ECONOMIC REPORT

Newsletter of the National Confederation of Industry

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Stronger industry required for enhancing growth rate

The Brazilian economy is once again feeling the effects of a prolonged global crisis more clearly in the second half of the year. The fear that growth rates might decline more significantly has led to a shift in economic policy. Rising interest rate cycles and a restrained fiscal policy coexisted in the first half of the year. In the second half, spending is more significantly up and interest rates are declining, showing that concerns about growth have become dominant.

In fact, there has been a clear slowdown in the growth pace this year. In 2011, with a 3.4% increase, the GDP growth rate will be less than half that seen last year. In the three past years, it grew by an average of about 3.4%, compared to a 4.6% average in the 2005-2008 period.

Domestic demand has shown a better performance as household consumption holds. Worsening expectations, however, have affected investments more intensely: capital formation will grow by only 5.5% in 2011.

Part of this boost in domestic demand was still led by imported products, causing the foreign trade sector's net contribution to GDP growth to be negative once again (by 0.6 percentage points). Maintaining a positive trade balance will not result in higher production growth, as it is sustained mainly by high commodity prices.

Loss of competitiveness, which is not exclusively related to the strong exchange rate appreciation experienced during much of the year, has affected manufactured products in a more pronounced fashion. Industrial companies are facing weak global demand, owing to stagnation in developed countries, and difficulties to compete with imported products in the Brazilian market. This situation is expressed in a mere 1.2% expected GDP growth in manufacturing.

This performance puts us further away from the group of emerging countries. IMF estimates show that these economies are likely to grow by 6.4% in 2011. Unlike Brazil, manufacturing is the main engine of growth in these countries.

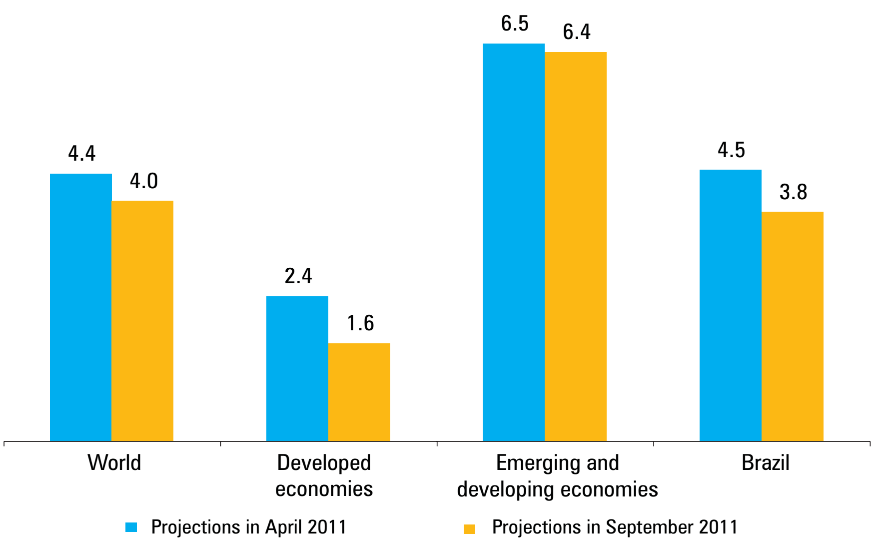
For Brazil to get back on a path of rapid growth, manufacturing needs to make a more meaningful contribution. It is crucial to maintain a more competitive exchange rate level, otherwise industry will find fewer and fewer markets for its products. Yet it is essential to act urgently to address the determinants of competitive conditions and reduce production costs in Brazil. The measures provided for in the Greater Brazil Plan (Plano Brasil Maior) were not enough to cope with challenges such as a rising tax load, greater capital costs, higher input costs – e.g. electricity – and increasing salary costs.

Brazilian economy in the third quarter of 2011

GDP growth forecast for 2011

Percentage variation (%)

IMF believes Brazil will grow below the world average



Source: FMI

economy activity

Economy will grow less

Higher GDP growth requires upturn in industry

CNI revised its GDP growth estimate for 2011 downward from 3.8% to 3.4%. In consonance with the global economic slowdown and the resulting lower growth in investments, Brazil's GDP will grow less in 2011.

One can see a difference between the Brazilian economy and other industrialized economies. The Brazilian economic growth has surpassed that of developed countries due to the influence of a higher domestic demand. Household consumption is still on the rise as the unemployment rate remains at historically low levels, income rises and credit conditions improve. On the other hand, difficulties remain to recover foreign demand, as a result of high unemployment rates and, consequently, low consumer confidence.

Industry continues to be the most affected economic sector. Industrial GDP posted a negligible 0.2% growth in the second quarter of 2011 in relation to the previous quarter, according to IBGE's National Accounts methodology. In the first two months of the third quarter, manufacturing production showed no recovery: it grew by 0.3% in July and dropped by 0.2% in August as compared to the respective previous months (PIM-PF/IBGE).

An upward trend in real manufacturing revenues (CNI Industrial Indicators) was clearer than the one observed in production. In the first two months of the third quarter, revenues experienced growth as compared to the month before. This difference in the behavior of the two variables may be explained by two hypotheses.

