A Newsletter from Brazilian Confederation of Industry

CNI

Economic Report

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Better scenario in 2007 may not benefit all industries

Clear improvements have been registered in the Brazilian economy in this first quarter of 2007. Domestic demand has been growing at a pace similar to the one observed in 2004, inflation is still below the target set by the Monetary Policy Council (Copom), and markets operate without major turbulences. However, this better economic situation is not being felt in the production sector at large. In the industrial sector, for example, production and job growth is concentrated in a small number of industries – particularly in the Food and beverages, Ethanol, Machinery and equipment, Metallurgy, and IT Equipment industries.

Among the reasons which explain the heterogeneous sectoral performance of the manufacturing activity, foreign demand – mainly focused on basic products – and the exchange rate stand out. The significant appreciation of the real has been restricting growth in exports and stimulating the replacement of domestic products with imported ones. This effect of the appreciated exchange rate can be more clearly perceived in labor-intensive industries which compete in internationalized markets.

The appreciation of the Brazilian currency has been mostly determined by two factors: a) a strong trade surplus, as a result of the Brazilian success in exports this decade; and b) a significant difference between interest rates in Brazil and abroad – today, the Selic rate stands at 12.5% a year, while basic interest rates in the US, for example, amount to 5.25% a year.

Although basic interest rates are falling, the stimulus to arbitration with the Brazilian currency in the international market remains strong. This is so because the Selic rate has been dropping less intensely than the combined effect of a lower inflation and a lower country risk. A situation marked by high financial profitability (high interest rates and appreciated real) and low risk (low exchange rate volatility and lower country risk) continues to prevail in Brazil.

The most striking economic fact early this year was the realization that the growth pace over the past four years was actually a little higher than the figures suggested – as a result of a revision of the procedures adopted by IBGE (Brazilian Institute for Geography and Statistics) for calculating GDP, which led to the adoption of a more appropriate methodology and more accurate information. However, the new figures don't change the previous diagnosis of low economic growth in Brazil, particularly as compared to the growth rates registered in other emerging economies. Our performance is still affected by the country's low saving capacity – and resulting low investment rates – and by a continued increase in public spending.

In 2007, GDP is expected to grow by 4.2% mainly as a result of domestic demand, which is anticipated to grow by 5.8%. This higher domestic demand will be largely met by stepped up imports. As a result, the net contribution of the foreign trade sector to GDP growth will be negative. It should also be mentioned that, as opposed to 2000 and 2004 – years marked by strong economic growth –, the industry, particularly the manufacturing industry, will not lead this growth. It will actually grow less than the GDP.

Growth in the manufacturing activity is concentrated

Production in the manufacturing industry grew by 3.6% in the first two months of 2007 in relation to the same period in 2006. The real revenue of industrial corporations increased by 4.9% in the same comparison. This growth in the manufacturing activity was caused by a higher domestic demand. In the last quarter of 2006, family consumption grew at a pace of 5.0% a year. Retail sales increased by 8.9% in the first two months of 2007 as compared to the same period in 2006. This performance was based on: a) better conditions for taking credit, as a result of the downward path of interest rates; and b) household income on the rise – both in wages and social benefits.

A striking feature of the manufacturing production is the sectoral heterogeneity of the growth experienced in it. Five sectors – Machinery and equipment; IT Equipment; Food; Basic metallurgy; and automotive Vehicles – concentrate almost 80% of the growth observed in 2007 (Monthly Industrial Survey/IBGE). This sectoral concentration of the production was also observed in the two previous years, but there are signs that this trend is getting stronger. In 2006, for example, the five highest sectoral contributions accounted for 60% of the growth registered in the manufacturing production.

As observed in production, the increase registered in the industry's real revenue is concentrated in a few industrial sectors (Industrial Indicators/CNI). Chemical products, Petroleum and ethanol refinement, Food and beverages, and Machinery and equipment account for 80% of all the growth observed in industrial sales, in the comparison between the first two months of 2007 and 2006.

Among the reasons that explain the heterogeneous sectoral behavior of the manufacturing activity, foreign demand and the exchange rate stand out. The marked increase observed in food production – particularly, sugar, corn, meat – and in the production of ethanol, iron ore, and metallurgical products is largely led by foreign demand. With production on the rise, the installed capacity in these sectors began to be more heavily used, leading to the need to expand the industrial structure. Machinery and equipment production has therefore grown.

On the other hand, the significant appreciation of the real has restricted exports and stimulated the replacement of domestic products with imported ones, which are cheaper. This effect of the appreciated exchange rate can be more clearly perceived in the Clothing, Shoe, Textile, and Timber industries, with negative impacts on production.

