% of GDP in May 2011. With respect to regional governments and their state-owned enterprises, the figure increased from 0.64% in December 2010 to 0.71% of GDP in May 2011.

For this reason, the consolidated public sector's primary surplus grew from 2.8% in December 2010 to 3.3% of GDP in the last 12-month period ending in May 2011. This increase more than offset the growth in interest costs, which rose from 5.3% to 5.7% of GDP on the same comparison basis. This movement resulted in a small drop in the nominal deficit (from 2.55% to 2.4% of GDP) and, consequently, in the net debt/GDP ratio, which fell from 40.2% in December 2010 to 39.8% of GDP in May 2011.

Contractionary fiscal policy expected to remain

Federal public expenditures are likely to keep growing at a moderate pace until the end of 2011. This is expected on account of the behavior of the Federal Government, which, despite an increase in revenues, has not raised the limits of non-compulsory spending in the first two evaluation reports on budget execution.

We therefore expect to see a real growth of 3.0% in federal spending in 2011, compared to a real increase of 3.8% of GDP. As for the Federal Government's net revenue, the results for the March-May period led us to revise our forecast of a real growth of 5.2%, as presented in the Economic Report issued in the first quarter, upward to 6.5%.

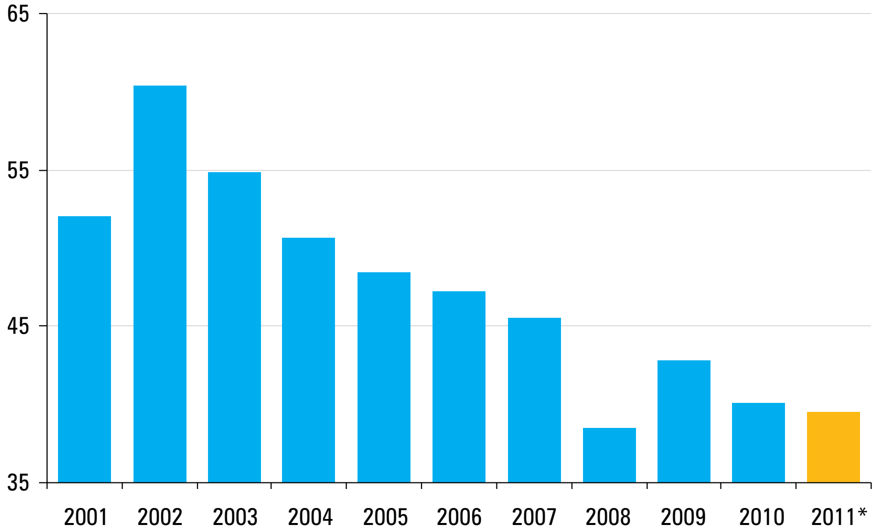
In this scenario, the primary surplus estimated for the Federal Government will amount to R$ 78.0 billion in 2011. Since federal state-owned enterprises are expected to register a primary deficit of about R$ 1.0 billion, the federal primary surplus will likely hit the mark of R$ 77.0 billion, against a target of R$ 81.8 billion – without considering costs related to the Growth Acceleration Program (PAC) (up to R$ 32.0 billion).

As in 2010, regional governments and their state-owned enterprises will probably not achieve the primary surplus target of R$ 36.1 billion. This result is likely to continue to improve by the end of the year, but we

Evolution of the Public-Sector Net Debt/ Ratio

Percentage of GDP (%)

Despite a higher public deficit, public debt will drop again in 2011



Source: Central Bank *Elaboration and projection for 2011: CNI

estimate a maximum primary surplus of R$ 32.5 billion. Thus, the primary surplus estimated for the consolidated public sector in 2011 totals R$ 109.5 billion (2.7% of GDP as projected by CNI), below the target of R$ 117.9 billion (2.9% of GDP) without considering PAC-related costs.