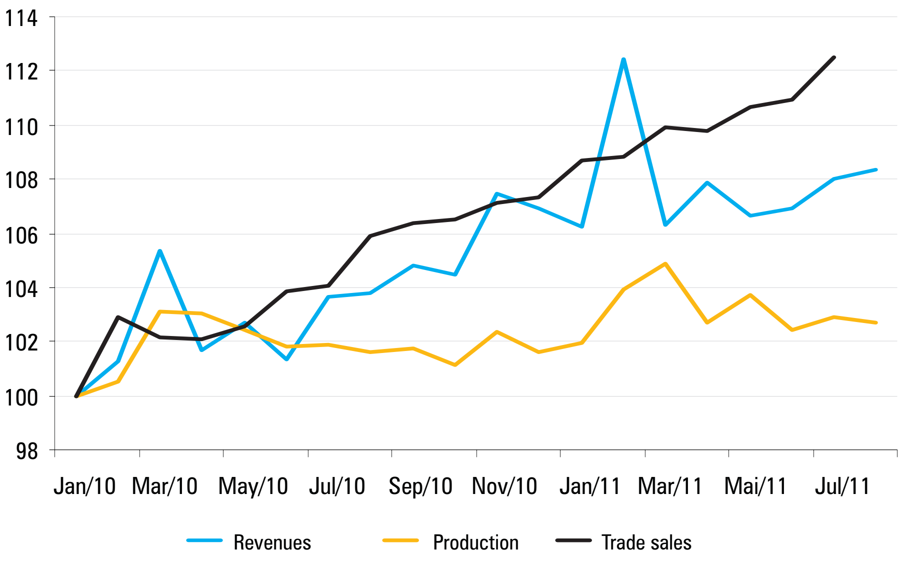
First, as industrial product stocks have been above planned levels since the beginning of 2011 (CNI Industrial Survey - Manufacturing and Mining), industry is expected to sell all undesired stocks before producing again.

Second, there is evidence of a greater proportion of imported inputs in the Brazilian industry's production process. As a result, many inputs that were previously acquired in the Brazilian industry are now being purchased abroad, due to the decrease in prices brought about by the appreciation of the Brazilian currency. For this reason, Brazilian companies that lost competitiveness to foreign companies are no longer selling their products and are losing market share.

Evolution of real revenues, manufacturing production and retail trade sales

Jan/10 index = 100 - seasonally adjusted

Trade sales growing more rapidly than industrial sales



Source: CNI and IBGE

Industrial GDP to grow by 2.2% in 2011

Manufacturing companies are facing difficulties to attract demand. On the one hand, foreign demand remains weak and shows no signs of recovery in the medium run; on the other, while domestic demand is increasing at a rate higher than GDP growth, this trend is largely driven by imports. As a result of the exchange rate appreciation, imported products are relatively cheaper than locally produced ones, both for consumption and investment.

There are also clear signs that the construction industry has been losing momentum. The actual-usual activity indicator for the construction industry (CNI Construction Industry Survey) has been around 50 points since 2011, which indicates stability. This indicator decreased to 48.8 points in August, meaning that activity remained below usual levels for the month. With regard to expectations, the Construction Industry Survey shows optimism has fallen.

Mining and quarrying grew by 0.9% between August 2010 and 2011 (PIM-PF/IBGE). This sector has benefited from rising global consumption of mineral commodities. The high demand for these products brings about a positive impact on exports of mining and quarrying products.

For this reason, taking into account the four industrial segments, CNI revised its growth projection for the sector in 2011 downward from 3.2% to 2.2%. This lower growth resulted mainly from a lower increase in manufacturing industry.

Trade has risen at a rate higher than GDP growth for the last four quarters on a quarter-on-quarter basis. The services sector, which has not been affected by the effects of international competition, tends to follow more closely the evolution of national consumers' income and credit.

Investments to grow less in 2011

The outlook for investments is ambiguous. While, on the one hand, GDP will grow at a slower pace in 2011, on the other the beginning of a downward trend in interest rates is likely to stimulate investments. These, however, will probably grow in a more moderate fashion in 2011.

Production of capital goods (PIM-PF/IBGE) rose by 5.6% in the first eight months of 2011 in relation to the same period a year earlier. Investments, a demand component measured by the gross fixed capital formation (IBGE), increased at a 1.2% rate in the second quarter as compared to the previous quarter. This growth rate is expected to gather speed over the following quarters, amounting to 5.5% in 2011.

Foreign trade to reduce GDP growth by 0.6 percentage points in 2011

CNI also revised its estimates of foreign demand on account of the deterioration in the global scenario. Exports (National Accounts concept) are expected to post growth of 6% in 2011, less than the 10% figure that had been previously estimated. Imports have been revised as well, owing to a lower investment growth, and will likely grow by 10.5%.

As a result, the contribution of net exports to GDP growth in 2011 is estimated at -0.6 percentage points.

Difficulties in the global economy will result in a slower recovery in the Brazilian GDP

The downward trend in GDP will probably be reversed in early 2012. There may be an increase in both consumption and investments should interest rates continue to grow.

However, uncertainties in the global economic scenario are far coming to an end and are expected to linger for some years to come. The impact on the Brazilian economy will be defined by the intensity of these problems and by how they will be addressed.

CNI's GDP growth estimate
Percentage variation and components' contribution to GDP growth

		2011	
	GDP components	Growth rate (%)	Contribution (p.p.)
Demand side	Household consumption	4.5	2.7
	Government consumption	3.0	0.6
	Gross formation of fixed capital	5.5	1.0
	Exports	6.0	0.7
	(-) imports	10.5	-1.3
Supply side	Agriculture/livestock	4.3	0.2
	Industry	2.2	0.6
	Mining and quarrying	2.5	0.1
	Manufacturing	1.2	0.2
	Construction	3.6	0.2
	Public administration. health. and public education	4.0	0.1
	Services	3.8	2.6
	GDP	**3.4**	

employment and income

Less jobs are being created

Jobs created are of higher quality

The moderation in economic activity has reflected in a slowdown in the labor market. The sharp employment growth rates registered in 2010 have not been seen this year.

