CNI ECONOMIC REPORT

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Slowdown in industry explains GDP drop in 2009

Economy recovering after economic recession

The international financial crisis has caused a second quarterly slowdown in a row in the Brazilian economy, characterizing a technical economic recession. However, recession will be short-lived, as economic growth is expected to be resumed in the second quarter, paving the way for a recovery process. Despite this resistance, GDP growth will be negative by 0.4% this year.

Industry is the sector that was hit most, having suffered the sharpest decrease in activity due to its greater exposure to the international economy. Industrial GDP fell by 11.1% in the two first quarters of this year and manufacturing production declined by about 15% in the first four months in relation to the same period in 2008. This is such a sharp drop that, regardless of growth being resumed in the second half of the year, industrial GDP will still drop by 3.5% in 2009.

Despite an unfavorable environment in the world at large, the Brazilian economy has been reacting very positively. Robust economic foundations and economic policy measures designed to lessen the effects of the crisis – particularly tax and credit recomposition measures – partly explain this reaction, which can also be attributed to the features of the domestic sector, which has managed to preserve its dynamism, sustained by the expansion of real total payroll and social benefits. As a result, household consumption – the main demand component in GDP – has already increased in the first quarter of this year.

However, the resilience of domestic demand will not be sufficient for a solid growth pace to be resumed in the very short term. The significant drop in investments and exports is the main factor pushing GDP down and a major concern, given its key role for consolidating economic recovery. While a high industrial idleness has led investment decisions to be postponed – with widespread impacts on the capital-good production chain –, the strong economic recession being experienced in the world has kept export prospects down.

The rekindling of foreign demand, which has played a major role in leveraging the solid pace observed in recent years, is a key element for ensuring economic growth in the future. However, in a depressed foreign market, with fierce competition prevailing, competitiveness requirements have become stronger, particularly for manufactured products.

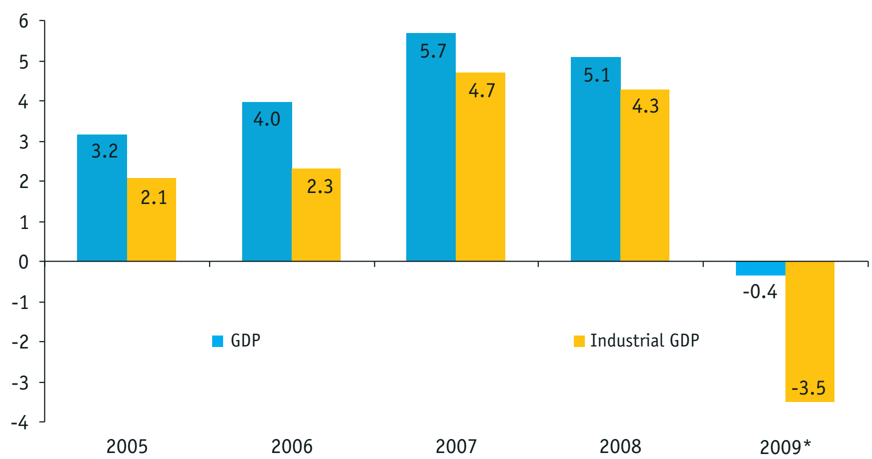
The appreciation of the Brazilian currency has worsened this scenario and more effective actions are required for overcoming competitive disadvantages brought about by typical dysfunctions of the Brazilian economy. Correcting tax, export and investment distortions is a priority. At the same time, ensuring favorable institutional conditions for bringing nominal interest rates down to international levels is crucial, and this will require lower indexation of the economy and inflation targets consistent with international standards.

Brazilian economy in the second quarter of 2009

GDP and industrial GDP evolution

Annual variation (%)

Performance of the industrial sector will push GDP down in 2009



* CNI Projection
Source: IBGE

economic activity

Sharp drop in investments prevents GDP growth

Brazilian economy will decrease by 0.4% in 2009

The 0.8% drop in GDP in the first quarter of 2009 in relation to the previous quarter was within the range expected by CNI – our estimate, as published in the previous Report, pointed to a 0.5% drop. This result led to a revision in GDP projections for 2009 from zero growth to a 0.4% decrease in relation to the previous year.

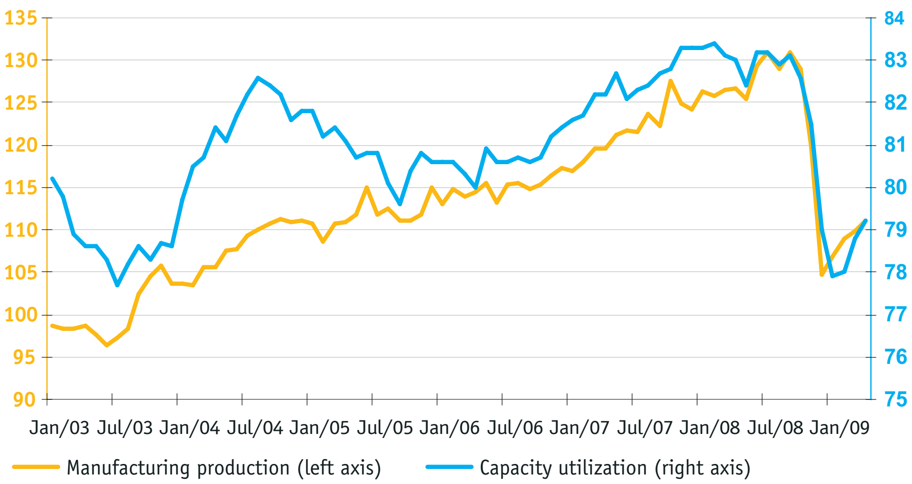
Disaggregating GDP components, one observes significant changes in relation to the drop estimated early this year. On the supply side, industry decreased by 3.1% in the first quarter of the year, in seasonally adjusted terms, as compared to the fourth quarter in the previous year – a decline of 9.3% as compared to the first quarter of 2008. On the supply side, this component was the main factor that led to a new industrial GDP estimate in 2009, down from -2.8% to -3.5%

The first data for the second quarter point to a recovery trend, but one that is insufficient for industrial production to return to the levels registered before the crisis struck. Manufacturing production (PIM-PF/ IBGE) grew by 1.1% in April in relation to the previous month. Despite this result – the fourth consecutive growth, according to the seasonally adjusted indicator –, production is still at a level similar to the one registered in 2005. In April, industry produced 14.8% less than in the same month in 2008. This lower industrial activity is also evinced by the depressed capacity utilization observed in the manufacturing industry (CNI). After dropping sharply in the last months of 2008, the growth rate since February 2009 led CU to hit the mark of 79.2% in April – a similar index to the one registered in December 2003.