Since the positive impacts of the Petrobras capitalization operation were only experienced once, the expected primary surplus result in 2011 is lower than that observed in 2010 (2.8% of GDP). This decrease, coupled with expectations of higher interest costs (from 5.3% to 5.9% of GDP), will lead to a significant increase in the nominal deficit – from 2.55% in 2010 to 3.2% of GDP in 2011.

This higher nominal deficit will not result in an increase in the net debt/GDP ratio, as the nominal GDP is projected to grow significantly, boosted by higher inflation rates.

For this reason, we estimate that the net debt/GDP ratio will drop from 40.2% at the end of 2010 to 39.5% in December 2011.

2012 budget is once again based on an expansionary fiscal policy

The Budget Guidelines Law (LDO) for 2012 shows a reversal in the contractionary nature of the fiscal policy. Minimum wage-related expenditures will grow strongly, since the minimum wage is set to increase by 13.1%. It should be noted that the Budget Guidelines Law underestimates this increase in the minimum wage. This is so because the inflation rate built into the budget projection is 5.2%, while the index is estimated to close the year at about 6.0%. In addition, real price adjustments in social security benefits provided for in the Budget Guidelines Law are higher than the minimum wage.

A positive highlight in the law passed was the determination that current expenditures cannot grow more than investments, which – if implemented – will ensure an improved composition of public spending.

foreign trade sector and exchange rate

Brazilian currency continues to appreciate

Some factors pushing the Brazilian currency up are expected to linger until the end of the year

The real experienced an appreciation trend in the second quarter of 2011, reaching its lower rate in the last 12 years. In the last twelve-month period, it appreciated by 9.7% – 4.3% in the last 3 months alone. In real terms, the Brazilian currency is at its most appreciated level since it was created.

A significant inflow of foreign currencies is the main factor behind this appreciation. This inflow is mainly a result of: (i) high commodity prices and the resulting trade balance; (ii) an expansion in the domestic economy, attracting direct and portfolio investments; (iii) the economic stability and a high international liquidity, simulating Brazilian companies to issue foreign debt bonds and attracting investments in government bonds; and (iv) last but certainly not least, the high differential between domestic and foreign interest rates.

The government has adopted a series of measures designed to reduce the inflow of resources until the beginning of the second quarter. Even though they had effects on the appreciation path, which has lost momentum slightly, these measures were not sufficient to reverse or even interrupt the appreciation trend.

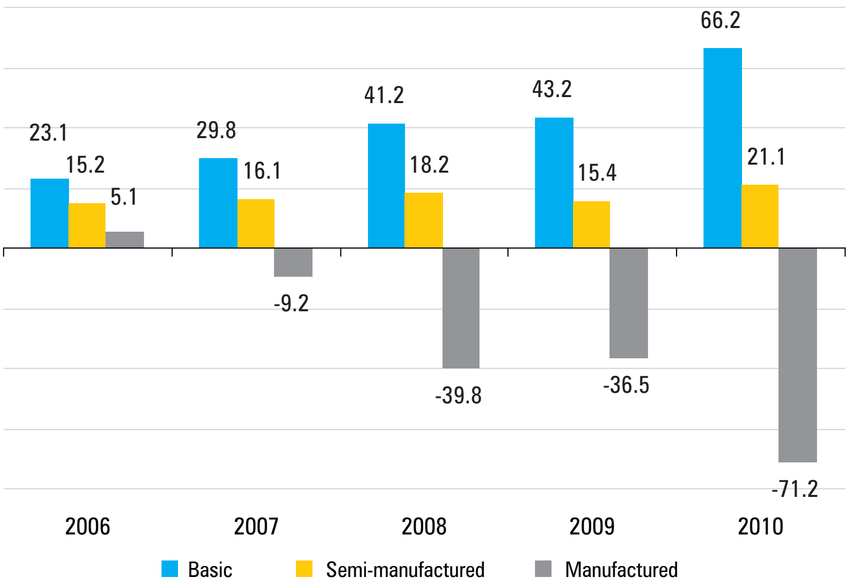
Factors behind the inflow of foreign currencies remain and this scenario is expected to change little until the end of the year. Commodity prices are not expected to drop; instead, the fact that world demand will remain strong and that international liquidity is high is likely to cause prices to remain on a downward path – albeit at a more moderate pace. There are also no reasons to believe that the Country risk, which has remained stable over the year, will change significantly, which would reflect greater concerns about economic stability and rising costs for companies to issue debt bonds.