Job creation has been slowing down since June 2010, when a 3.5% year-on-year increase (PME/IBGE) was observed in six major Brazilian metropolitan areas.

In August 2011, metropolitan jobs rose by 2.2% in comparison with the same month the year before.

Formal jobs, however, continue to increase their share in the labor market. In the private sector, formal employment rose by 7.5% in August on the same comparison basis, a much higher variation than the average for all other occupations. The guarantees provided by formal jobs make people feel safe to maintain their consumption pattern.

An interesting aspect of the economic activity slowdown is that informal occupations are the ones that are losing ground in the labor market. Informal employment in the private sector fell by 8.3% between August 2010 and 2011. Self-employment also experienced a decrease in August on the same basis of comparison.

Therefore, the metropolitan market formality index – which is calculated by summing up all formal, military and statutory jobs by all occupations – has been on the rise. This indicator hit the mark of 60.7% in August, representing the largest share of formal workers in total metropolitan employment since the beginning of the series, in March 2002.

According to data of the General Registry of Employed and Unemployed Persons (CAGED) – a nationwide registry of the Ministry of Labor and Employment (MTE) – collected up to August 2011, 1.6 million formal jobs were created in the 12-month accumulated figure. The job creation pace has declined since March this year. The Services sector was the one in which more jobs were created, with 46.3% of all jobs generated in the last twelve-month period ending in August.

This fact is justified by higher activity levels in the service industry, which depends directly on household income and credit growth. This GDP component is therefore expected to rise above the rate of GDP growth in 2011.

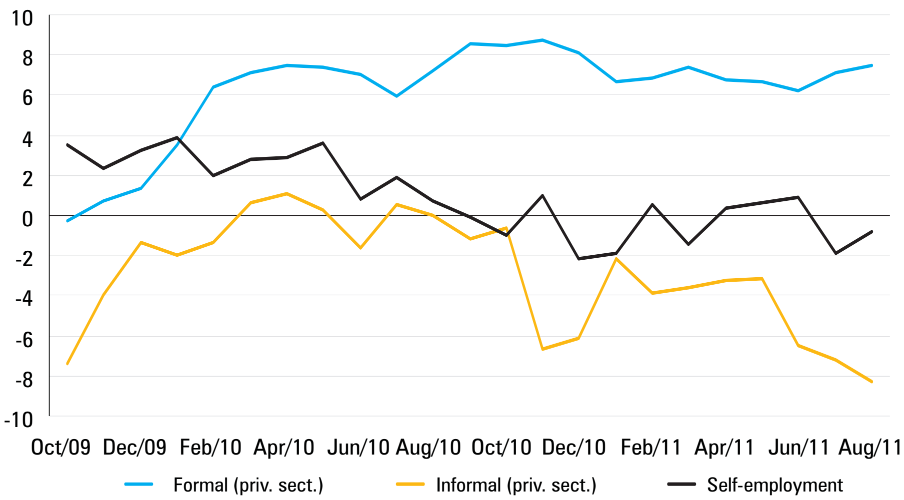
Industry, the sector which suffered the effects of the current domestic and international economic scenario the most, created 29.1% of all formal jobs in Brazil. Although trade sales have increased more than industrial sales, the trade sector accounted for 19.4% of all new jobs created.

The 7.0% year-on-year decline in August in the number of uneducated people with up to three years of education and who hold a job is a noteworthy fact. Brazil is far behind the rest of the world when it comes to providing quality basic education. As a result, low-skilled individuals are the ones having the hardest time to enter the labor market. The number of employed people with 11

Employment by occupation categories

Percentage variation in relation to the same month last year

Positive momentum in the labor market is attributed solely to formal employment



Source: IBGE

years of education is up by 5.1% over the same period.

Unemployment rate to average 5.9% in 2011

The positive aspect of the current situation in the labor market is that the unemployment rate remains at historically low levels, which translates into a lower number of unemployed people. The lower number of people looking for work, i.e. the labor force (PEA), has relieved pressure on the unemployment rate, as jobs are being created at a faster pace than the labor force. In August, the labor force increased by only 1.4% as compared to the same month last year.

Averages wages continue to increase as companies look for more skilled professionals in keeping with the more pronounced increase in formal employment. Usually earned real income has been growing steadily, which, coupled with increased credit availability, allows for household consumption to remain at the same levels, a key aspect to ensure economic growth in Brazil.

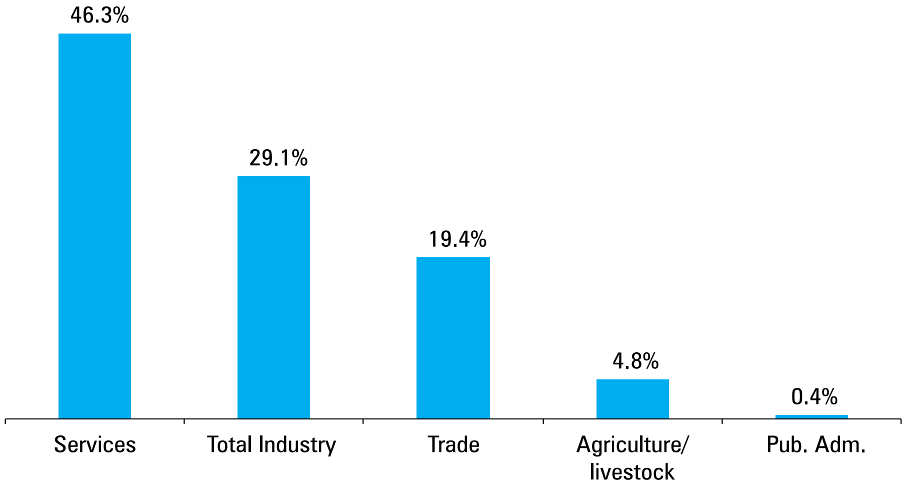
Average income to keep growing

In August, average real income rose by 3.2% over the same month in the previous year. Albeit lower, this growth rate remains on a steady path and shows no signs of reversal. In this regard, domestic demand will continue to sustain economic growth in Brazil.