Manufacturing production and capacity utilization (seasonally adjusted)

Average base index 2002=100 (left axis) and % (right axis)

Abrupt drop in manufacturing activity indicators



Source: IBGE

A sharp GDP drop in the civil construction industry also influenced our new estimate for industrial GDP. The 9.8% drop in the first quarter of 2009 in relation to the same period in the previous year is surprising because this sector is uniquely dynamic, considering the longer maturing cycle of civil construction projects – from commission to delivery. However, the impact of the international crisis on the sector was faster and more intense than expected. Even believing that a pronounced recovery in the civil construction industry over the next quarters is possible (as a result of the launching of a new governmental housing program and the expected drop in interest rates for financing the purchase of real estate), the probability that the sector will grow in 2009 is low. Our estimate for GDP variation in the civil construction industry dropped from 0.4% to -3.5%.

The only component of industry that is expected to grow in 2009 is electricity, gas and water production and distribution, whose estimated growth in 2009 was kept at 1.5%.

The performance of the agriculture/ livestock industry was better performance than expected for the first quarter, leading us to revise our estimate from a -3.7% to a 2.1% decrease.

The service industry (particularly retail trade) grew once again by 0.8% in the first quarter of this year in relation to the previous quarter – more than making up for the drop registered in the previous quarter (-0.4%). Growth in the service industry was fostered by a higher household consumption with the same income level. For this reason, we estimate that this sector will grow by 2.0% in 2009 (up from an estimated 1.5% growth).

(On the demand side, household consumption grew by 0.7% in the first quarter of this year as compared to the previous quarter. Despite a loss of momentum in their growth pace in recent months, total earnings continue to increase. Added to a gradual credit recomposition, this growth will make it possible for household consumption to rise by 0.7% in 2009 (as opposed to our previous estimate of a 0.9% drop).

The government also contributed positively to this result by increasing its spending. The indicator for spending defrayed by the government in the 12-month accumulated figure (National Treasury) increased in all the first four months of 2009. As a result, our estimate of a 3.0% increase in government consumption has been maintained.

The drop in investments is the main development which, from the perspective of demand, justifies lower expectations for GDP. Gross formation of fixed capital (GFFC) dropped more intensely in relation to the previous quarter, from -9.3% in the fourth quarter of 2008 to -12.6% in the first quarter of 2009 (the sharpest drop since the beginning of the IBGE series, in 1996). The need to get rid of undesired stocks, a scenario of low capacity utilization, and difficulties for accessing credit have all been affecting corporate investment decisions. Therefore, we have scaled down our projections to a 9.0% drop in GFFC in 2009 – twice the drop estimated early this year.

Estimates for exports and imports – according to IBGE's national accounts methodology – were also revised. The world economic recession and the appreciation of the real in relation to the US dollar will lead to an even sharper drop in exports – we estimate a decrease of 10.0% in 2009. In the case of imports, while on the one hand a stronger real can stimulate purchases in foreign markets, lower investment rates and manufacturing activity will have a greater bearing on reducing imports. Our estimates for imports in 2009 suggest that they will decrease by 12.0%.

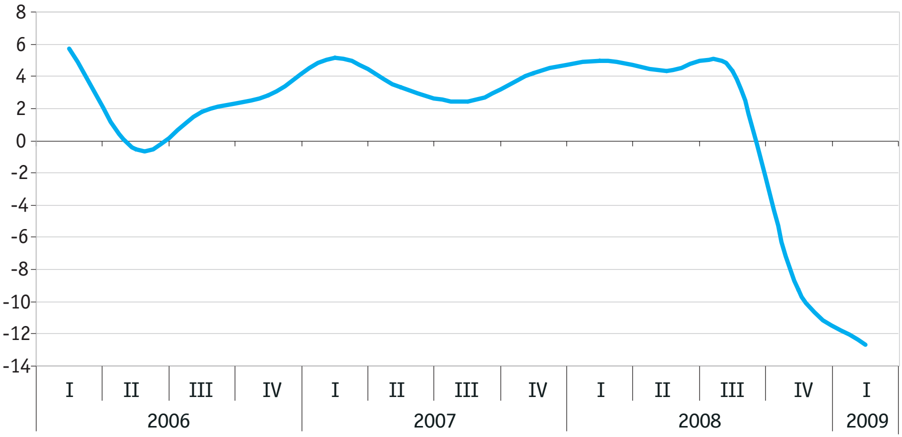
GDP will begin to grow once again from the second quarter on

CNI expects GDP to grow by 1.4% in the second quarter in relation to the previous quarter (net of seasonal effects), more than making up for the 0.8% drop in the first quarter. However, if confirmed, this result still represents a drop of 1.0% as compared to the same quarter the year before. On this comparison basis, GDP will be dropping more intensely in the third quarter (-1.5%) – given the high comparison basis in the third quarter of 2008 – and will only resume a growth path (an estimated 2.9%) in the last quarter of the year. This path will result in a 0.4% GDP drop in 2009 in relation to 2008.

Gross fixed capital formation

Variation in relation to the previous quarter (%) - seasonally adjusted indicators

Drop in investments is the most intense since 1996



Source: IBGE

Estimated growth for GDP and its components in 2009

	GDP Components	2009 Growth rate (%)	2009 Contribution (p.p.)
Demand side	Household consumption	0.7	0.4
	Government consumption	3.0	0.6
	GFCF	-9.0	-1.7
	Exports	-10.0	-1.4
	(-) Imports	-12.0	-1.7
Supply side	Agriculture/livestock	-2.1	-0.1
	Industry	-3.5	-1.0
	Services	2.0	1.3
	GDP	**-0.4**	

jobs and income

Less jobs are being created

Industrial jobs decreased for the sixth month in a row in April

Lower investments in production interrupted a virtuous growth cycle in the labor market characterized by pronounced job creation, a lower unemployment rate, formalization of occupations, and higher total earnings.