The Brazilian economy will probably remain in evidence, attracting investments. The US and Brazilian interest rates are expected to hold steady by the end of the year. As a result, the domestic currency will be pushed further up, requiring government to adopt new measures to achieve its goal of curbing this appreciation.

These measures, if effective, will cause the exchange rate to remain close to the level observed early in July, oscillating between R$/US$ 1.60 and R$/US$ 1.55 over the first half. Consequently, the rate will average R$/U$ 1.56 in December and R$/US$ 1.59 in 2011 as a whole, a 9.7% appreciation in relation to the average figure for 2010.

Trade balance by use category
In US$ billion

Trade deficit in manufactured products is on the rise



Source: Funcex

Trade balance is sustained by exports of basic products

The Brazilian trade balance increased significantly in the second quarter and hit the mark of US$ 12.9 billion in the year-accumulated figure up to June, a growth of 64.8% in comparison with the same period in 2010.

This increase in trade balance resulted from a strong growth in exports, which have outpaced imports. Exports accumulated US$ 118.3 billion in the first half of the year, a 32.6% growth in relation to the same period in 2010. Imports in turn grew by 29.5% on the same comparison basis. At US$ 223 billion, total trade is at a record-high for the period.

It should be stressed, however, that the trade balance has been sustained only by basic and semi-manufactured products. The trade balance in basic products totaled US$ 39.9 billion over the past six months, while the balance of semi-manufactured products amounted to US$ 11.7 billion. The trade in manufactured goods, in turn, registers a deficit: US$ 41.1 billion in the first half of 2011.

This deficit in the trade of manufactured products has grown mainly on account of a sharp upturn in imports. Exports of manufactured products grew by 19.1% in relation to the first half of 2010. Imports of manufactured products, in turn, rose by 26.9% as compared to the first halves of 2010 and 2011.

Even the high commodity surplus can be explained not only by higher exported volumes, but also by substantial price gains. In the comparison between the first half of 2011 and 2010, exported volumes rose by only 1%, while prices grew at a rate of 45%. It is worth highlighting that commodity prices are on the rise due to an increased demand and high international liquidity, which favor the prices of these products.

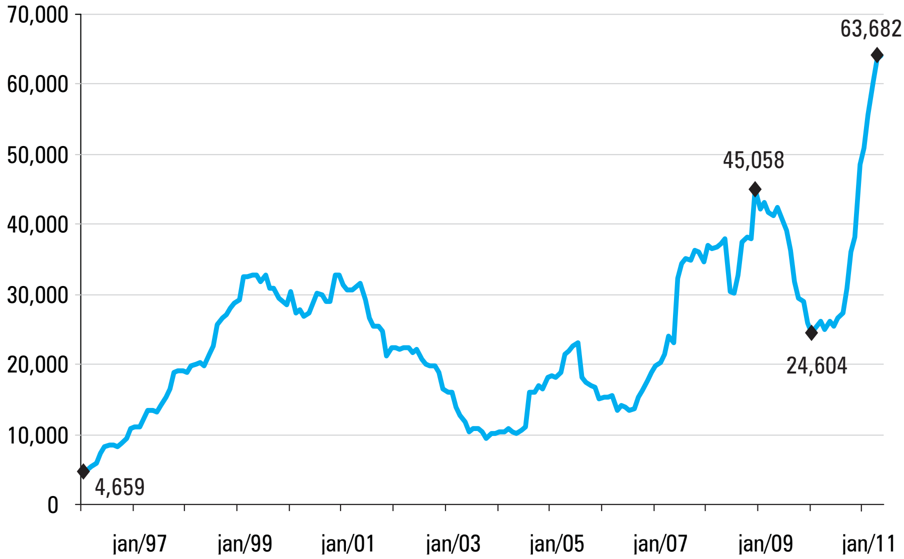
The foreign scenario of high liquidity and increased demand for basic products is not expected to change, allowing for export values to keep growing in spite of a weak performance of foreign sales of manufactured goods, which are not likely to improve significantly. CNI maintains its forecast that exports will total US$ 250 billion in 2011.