Share in the total number of jobs created in the 12-month period up to August 2011

In %

Services sector, less impacted by the current economic scenario, creates more jobs

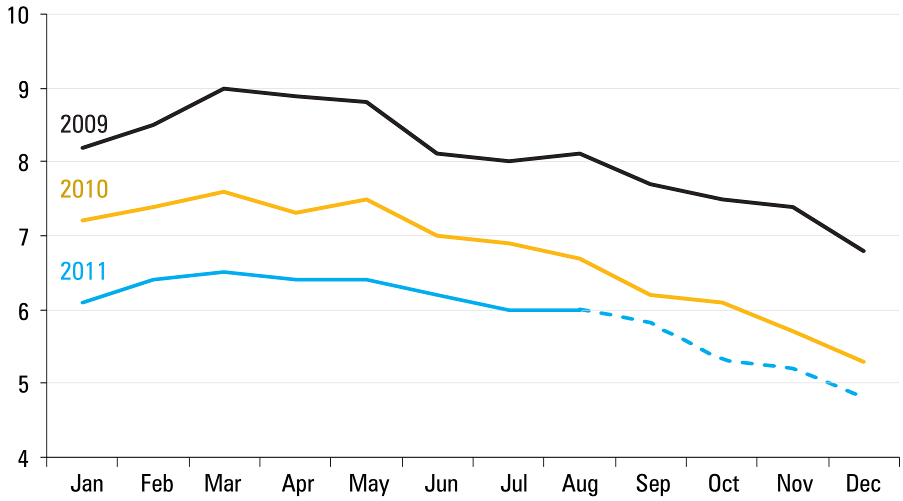


Source: CAGED/MTE

Unemployment rate

In % of the labor force (PEA)

Unemployment rate drops steadily as jobs continue to grow more than the labor force



Source: IBGE. Estimates CNI

Inflation, credit, and interest rates

Inflation target is not guaranteed for 2011

Slowdown in food prices may not be sufficient for the target to be achieved

The Extended Consumer Price Index (IPCA) has been on the rise in recent months. Since August 2010, when the index was still on the central inflation target (4.5% per year), the annualized rate has grown by 2.8 percentage points. In September, the 12-month accumulated IPCA hit the mark of 7.31%, the highest level since 2005.

While the IPCA experienced close-to-zero rates in June, July and August 2010, the index rose by 0.15%, 0.16% and 0.37% in the same months of 2011, respectively. The growth rate observed in September was also higher on a year-over-year basis (0.53%, against 0.45% in 2010), which explains the strong uptrend seen in recent months.

This movement resulted from a hike in food, service and industrial product prices. The steady growth rate of regulated prices is a result of adjustments made early this year.

Service prices have accelerated steadily since early 2010. This group accumulated a 9% growth in the last twelve-month period ending in September. Accounting for 25% of the IPCA, this figure raises concern over whether or not the inflation target will be achieved. There are minimal prospects of a reversal in this scenario in coming months – and especially in 2012 – due to the indexation of the economy (mainly to the General Market Price Index (IGP-M), which remained high in 2010) and the strong increase in the minimum wage.

Industrial prices have also experienced an upward trend in recent months, but this group is still the one with the least influence on current inflation levels. The twelve-month cumulative figure for this group amounted to 4.5% in September. By the end of 2011, there will be no risk of a mismatch between domestic supply and demand (industrial installed capacity has held relatively steady since 2010 and remained below usual levels over 2011). However, the change in the exchange rate level may influence the behavior of this group.

Food prices accelerated again in the third quarter. The 12-month cumulative index for this group, which stood at 7.8% in April, is close to 10% in September. The end of 2010 was marked by a sharp rise in this group, which even experienced an increase of 2%, an unlikely scenario for 2011. This movement will probably lead to a decrease in the cumulative figure for the food group, as in September.

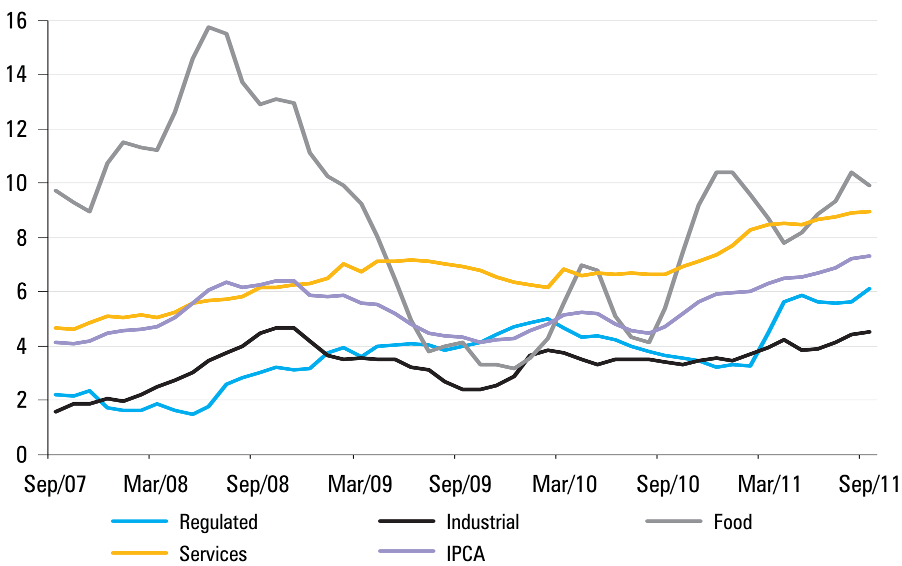
Food prices are expected to rise by the end of the year as a result of year-end celebrations and payments of the 13th salary, but the average figure was exceeded in 2010. That is not the case in 2011. The labor market remains on the rise, which may still result in price hikes in this group. As the crisis enters a new phase, however, the global economic slowdown is already pushing international commodity prices down, thus stimulating a decline in domestic prices.