Historically, the first months of the year are marked by a lower occupation rate due to the seasonal lay-off of temporary workers. But the crisis has intensified this trend: the drop observed in occupations in the six main metropolitan regions of Brazil (Monthly Job Survey/IBGE) amounted to 595,000 between January and April 2009 – a very sharp reduction as compared to the average drop in the same four months in the past four years (154,000). This movement pushed the indicator for job creation down in the 12-month accumulated figure to only 50,000 (or a 0.2% variation), representing the lowest expansion in IBGE’s historical series, initiated in March 2002. As a comparison, jobs created in the 12-month accumulated figure in April 2008 amounted to 784,000 (a 3.9% increase).

Considering formal jobs in all the national territory (Caged/MTE), the situation has, without any doubt, gotten worse. Job creation in the 12-month accumulated figure, which amounted to 1.8 million in April 2008, decreased to only 580,000 in April 2009 – the net job flow has returned to the level observed early in 2002.

Manufacturing industry was the sector in which jobs decreased most as a result of the crisis

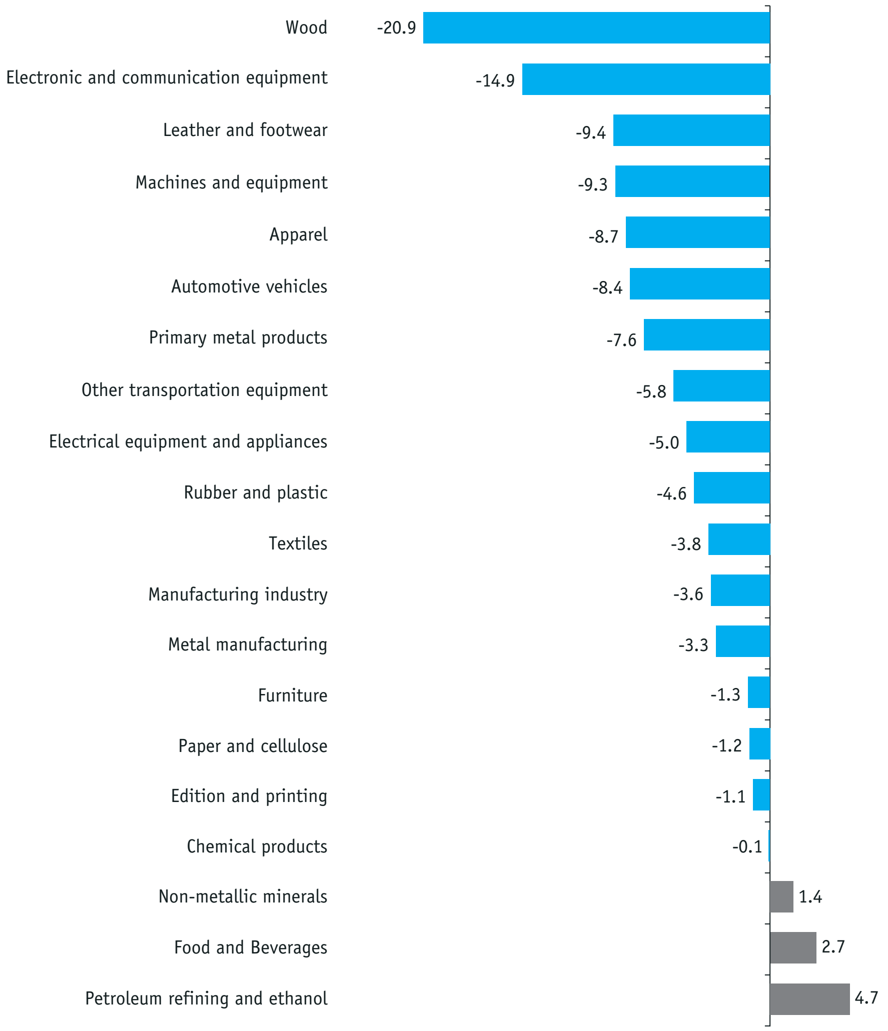
The indicator for job creation in the manufacturing industry amounted to -233,000 in the 12-month accumulated figure in April. CNI Industrial Indicators corroborate this scenario. In April, the data for industrial jobs dropped for the sixth consecutive time as compared to the previous month – which is a new fact in the survey series, initiated in January 2003. In relation to the same month the year before, jobs decreased in 16 of the 19 sectors of the manufacturing industry covered by the survey.

It should be highlighted that the lower growth observed in formal jobs in the

Jobs by industrial sector

Variation as compared to the same month in the previous year

Drop in jobs is widespread sectorally



Source: Indicadores Industriais/CNI

annual comparison, that is, in relation to the same month in the previous year, has not reduced formality in the labor market. This indicator – which is calculated by the sum of all formal, military and statutory jobs divided by all occupations – hit the mark of 57.3% in April, the highest level in the IBGE series since it began, in March 2002. This phenomenon was only possible because informal jobs and self-employment dropped by 2.8% in April as compared to the same month in the previous year.

Unemployment rate is stable in April

The unemployment rate (Monthly Job Survey/IBGE) rose in the first three months of the year. Although the drop in the occupation rate in the first four months of the year was intense in historical terms, a reduction in the labor force (EAP) in April – in relation to the previous month – interrupted the upward trend of unemployment. Mention should be made that the labor force reduction in April is the sixth one in a row on this comparison basis, which is not a common phenomenon in the IBGE series. However, we believe that the labor force will not continue to decrease over the next few months. Higher consumer confidence indices (CNI) may encourage more people to look for a job, increasing the pressure on the unemployment rate.

We believe that the unemployment rate will remain close to 9.0% over the next few months and that it could increase in the short run before dropping at the end of the year. Our estimate for the annual average of this indicator is 8.9% for 2009.