Imports, in turn, will likely continue to grow at the same rate observed in the first half of the year. Imports of consumer goods are expected to keep growing

Net foreign investments

12-month accumulated figure (US$ million)

Foreign investments are the main source of funding for the current account deficit



Source: Central Bank

at the current pace, as household consumption will probably remain on the rise. Imports of intermediate and capital goods are estimated to experience a downtrend, as manufacturing production is projected to grow at a more moderate pace until the end of the year. Imports are set to hit the mark of US$ 230 billion at the end of the year, which would generate a US$ 20 billion balance.

Direct investments finance rising current account deficit

The appreciation of the real contributes toward increasing the negative current account balance while boosting imports. The current account deficit totaled US$ 51 billion in the 12-month period up to May.

This higher deficit reflects a decline in the services and income account, whose deficit rose by 25.6% in the comparison between the first five months of 2011 and 2010. The increase in negative balances in profit and dividend remittances, international trips, and equipment rental deserves special mention. A higher trade balance in the beginning of 2011 was partly responsible for preventing the current account deficit from rising even further.

The services and income deficit is expected to keep growing until the end of 2011 on account of two factors: exchange rate appreciation and increased household consumption. As a result, the current account deficit is expected to keep expanding at the pace observed currently. CNI estimates this deficit at US$ 61 billion at the end of 2011, equivalent to 2.4% of GDP in dollars.

Foreign direct investments (FDI) are another major factor: they have grown strongly in recent months and continue to be the main source of funding for the current account deficit. In the last 12-month period, foreign direct investments accumulated US$ 64.1 billion, compared to US$ 26.0 billion in the cumulative figure up to May 2010.

prospects for the Brazilian economy

	2009	2010	2011 *previous projection Mar/11*	2011 *projection*
Economic activity				
GDP (annual variation)	-0.6%	7.5%	3.5%	**3.8%**
industrial GDP (annual variation)	-6.4%	10.1%	2.8%	**3.2%**
Household consumption (annual variation)	4.2%	7.0%	4.5%	**4.5%**
Gross fixed capital formation (annual variation)	-10.3%	21.9%	9.0%	**8.5%**
unemployment Rate (annual average - % of the labor force)	7.9%	6.7%	6.0%	**5.9%**
Inflation				
Inflation (IPCA - annual variation)	4.3%	5.9%	6.0%	**6.0%**
Interest rates				
Nominal interest rates				
(average rate in the year)	10.13%	9.90%	12.13%	**12.07%**
(year end)	8.75%	10.75%	12.50%	**12.50%**
Real interest rate (annual average and deflated rate: IPCA)	5.0%	4.6%	5.4%	**5.2%**
Public accounts*				
Nominal public deficit (% of GDP)	3.34%	2.55%	3.05%	**3.20%**
Public primary surplus (% of GDP)	2.03%	2.80%	2.70%	**2.70%**
Net public debt (% of GDP)	42.8%	40.2%	39.9%	**39.5%**
Exchange rate				
Nominal exchange rate - R$/US$				
(average in December)	1.75	1.69	1.63	**1.56**
(average in the year)	1.99	1.76	1.63	**1.59**
Foreign trade sector				
Exports (US$ billion)	153.0	201.9	250.0	**250.0**
imports (US$ billion)	127.6	181.6	230.0	**230.0**
Trade balance (US$ billion)	25.4	20.3	20.0	**20.0**
Current account balance (US$ billion)	-24.3	-47.5	-57.0	**-61.0**

* Excludes Petrobras and Eletrobras Group's companies

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