These combined factors will likely cause the IPCA to slow down by the end of the year. This slowdown, however, will result more from a less marked increase in food prices in 2011 than from a general downtrend in the index's components. The reduction in the basic interest rate (Selic) in August tends to make this downturn less severe than previously anticipated.

IPCA by groups

12-month accumulated figure (%)

Food prices already slowing down



Source: IBGE Elaboration: CNI

Under this scenario, CNI estimates inflation in 2011 at 6.5% per year, which would keep it within the upper target limit. However, any specific and unforeseen increase may prevent this target from being achieved. This situation also gives a clear indication of the challenge that will be faced in 2012: high inflation rates, with expected adjustments in the 2011 indices and an increase in the minimum wage of about 14%.

Changes in how monetary policy is conducted reduces the *Selic* rate

The Monetary Policy Committee (Copom) meeting in August 2011 showed a change in how monetary policy is conducted. Until the July meeting, the decision had been to raise the basic interest rate. Although domestic inflation is still on the rise, a worsening of the international scenario was seen in the 45-day interval between the two meetings.

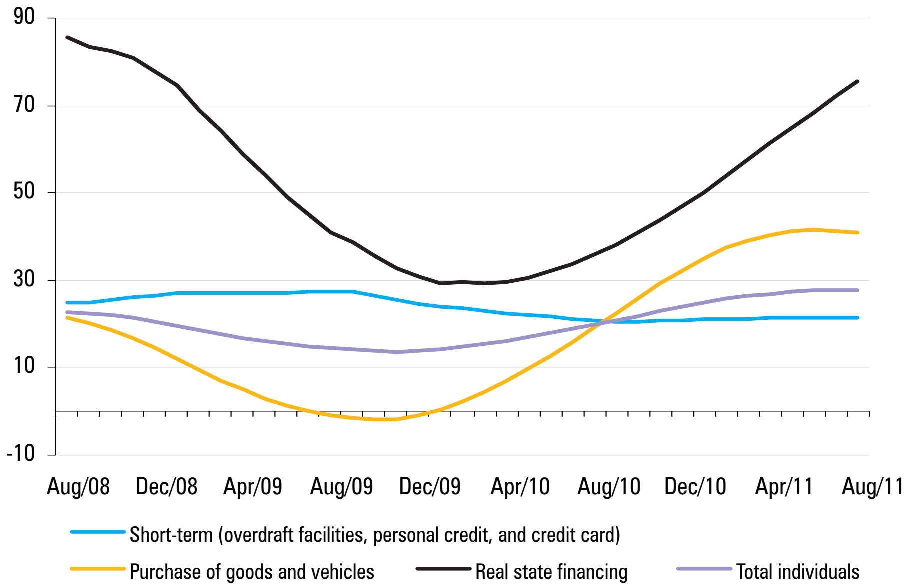
The Copom decided to anticipate predictable negative effects on the Brazilian economy brought about by this new stage of the crisis and to reduce the Selic rate. This decision has two implications: Government has no intention of giving up economic growth, and inflation tends to be controlled by means of other instruments, such as a less expansionary fiscal policy and macroprudential measures.

Even if the inflation rate continues to slow down until the end of 2011, achieving the central target in 2012 will be no easy task. The recent change in the monetary policy reinforces the need to implement other complementary policies. CNI believes that the Selic rate will experience two further reductions in 2011, hitting the mark of 11.00% per year, which would increase the year's average interest rate to 4.8% per year.

Balance of loans to individuals

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

Real estate lending on the rise



Source: Central Bank of Brazil - Elaboration: CNI

Slowdown in loans to individuals

The granting of credit with non-earmarked (no specific destination) resources has slowed down in recent months. According to Central Bank data, lending to individuals in the twelve-month period up to January were 22.1% above the same figure registered in the 12 previous months. In August, this indicator dropped to 15.9%.

Based on the same calculation, loans to corporations in the twelve-month period up to February remained 9.7% higher than in the 12 previous months. There was a slowdown in lending in the months that followed, but a much less intense one, causing it to fall to 9.1% in August.

The evolution of lending to individuals is different between non-earmarked and earmarked resources (housing finance). When breaking down the credit balance into categories, it can be seen that real estate financing keeps growing strongly and that the slowdown is limited to loans for purchasing goods and vehicles. Two reasons are behind this lower lending rate: containment measures adopted over the year, particularly an increase in the Tax on Financial Operations (IOF), and a higher rate of late payments. Delays of more than 90 days in loans to individuals, which totaled 5.7% in December 2010, hit the mark of 6.7% in August.