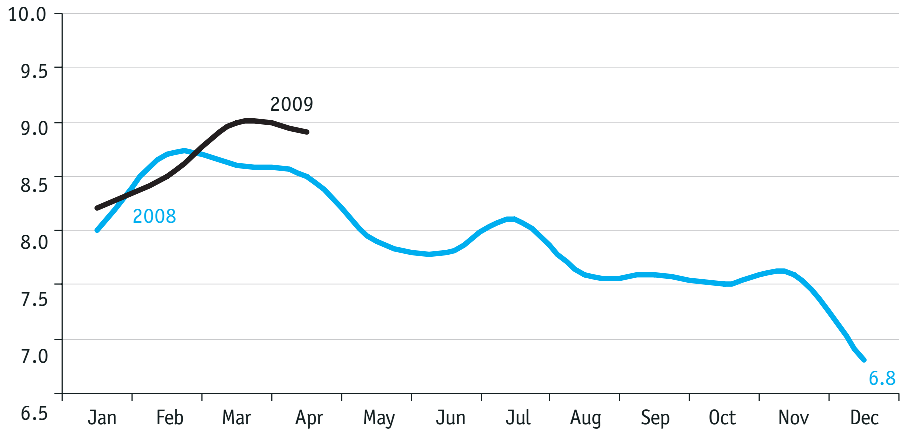
Deterioration in the labor market is also reflected in smaller gains in workers' income (Monthly Job Survey/IBGE). A lower occupation rate led to a decline in the actual real total payroll (as calculated by multiplying the number of occupied people by the average of real earnings) in the first three months of the year. In March (the last datum available for actual income) total earnings grew by 3.2% as compared to the same month the year before. This behavior contrasts with the path of the indicator at the beginning of the previous year, when it was gathering speed upward.

Despite their momentum loss, total earnings continued to increase in 2009 –deceleration of the inflation rate over the period buffered the negative effect of a lower occupation rate on the real total payroll path. Therefore, our estimate is that total earnings will increase by 1.0%-2.0% in 2009.

Metropolitan unemployment rate

In %

Decrease in the labor force reduces pressure on unemployment rate

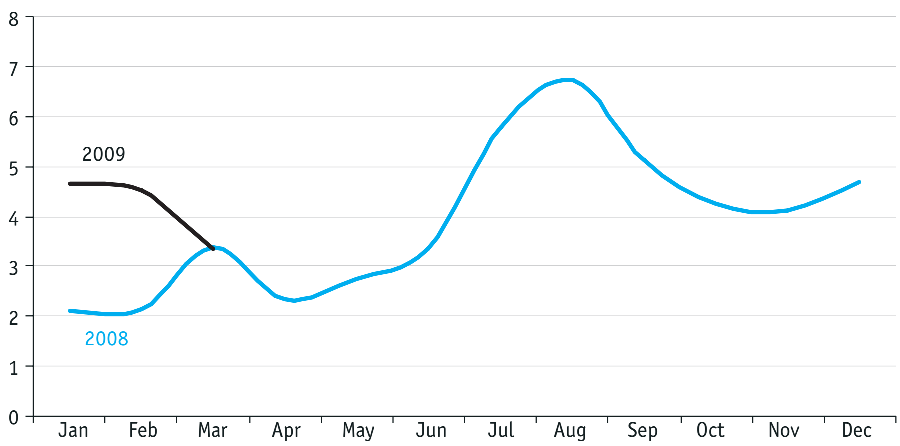


Source: IBGE.

Actual real total payroll

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

Deterioration in the labor market causes negative impacts on total earnings



Source: IBGE Cálculo: CNI

inflation, interest rates and credit

Credit conditions for the industry are not back to normal yet

Inflation continues to converge to the target with deceleration of industrial prices

Deceleration in prices due to the international crisis has continued in recent months. The prices of industrial products began to drop more sharply as a result of a lower foreign demand and of the exchange rate depreciation. This situation could be more clearly confirmed by a drop in wholesale prices and in the prices of manufactured products, mainly of durable goods. As a result, the inflation target for 2009 is certain to be achieved, paving the way for a further decrease in interest rates.

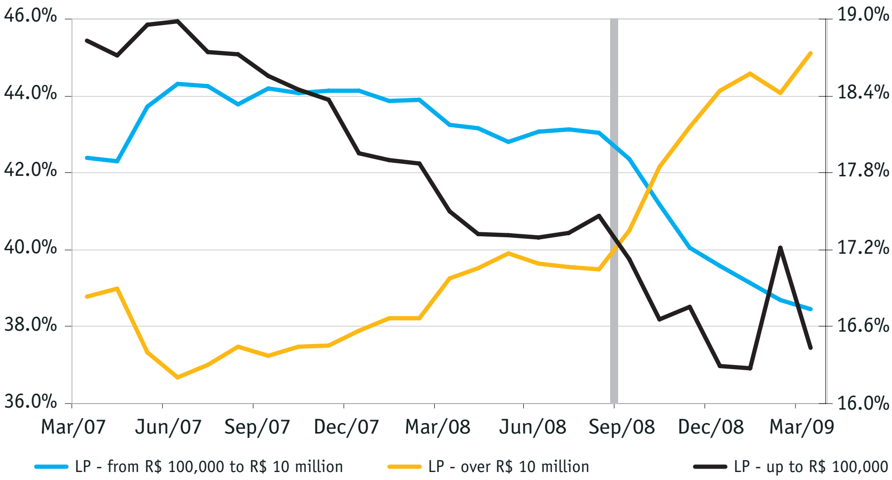
Preserving the trend observed in recent months, the Wholesale Price Index-Internal Availability (FGV) continues to drop sharply. From November 2008 to May 2009 (last datum available), the index accumulated a deflation of 3.3% and has become the main component accounting for the deceleration observed in the General Price Index-Internal Availability (FGV). However, there has been no pass-through to consumers yet, considering that the IPC is still on the rise. The General Market Price Index (IGP-M) (FGV), which is used for indexing monitored prices, has accumulated an increase of 3.6% in 12 months, as opposed to 15.1% in July 2008. Our projections suggest that this index will close the year below 2%, mainly because of the drop in wholesale prices.

The 12-month accumulated Extended Consumer Price Index (IPCA) – the reference for the inflation target – has also decelerated between October 2008 and May 2009 (dropping from 6.41% to 5.20%), rapidly converging to the annual target of 4.5%. This decrease is mainly attributed to a marked slowdown in manufacturing production combined with a sharper decline in demand for durable goods. The component related to services is the one that has been avoiding a greater deceleration in the Extended Consumer Price Index (IPCA), which has increased by 4% in the year, in tune with the sector's performance in the quarter.