There are two controversial signs on loans to individuals for the next few months. Weighing in favor of increased lending, the reduction in the Selic rate could lead to a greater availability of credit. But the factor weighing against it is that, if the Brazilian economy is contaminated by the worsening global economic scenario, there could be a drop in demand for credit as a result of increased risk aversion.

Moreover, according to the Brazilian Central Bank, both household spending and debt are at their highest level since 2005. Credit is therefore likely to continue to slow down, but not as strongly as in recent months.

fiscal policy

Spending on the rise and above GDP growth rate

Fiscal policy at the federal level has change

Unlike the scenario that prevailed until the end of the first half of 2011, fiscal policy is no longer contributing toward reducing the demand growth rate and, therefore, economic activity. This reversal is explained by an increase in Federal Government's spending, which is now rising at a much higher rate than that of GDP growth.

By August 2011, Federal Government expenditures had increased by 3.8% in real terms over the same period in 2010, against the Central Bank's estimate of a 3.5% real economic growth until July. Until May, federal spending had increased by 2.7%.

Spending in states and municipalities has grown at a slower pace – by 7.1% in the first seven months of 2011 as compared to the same period in 2010 –, yet it continues to rise above the GDP growth rate.

Extraordinary revenue growth

By August, federal revenues had a net increase of 11.5% in relation to the same period last year. This result was driven by extraordinary revenues of almost R$ 15 billion: R$ 5.8 billion in collections of overdue debt relating to the Social Contribution on Net Income (CSLL) and almost $ 9.0 billion on account of overdue tax payments from taxpayers who joined the Refis da Crise (Crise Reffils) program, which allows them to settle their debts in special installments without fines for delayed payment.

In states and municipalities, revenues kept growing at the same pace. On a year-on-year basis, regional revenues are up by 8.9%. Until May, state and local revenue was rising at a rate of 8.7%.

For this reason, despite the fact that Federal Government spending is more significantly up and that expenditures in states and municipalities remained at a high level, the behavior of revenues led to a very positive primary result.

The Federal Government's primary result, which was 2.6% of GDP in the last twelve-month period up to May, increased to 3.0% by August 2011. For states and municipalities, the primary result, which was 0.7% of GDP in the 12-month cumulative figure up to May, grew to 0.8% until August 2011. Consequently, the primary result for the consolidated public sector rose from 3.3% in May 2011 to 3.8% of GDP in the last twelve-month period ending in August 2011.

This new fiscal scenario also resulted in a decline in nominal deficit (from 2.4% to 2.1% of GDP) and a reduction in the net debt/GDP ratio, which fell from 39.8% in May to 39.2% of GDP in August 2011

Real growth in Federal Government's spending and in GDP

Real growth rate (%)

Federal Government's spending is 0.3 p.p. above GDP

Source: National Treasury, IBGE and Central Bank of Brazil
*: IPCA-deflated spending accumulated in Jan-Ago/11
GDP: Central Bank ICB/BR Jan-Jul/11

Increased revenues allow public sector to achieve fiscal target

Federal Government's spending is not expected to grow at increasing rates in coming months. The increase in mandatory spending observed in the third quarter is not likely to repeat in the fourth one either. Furthermore, despite an unexpected growth in revenues, non-mandatory spending limits have been maintained due to the R$ 10.0 billion increase in the primary surplus target. We therefore estimate a real growth of 3.8% in federal expenditures in 2011 as compared to the same period in 2010.

With regard to the Federal Government's net revenue, extra revenues collected between June and August raised the forecasted real growth to 8.8% in 2011.

As a result, the Federal Government's primary surplus is estimated to hit the mark of R$ 87.0 billion in 2011. Federal state-owned enterprises, in turn, will likely register a stable primary result. The primary surplus at the federal level is thus expected to remain unchanged at R$ 87.0 billion, compared with a stretch target of $ 91.8 billion. It is worth highlighting, however, that this expected surplus will probably be higher than the full target – i.e. without deducting costs related to the Growth Acceleration Program (PAC) –, which was initially set at R$ 81.8 billion.

As in the Federal Government, revenue growth in states and municipalities is expected to allow for the primary surplus target of R$ 36.1 billion to be achieved For this reason, the primary surplus for the consolidated public sector in 2011 is projected at US$ 123.1 billion (3.0% of GDP as predicted by CNI), above the initially proposed full target of R$ 117.9 billion.

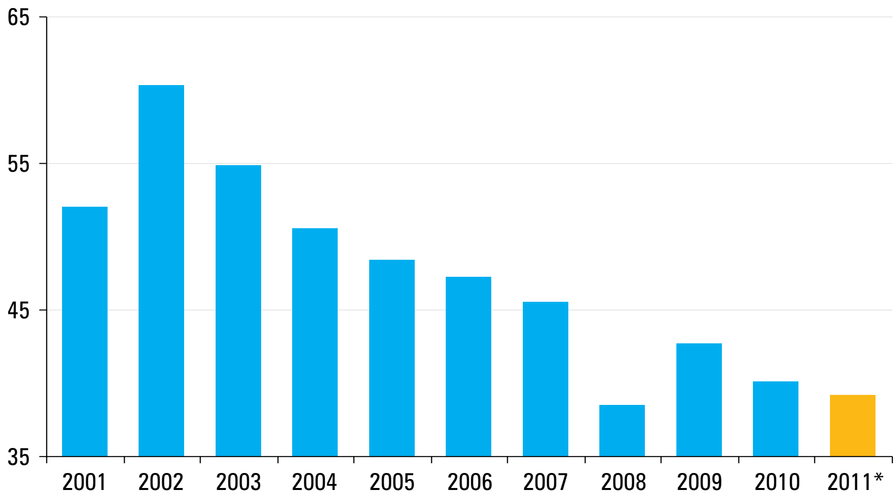
This projected figure for primary surplus in 2011 represents growth as compared to the level observed in 2010 (2.8% of GDP). However, the increase in interest expenses (from 5.3% to 5.9% of GDP) will lead to a rise in the nominal deficit – from 2.55% in 2010 to 2.9% of GDP in 2011.

Notwithstanding an increase in the nominal deficit, the net debt/GDP ratio is

Evolution of Public Sector Net Debt

Percentage of GDP

Public debt to GDP ratio to fall by 1 percentage point in 2011



Source: Central Bank of Brazil
*Projection for 2011: CNI

expected to continue on the downward trend observed since 2010. A high nominal GDP growth, driven by rising inflation, will be responsible for causing it to drop from 40.2% in late 2010 to 39.2% in December 2011.

Government to adopt expansionary fiscal policy in 2012

The Annual Budget Bill (PLOA) for 2012 indicates that government will once again implement a strongly expansionary fiscal policy. Expected primary spending is likely to grow by 14.5% in relation to the expected figure for 2011.

If we consider the 2012 inflation forecast indicated in the Central Bank Focus Newsletter, expenses will probably grow by 8.5% in real terms, compared to an expected real GDP growth of 3.7%.

A significant share of the expected growth in expenditures is explained by higher minimum wage-related costs. However, the increase in the minimum wage provided for in the PLOA (13.6%) is underestimated, as the 2011 inflation figure used in the calculation was 5.7% and it will likely close the year at about 6.5%.

The expectation indicated by the PLOA is that investments will grow again in 2012. The amount budgeted is R$ 58.5 billion, representing a real increase of 24.9% over the amount available in 2011.

As regards revenue, the PLOA estimated a real growth of 3.9% in relation to the 2011 figure. Albeit close to the 2012 GDP growth rate predicted by the Focus Bulletin, this revenue growth is significant, given the large volume of extraordinary revenues obtained in 2011.

Finally, the full primary surplus target was set at R$ 139.8 billion. If this target is achieved, the primary result would amount to 3.1% of GDP.

Foreign trade sector and exchange rate

Sudden shift in the exchange rate scenario

Exchange rate volatility on the rise but not trending

In September, the Real/Dollar exchange rate depreciated by an astounding 19% and closed the month with a devaluation of 16%, the fifth highest figure since the beginning of the Real Plan. The exchange rate, which fluctuated below R$1.60/ US$ at the end of July, ended September at US$1.85/US$, close to the level observed in June 2010. In October, the Brazilian currency appreciated even further (by 6% in the first five days of the month).

The worsening international environment is certainly one of the factors behind this behavior. Over this period, there were increased fears of more serious fiscal problems in Europe and their potential consequences on the banking system, besides the perception that the difficulties facing the U.S. economy are more likely to linger. This scenario has led to high risk aversion, negatively affecting the currencies of emerging countries (considered to be higher-risk assets).

There is an additional factor in the Brazilian case. The 50-point drop in the Selic rate, a decision made at the last Copom meeting held in late August, signaled a change in the Brazilian monetary policy. The decision has led to the perception that the rate will be further reduced in future meetings. The interest rate differential was a major factor stimulating the inflow of foreign currencies and, hence, the appreciation of the Brazilian currency. This new approach to managing the monetary policy, which points to lower interest rates, has placed a greater emphasis on economic growth.

Real/Dollar exchange rate evolution

PTAX closing exchange rates (R$ / US$)

Sharp depreciation in September

Source: Central Bank of Brazil

Under this new scenario, it is not known for sure what would be the new equilibrium exchange rate. It seems clear that the moderate economic activity growth in Europe and the U.S. will linger on for some time. Brazil's GDP growth rate is expected to surpass that of developed economies, which would, in theory, cause the current account deficit to decline further and, consequently, the Brazilian currency to depreciate.

However, we are not expecting to see a rapid and intense worsening of the international economic scenario, as in 2008. For this reason, the inflow of foreign direct investment (FDI) into Brazil will remain high and capable of sustaining the increasing deficit. We are not expecting to witness a slump in commodity prices either, as supply restrictions prevent these prices from declining further.

On these grounds, it is unlikely that the dollar will continue to depreciate in the medium term. Should these hypotheses prove true, we estimate that the real/dollar exchange rate will appreciate again and stand at around R$ 1.75/US$ by the end of the year. Still, the volatility in the exchange rate is expected to remain until more permanent improvements are made to the global economy, especially in Europe.

Prices remain high and sustain exports

The Brazilian trade balance kept growing at an accelerated pace over the third quarter. By September, the accumulated balance had amounted to US$ 23 billion, up by 81% in relation to the same period in 2010.

This increased balance results from a consistent and sharp rise in exports, surpassing the growth rate of imports. Brazilian exports added up to US$ 190 billion in September, a figure 31% above the one registered in the same period in 2010. Imports, in turn, totaled U.S. $ 167 billion, up by 26% on the same comparison basis.

The marked increase in the trade balance in the comparison between the first three quarters of 2010 and 2011 is driven exclusively by commodities and semi-manufactured products. While the trade balance in commodities and semi-manufactured goods has increased by 43% and 33%, respectively, the deficit in manufactured products has registered growth of 30%.

The increase in export values is determined by export prices, especially in the case of basic goods. Export prices are significantly on the rise: 40.5% for basic products, 22.1% for semi-manufactured goods, and 12.3% for manufactured products.