Credit for legal persons by operation value*

As a percentage of the full credit available to legal persons

Credit operations for large companies grow to the detriment of micro, small and medium enterprises



Source: SCR / Central Bank

* from R$ 100,000 to R$ 10 million and above R$ 10 million: left axis; up to R$ 100,000: right axis

Reductions in the Selic rate have not changed the downward path of the (IPCA) in 12 months

It should be highlighted that the continuous drops in the *Selic rate* decided upon in recent Copom meetings have not changed the inflation rate path. For this reason, CNI kept its previous projection for the Extended Consumer Price Index (IPCA) in the year at 4.2%. The prices of food products might go up at a faster pace because of the upward trend in agricultural commodity prices and in the prices of industrial products, with a more apparent recovery of the category, but only closer to the end of the year.

Basic interest rates hit historical one-digit mark

Copom has maintained its policy of reducing the over-Selic interest rate at its meetings in April and June, reducing them by a further 2.0 percentage points. In the year, the over-Selic interest rates have accumulated a drop of 4.5 p.p., in tune with the monetary policy adopted by the main world economies, but more slowly and less intensely. Due to the new reductions, the *Selic rate* at its lowest level historically, namely, 9.25% per year. Real interest rates also dropped (from an average 6.2% per year up to April to 5.9% a year up to May), paving the way for lower credit operation rates (which have not, however, been observed in practice so far).

Nevertheless, with the new level of the *Selic rate* (one-digit level since the June meeting), a problem that has lingered since the times of high inflation rates needs to be tackled: the economy's excessive indexation. One of the main hurdles for reducing interest rates even further is the need to guarantee the remuneration of savings, as indicated by CNI in the last Report. Because of its basic remuneration (6.17% a year, plus TR (reference rate)), this financial investment is more profitable than most fixed-income funds, linked to public debt bonds. Therefore, the migration (which has started already) of resources from these funds to savings accounts generates a potential financing difficulty for the Government. For this reason, discussions are being held on the need to change the tax regime applied to savings and/or investment funds.

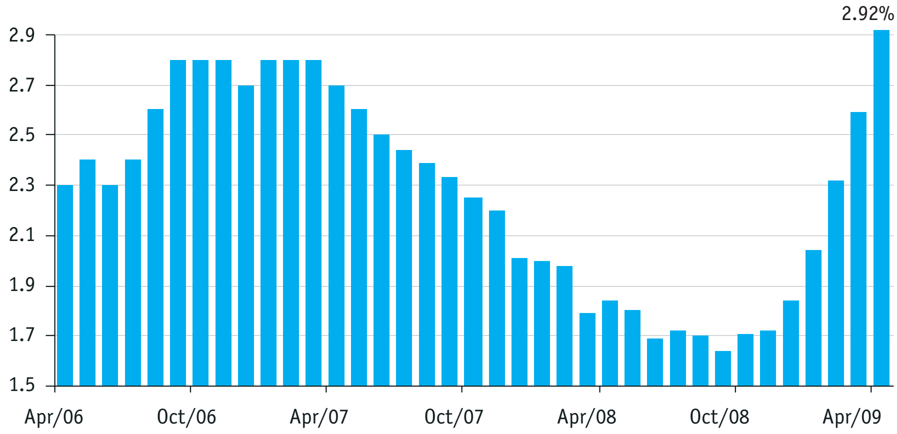
Investments in savings are becoming more profitable than in fixed-income funds

In this scenario, CNI projects that the *Selic rate* will close the year at 8.75% per annum, with a further 0.5 p.p. reduction at the next Copom meeting, in July 2009, and an yearly average of 10.15% per annum. As a result, real interest rates in December would amount to 4.4% per year and the average rate in 2009 would be 5.0% a year.

Repayments overdue for more than 90 days - Legal persons

In % of the credit

Rate of repayments overdue for more than 90 days for legal persons has been increasing rapidly



Source: Central Bank

Credit composition reveals the negative situation faced by industry

Despite relatively positive results for credit in recent months, they disguise the actual credit situation prevailing in Brazil. For credit with non-earmarked resources, a slight increase was observed in March and April as compared to the previous month (0.61% and 0.45%, respectively), as opposed to the reduction registered in February (-0.53%, on the same comparison basis).

Observing the components of this total, it can be seen that only credit for individual borrowers has actually expanded since December 2008. For legal persons, credit has become scarcer in all months in 2009, except in March. For comparison purposes, credit for legal persons increased from 2006 to 2008 by 2.28% in average in relation to the previous month, while in 2009 the average drop amounted to 0.65% (data up to April).

In addition, considering credit by amount ranges, it can be seen that the percentage of credit available to legal persons for operations of up to R$ 100,000 and from R$ 100,000 to R$ 10 million have been dropping in relation to total credit since September 2008. On the other hand, the same percentage for operations involving sums in excess of R$ 10 million has been growing since the same month, revealing that the credit available on the market is being mainly granted to large companies, to the detriment of micro, small and medium enterprises.

High interest rates constitute an additional hurdle. As mentioned in the last Economic Report, despite the drop in the *Selic rate*, banking *spreads* for legal persons are still high. The *spread* for legal persons (Central Bank) is still above 18% a year, much higher than the averages registered in 2008 (15.31%) and 2007 (12.78%). This situation is partly explained by an increasing default rate. The indicator for repayments overdue for more than 90 days for legal persons hit the mark of 2.92% of total credit, the highest level since May 2001.

fiscal policy

Fiscal policy has become more expansionist

Reduction of the primary surplus target paves the way for greater tax expansion

Lower-than-expected tax revenues and attempts to reduce the impacts of the economic crisis through tax deductions and a higher spending led to a marked deterioration in fiscal results in the first months of 2009. Given this scenario, the Federal Government reduced the primary surplus target set for the year. This change made it possible for the Federal Government to accommodate its lower tax revenue without the need of any financial programming for expenses and also without expanding its projected spending. Therefore, the expansionist approach of the fiscal policy was expanded in relation to the one adopted in the first quarter.

The consolidated public sector primary surplus accumulated in 12 months dropped from 4.1% of GDP in December 2008 to 3.1% of GDP in April 2009. This drop was mostly caused by the result of the Federal Government, which decreased by the equivalent to 0.9% of GDP. In addition, over the same period, the GPD of regional governments declined by 0.1% in their primary surplus.