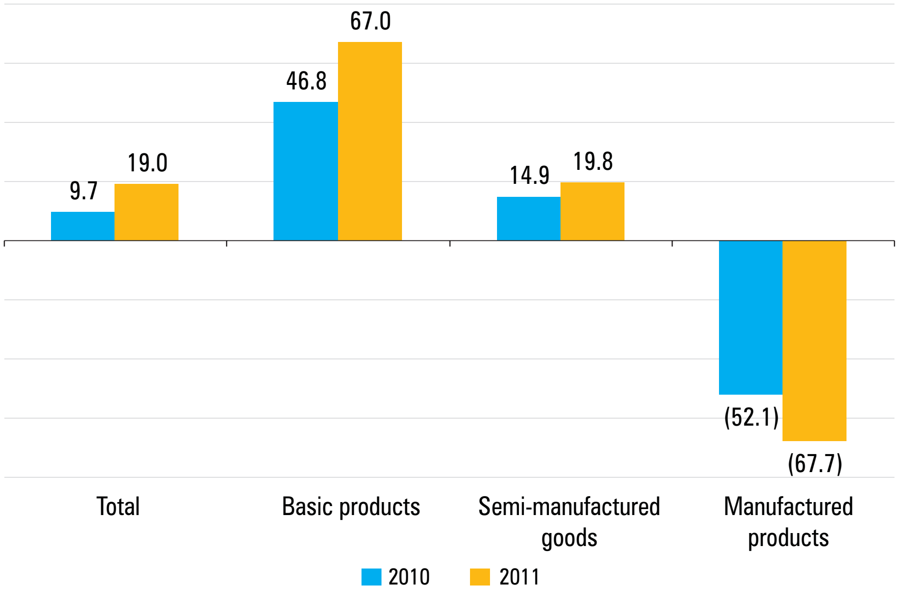
Imports are behaving as in the beginning of the year. They have increased is a result of price gains (11% in the 12-month period ending in August) and higher volumes (17%). Import volumes of consumer (durable and nondurable) and capital goods are strongly on the rise. Imports of intermediate products and fuels are growing at a slower pace, owing to a lower industrial production.

Despite signs of worsening in the foreign market, particularly among developed countries, exports will keep growing – export prices continue to sustain this increase. Notwithstanding a lower growth, exports are expected to increase by almost 30% by the end of the year, totaling US$ 260 billion.

Imports, in turn, are projected to keep growing at the rate observed since the beginning of the year: driven by price increases, particularly fuel prices, and by higher volumes of consumer goods. CNI maintains its forecast that imports will hit

Trade balance by product class (January-September)
In US$ billion

Trade surplus is up mainly on account of basic products



Source: Funcex

the mark of US$ 230 billion in 2011. As a result, we expect trade balance to stand at US$ 30 billion in 2011.

Foreign direct investments continue to financing current account deficit

The current account balance accumulated a U$ 49.7 billion deficit in the last twelve-month period ending in August, equivalent to 2.13% of GDP. This deficit is exactly the same as that accumulated in the second quarter. While the trade balance accelerated its growth in the third quarter, the deficit in services and income kept growing during the same period.

Services and income deficit rose by 24% in the comparison between the first eight months of 2010 and 2011. This higher current account deficit is being financed by foreign direct investments, which remain on the rise. In the last 12-month period ending in August, the cumulative FDI amounted to US$ 75.3 billion, compared to US$ 27.2 billion accumulated in the 12 previous months – a growth of 177%.

The deficit in services and income is expected to keep trending upward. Even though the Brazilian currency has depreciated, the appreciated exchange rate and a high household consumption will probably allow it to continue to expand. There is also a gap between setting a new exchange rate level and its consequences for the evolution of current transactions.

The current account deficit is estimated to grow at a slower pace, also on account of the trade balance. As a result, the deficit will likely hit the mark of US$ 53 billion at the end of 2011.

prospects for the Brazilian economy

	2009	2010	2011 *previous projection July/11*	2011 *projection*
Economic activity				
GDP (annual variation)	-0.6%	7.5%	3.8%	**3.4%**
industrial GDP (annual variation)	-6.4%	10.1%	3.2%	**2.2%**
Household consumption (annual variation)	4.2%	7.0%	4.5%	**4.5%**
Gross fixed capital formation (annual variation)	-10.3%	21.8%	8.5%	**5.5%**
unemployment Rate (annual average - % of the labor force)	7.9%	6.7%	5.9%	**5.9%**
Inflation				
Inflation (IPCA - annual variation)	4.3%	5.9%	6.0%	**6.5%**
Interest rates				
Nominal interest rates				
(average rate in the year)	10.13%	9.90%	12.07%	**11.76%**
(year end)	8.75%	10.75%	12.50%	**11.00%**
Real interest rate (annual average and deflated rate: IPCA)	5.0%	4.6%	5.2%	**4.8%**
Public accounts*				
Nominal public deficit (% of GDP)	3.34%	2.55%	3.20%	**2.9%**
Public primary surplus (% of GDP)	2.03%	2.80%	2.70%	**3.0%**
Net public debt (% of GDP)	42.8%	40.2%	39.5%	**39.2%**
Exchange rate				
Nominal exchange rate - R$/US$				
(average in December)	1.75	1.69	1.56	**1.75**
(average in the year)	1.99	1.76	1.59	**1.66**
Foreign trade sector				
Exports (US$ billion)	153.0	201.9	250.0	**260.0**
imports (US$ billion)	127.6	181.6	230.0	**230.0**
Trade balance (US$ billion)	25.4	20.3	20.0	**30.0**
Current account balance (US$ billion)	-24.3	-47.5	-61.0	**-53.0**

* Excludes Petrobras and Eletrobras Group's companies

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