Lower tax revenue and marked increase in federal government spending

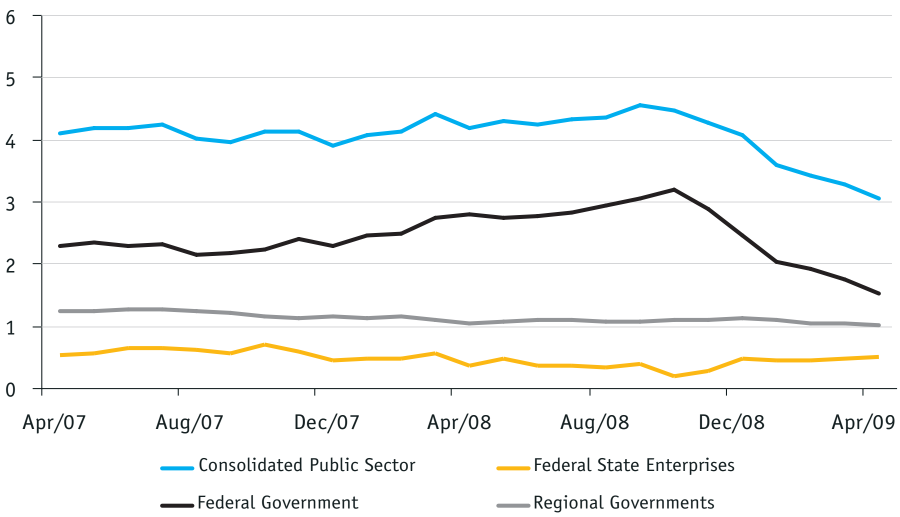
The net Federal Government revenue decreased by 5.9% in real terms in the first four months of 2009 in relation to the same period in 2008. In addition to the slowdown in economic activity, with impacts on the revenue from the Tax on Industrial Products (IPI), from PIS (Social Integration Program benefits)/PASEP, and from the Contribution to Social Security Financing (COFINS), and to the lower profitability of companies, which led to a lower revenue from the income tax (IR) and from the Social Contribution on Net Income (CSLL), tax deductions have also contributed to a lower revenue. According to the Internal Revenue Service, deductions on the Tax on Industrial Products (IPI), the income tax (IR), and the Tax on Financial Operations (IOF) announced in December 2008 accounted for a decrease of R$ 4.6 billion in the tax revenue between January and April 2009. However, even excluding this effect, the net revenue of the Federal Government still dropped, in real terms, by 3.6% in the four first months of the year in relation to the same period in 2008.

On the other hand, the primary spending of the Federal Government had a real increase of 12.6% between January and April 2009 in relation to the same period in 2008. The main sources pressuring expenses up were spending with staff, which increased by 17.5%, and fixed and capital expenses, which rose by 15.2%. The higher spending with staff reflects salary adjustments granted in 2008. In relation to fixed and capital expenses, a higher discretionary spending deserves special mention. Fixed expenses with the public apparatus and public programs increased by 16.6% in real terms, while investments grew by 19.0% between January and April 2009 as compared to the same period in 2008.

Evolution of the public sector primary surplus

In % of GDP

Public sector primary surplus accumulated in 12 months dropped by 1.0 p.p. of GDP between December 2008 and April 2009.



Source: Central Bank

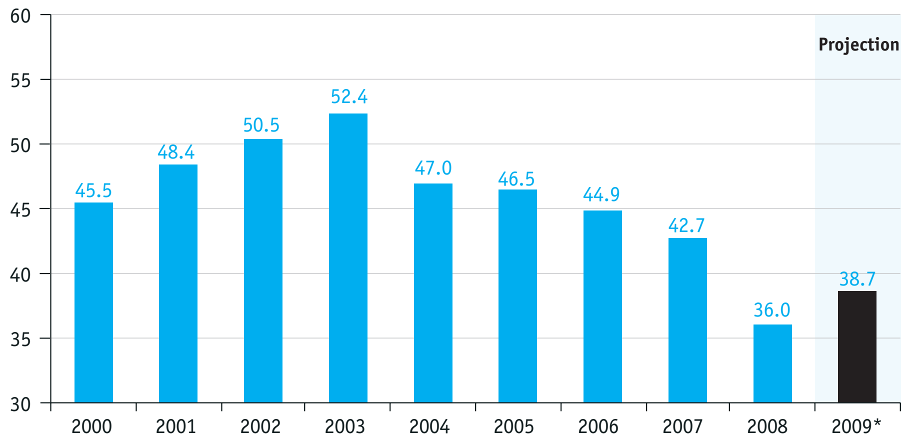
Lower revenues lead to cuts in spending in states and municipalities

The performance of state and municipal revenues was in tune with the one with the Federal Government's performance and the available data point to a real drop of 5.5% in the four first months of 2009 in relation to the same period in 2008. This decrease was caused by a lower revenue from the Turnover Tax (-5.1%) and by reductions in transfers from the Federal Government (-12.1%). As for expenses, the behavior of regional public accounts is different from the one observed for the Federal Government. We estimate that the spending of states and municipalities dropped by 3.1% in real terms in the first four months of 2009 as compared to the same period in 2008. Restrictions imposed by the Fiscal Responsibility Law (LRF) and by debt renegotiation agreements with the Federal Government led the spending of states and municipalities to drop in pace with their decreasing revenue.

Evolution of the public sector net debt/GDP ratio

In % of GDP

Expansionist fiscal policy and real drop in GDP are expected to interrupt the downward path of the public debt



Source: Central Bank
Projection 2009: CNI

Federal Government lowers primary surplus target for the public sector in 2009

The Federal Government lowered the primary surplus target in 2009 from 3.8% to 2.5% of GDP. For the Federal Government, the new target is 1.4% of GDP, against 2.15% contemplated in the 2009 budget. This means a further reduction 0.25% of GDP in the target plus reductions contemplated in the Pilot Investment Project (PPI) mechanism, which allows for spending with investments equivalent to 0.5% of GDP to be deducted from the primary surplus calculation. In addition, the target for federal state enterprises is now 0.2% of GDP, after companies linked to the Petrobras group were excluded from the calculation, for which a primary surplus of 0.5% of GDP was expected. Finally, the target for states and municipalities dropped from 0.95% to 0.9% of GDP, totalling the anticipated percentage of 2.5% of GDP.

By changing the target, the Federal Government sought to accommodate an increase of R$ 3.0 billion in compulsory expenses anticipated for 2009 and expanded the limit imposed on discretionary spending by R$ 9.1 billion.

Primary surplus target is not likely to be achieved in 2009

Based on current spending forecasts, it is not likely that the Federal Government will achieve the primary surplus target of 1.4% of GDP. We expect the primary result to amount to only 1.05% of GDP in 2009. We consider a real increase of 9.0% in primary spending and a real drop of 2.2% in the net revenue. To achieve the target, it would be necessary to carry out a financial programming of expenses in the order of R$ 11.0 billion.

Before the calculation method was changed, by excluding Petrobras, we were of the opinion that it would be difficult for federal state enterprises to achieve the primary surplus target of 0.7% of GDP. In 2008, these enterprises achieved a positive primary result of 0.5% of GDP and we expect them to achieve the same positive level in 2009.

Since Petrobras accounts for a little over 2/3 of this result, we project a primary surplus of 0.15% of GDP for all other federal government-owned enterprises.

Finally, considering the decrease in the spending of states and municipalities, we estimate that the primary result of these governmental spheres will amount to 0.95% of GDP. Therefore, we are projecting a primary surplus of 2.15% of GDP for the consolidated public sector using the new methodology (excluding Petrobras), below the target of 2.5% of GDP. According to the old methodology, we are projecting a primary surplus of 2.5% of GDP, but the target would be 3.0%.

Because the Central Bank is still disseminating these statistics including Petrobras, considering a primary surplus of 2.5% of GDP, we are projecting a 2.3% nominal deficit. Considering this result, and taking into account the expectation of a real drop in GDP and exchange rate adjustments in the public sector net debt, the debt/GDP ratio may rise from 36.0% at the end of 2008 to 38.7% of GDP in December 2009.

Brazilian foreign trade slowdown becomes more intense

Performance of basic products prevents exports from dropping further

Brazilian exports decreased by 23% in the first five months of the year in relation to the same period in 2008. The drop in the exported value resulted from reductions of 10% in prices and of 14% in exported volumes, according to Funcex calculations.

The performance of the exported volume could have been even worse were it not for the exports of basic products, which have grown even after the international crisis became more acute, in October 2008. The exported quantum of products falling under this category in the accumulated figure up to May grew by 5% as compared to the same period in 2008. The exported quantum of semi-manufactured products, and particularly of manufactured products, has been falling more and more, reflecting a lower foreign demand. On the same comparison, the exported volume of semi-manufactured products decreased by 14% and that of manufactured products dropped by 29%.

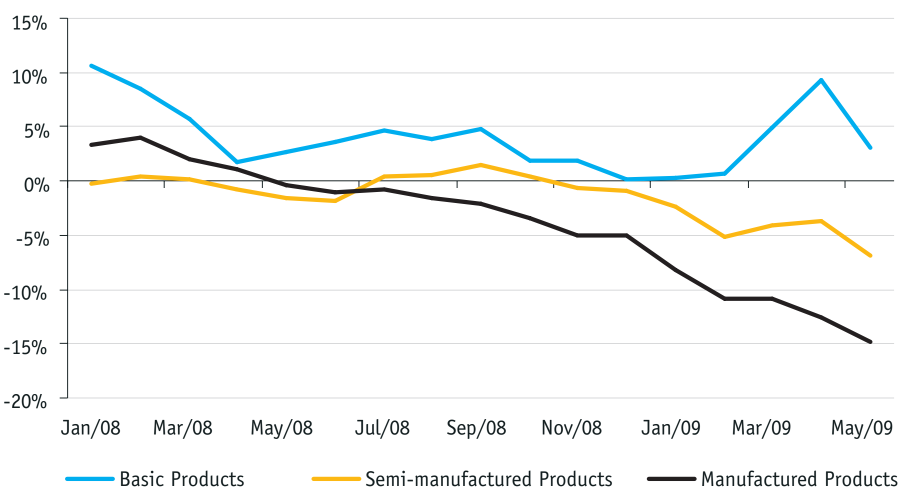
The prices of basic and semi-manufactured products dropped significantly since the international crisis broke out, annulling all gains registered in 2008. As a result, average export prices of basic products in the first five months of the year dropped by 11% as compared to the same period in 2008, while the decrease in the prices of semi-manufactured products hit the mark of 17%. The prices of manufactured products have dropped by 3%.

For the remainder of the year, the foreign market scenario is still unfavorable. There are signs of a high idleness in capacity utilization and of a slow recovery of manufacturing activity in the main developed economies.

***Quantum* of Brazilian exports**

Growth rate accumulated in 12 months in relation to the previous 12 months (in %)

Exported volume of basic products has not decreased with the slowdown in international trade



Source: Funcex

Despite modest signs of improvements in the American and Chinese economies, it will still take some time for international trade to recover. In addition, protectionism in several countries has become more intense. FMI estimates show that the value of international trade decreased by 30% between September 2008 and March 2009 and that the volume of exports may decline by more than 10% in 2009. This will be the first drop since 2001.

In addition to a negative scenario in foreign markets, the recent reappreciation of the real will discourage exports even more until the end of the year. We therefore expect to see a continued reduction in exported volumes. Export prices, on the other hand, have been falling at a slower pace, having dropped by only 1.3% between March and May. We expect prices to remain relatively stable, albeit at a lower level than the one registered in 2008. Therefore, we have revised our forecasts for the exported value in 2009 downward to US$ 151 billion, 23% less than in 2008.

Imported volume dropping sharply

Brazilian imports continue to decrease sharply, accumulating a drop of 27% up to May as compared to the same period in 2008. The drop in the value of imports has been mainly determined by a reduction in the imported volume. The imported volume dropped by 22% on the same comparison basis, while import prices decreased by 7%.

The drop observed in the imported volume has been mainly attributed to the performance of intermediate goods, which dropped by 32% in the accumulated figure up to May, in tune with the sharp drop registered in manufacturing activity. However, the imported volumes for all use categories have decreased.

The drop observed in the imported volume led us to revise the value of imports downward in 2009. It is now expected to hit the mark of US$ 130 billion, a decrease of almost 26%.

Greater net supply of foreign currencies led to a new appreciation of the real

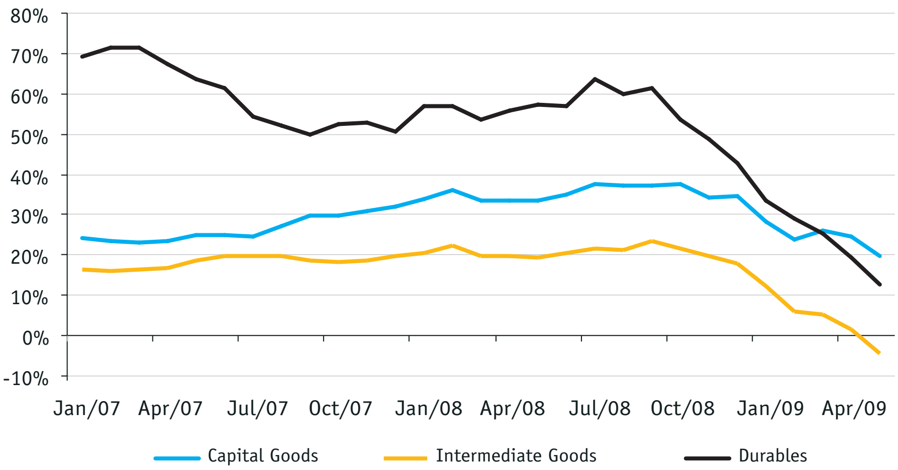
The second quarter of 2009 was marked by a significant inflow of foreign currencies to the country, leading to an appreciation of the real over the period. Since January, the real appreciated by 9% (as deflated by the IPA index) in relation to the 13 currencies of countries with which Brazil has closer trade relations. In May, there was a net inflow of US$ 3.1 billion to the Brazilian economy, the highest entry of money to the country since April 2008, when Brazil was awarded investment rating. June is expected to be the third consecutive month in which a net inflow of capital will be registered after successive net outflows since October of 2008 (excluding February), which totaled US$ 20.7 billion.

The inflow of foreign capital to the share market deserves special mention. May was the fourth consecutive month in which a positive balance of foreign capital was registered in the São Paulo Stock Exchange. A record balance of foreign operations, R$ 6.1 billion, was registered in that month. As a result, the balance in the year up to May amounted to R$ 11.2 billion, the highest one ever registered during this period. The trade surplus also played a significant role in attracting foreign currencies. The Brazilian trade balance accumulated a

***Quantum* of Brazilian imports**

Growth rate accumulated in 12 months in relation to the previous 12 months (in %)

Performance of intermediate goods follow sharp drop in manufacturing activity



Source: Funcex

surplus of US$ 9.3 billion up to May, a figure that is 9.3% higher than the one registered in the same period in 2008. The surplus accumulated in 12 months hit the mark of US$ 25.5 billion in May. The balance is expected to decrease along the year, but it will remain positive: with the new values anticipated for exports and imports, the surplus will be only 8% lower than the one registered in 2008, accumulating US$ 21 billion in 2009. It should also be stressed that demand for foreign currencies is also decreasing as a result of lower imports.

On the other hand, the reduction observed in the deficit in services and revenues represents a lower outflow of foreign currencies. The deficit decreased by 44% in the figure accumulated up to April 2009 as compared to the same period in 2008. Special mention should be made of a lower pace of remittances of profits and dividends, which dropped by 57.3% in the comparison between the first four months of 2009 and 2008.

Apart from domestic factors, there are additional stimuli for the real to appreciate in relation to the US dollar: the persistence of high trade deficits and the slowdown observed in the US economy have been pushing the US dollar down in the world. Therefore, we are projecting an exchange rate of about R$ /US$ 1.88 at the end of the year.

Current account gap will be lower in 2009

A higher trade surplus, combined with a sharp drop in the deficit of services and revenues, led current transactions in Brazil to register a surplus of US$ 146 million in April. This is the first positive current account balance since September 2007. With this result, the deficit accumulated in 12 months decreased from US$ 23 billion in March 2009 to US$ 19.8 billion in April. We expect the deficit to continue to decrease throughout 2009, as the trade surplus will drop only marginally, while the deficit in services and revenues is expected to continue on a more pronounced downward path. As a result, the current account gap is predicted to drop to about US$ 15 billion in 2009.

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prospects for the brazilian economy

	2007	2008	2009 projection	2009 previous projection Mar/2009
Economic activity				
GDP (annual variation)	5.7%	5.1%	**-0.4%**	0.0%
Industrial GDP (annual variation)	4.9%	4.3%	**-3.5%**	-2.8%
Household consumption (annual variation)	6.3%	5.4%	**0.7%**	-0.9%
Gross fixed capital formation (annual variation)	13.5%	13.8%	**-9.0%**	-4.4%
Unemployment Rate (annual average - % of the labor force)	9.3%	7.9%	**8.9%**	9.1%
Inflation				
Inflation (Broad Consumer Price Index - annual variation)	4.5%	5.9%	**4.2%**	4.2%
Interest rates				
Nominal interest rates				
(average rate in the year)	12.13%	12.45%	**10.15%**	10.20%
(year end)	11.25%	13.75%	**8.75%**	9.00%
Real interest rate (annual average and deflated rate: IPCA)	8.2%	6.4%	**5.0%**	5.2%
Public accounts*				
Nominal public deficit (% of GDP)	2.3	1.5	**2.3**	2.1
Public primary surplus (% of GDP)	4.0	4.1	**2.5**	2.7
Net public debt (% of GDP)	42.8	35.8	**38.7**	37.9
Exchange rate				
Exchange rate - R$/US$				
(average in December)	1.78	2.39	**1.88**	2.22
(average in the year)	1.95	1.83	**2.06**	2.30
Foreign trade sector				
Exports (US$ billion)	160.0	197.9	**151.5**	157.0
Imports (US$ billion)	120.0	173.2	**130.0**	139.0
Trade balance (US$ billion)	40.0	24.7	**21.5**	18.0
Current account balance (US$ billion)	4.5	-28.3	**-15.0**	-25.0

* Includes Petrobras

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