Manufacturing production:

Growth rate (first two months of 2007/first two months of 2006) and sectoral influence

Industrial sectors	(%) Change	Contibution (p.p.)	Added contribution (p.p.)
Machines and equipment	13,7	0,87	0,9
Food products	5,4	0,58	1,5
Computer equipment	34,8	0,53	2,0
Basic metal products	8,4	0,49	2,5
Automotive vehicles	4,7	0,43	2,9
Chemicals (other)	4,7	0,33	3,2
Mining and quarrying	5,7	0,33	3,6
Eletric machines, aplliances and materials	7,8	0,24	3,8
Beverages	6,9	0,24	4,0
Other transportation equipment	11,1	0,18	4,2
Furniture	12,0	0,13	4,3
Perfumery articles and cleaning products	6,6	0,12	4,5
Non-metallic minerals	2,8	0,11	4,6
Cellulose and paper	1,0	0,04	4,6
Metal products- excl. machines and equip.	1,0	0,03	4,6
Pharmaceuticals	1,1	0,03	4,7
Others	2,2	0,02	4,7
Medical products, appliances and materials	-0,3	0,00	4,7
Textiles	-0,2	-0,01	4,7
Rubber and plastic products	-0,7	-0,03	4,7
Clothing and accessories	-3,2	-0,04	4,6
Tobbaco	-8,5	-0,06	4,6
Wood	-5,7	-0,07	4,5
Shoes and leather	-5,8	-0,09	4,4
Printing and Press	-2,7	-0,12	4,3
Petroleum and alcohol refinement	-3,4	-0,25	4,0
Electronic and Communication equipment	-9,0	-0,29	**3,7**

Source: PIM-PF / IBGE

GDP is expected to grow by 4.2% in 2007

In 2007, GDP is expected to exhibit expansion patterns similar to the ones observed in 2006, with the following features: a) growth led by domestic demand; b) the industry will grow less than the average growth of the overall economy; c) the foreign trade sector will contribute negatively to GDP growth.

GDP growth is expected to hit the mark of 4.2% in 2007. All the components of domestic demand – family consumption, government consumption, and gross formation of fixed capital – are expected to expand at rates exceeding the GDP average. The projected growth of 5.2% in household consumption deserves special mention, as it may contribute 3.1 percentage points to the GDP growth rate. That is, household consumption will account for three-thirds of GDP growth.

Government consumption is expected to increase by 4.4% in 2007. The gross formation of fixed capital, in turn, will increase by 10.5%, exceeding the 8.9% rate observed in 2006. This more robust growth has been associated with: a) the downward trend of interest rates in the economy (Selic rate and TJLP, the long-term interest rate), making cheaper the credit for investment; b) the enhanced use of the installed capacity – which can be perceived in more dynamic industries; c) the positive performance of civil construction, supported not only by the record volume of credit for housing, but also by a higher expected spending in infrastructure – as contemplated in the Federal Government´s Growth Acceleration Plan (PAC).

GDP: projections for 2007

	GDP Components	2007 (%) Rate of change	2007 Contribution (p.p.)
Demand	Household consumption	5,2	3,1
	Government consumption	4,4	0,9
	GFCF	10,5	1,8
	Exports	5,0	0,7
	(-) Imports	20,0	2,3
Supply	Agriculture and livestock	6,0	0,3
	Industry	4,0	1,2
	Extractive (minerals)	6,5	0,2
	Manufacturing	3,3	0,6
	Construction	4,8	0,3
	Public utilities and services	4,0	0,2
	Services	4,0	2,5
	Taxes	5,0	
	GDP (market prices)	**4,20**	

Source: CNI

The volume of exports of goods and services is expected to increase by 5.0% this year and contribute 0.7 percentage points to the GDP growth rate. On the other hand, imports of goods and services are estimated to grow by 20.0% in 2007 – an unprecedented rate this decade, during which the floating exchange rate regime was in place. Because imports are expected to grow four times faster than exports, it is anticipated that the net contribution of the foreign trade sector will be negative by 1.6 percentage points in 2007.

That is, GDP will grow by 4.2% in 2007 in a scenario where the external contribution is negative by 1.6 percentage points. This shows that the economy's domestic demand (household and government consumption and investments) is likely to grow by 5.8% in 2007, almost as much as in 2004.

In years marked by strong economic growth, such as 2000 and 2004, the industrial GDP tends to lead growth. In 2007, however, this is not expected. Estimates of industrial GDP growth point to a rate of 4.0% in 2007, below the average economic growth. The manufacturing industry is expected to expand by 3.3% and to stand out negatively as the less dynamic one among all industrial sectors. What is taking shape, therefore, is an uncommon situation marked by the combination of a strong growth in consumption and a modest growth of the manufacturing industry.

The positive news in 2007 is the strong expected growth in the agriculture/livestock production, which might increase by 6.0%. Services are estimated to grow by 4.0%, mainly sustained by a significant increase in commerce.

Labor and wages

As observed in production, job generation was sectorally concentrated

The employed population in the six largest metropolitan regions of Brazil increased by 2.5% in the first two months of 2007 in relation to the same period in 2006 (Monthly Job Survey/IBGE). As in production, job generation was not uniform among all sectors of the economy. While services provided to companies and rent and financial intermediation services generated 180,000 jobs during the past twelve-month period ending in February – accounting for a growth of 5.7% –, jobs in commerce remained practically unchanged during the period.

Jobs in the manufacturing industry increased by 3.4% in the comparison between the first two months of 2007 and 2006 (Industrial Indicators/CNI). Following the behavior of the manufacturing production, job generation was concentrated in a small number of industrial sectors. The food and beverage industry hired 11.1% more workers during this period and accounted for two-thirds of the growth in jobs registered in all the manufacturing industry.

Job formalization is another striking feature of the Brazilian labor market. The number of formally employed persons increased by 4.1%, in the comparison between the averages registered during the two first months of 2007 and 2006 (data from the Monthly Job Survey/IBGE). This growth pace is particularly strong, as apart from occurring from a high comparison basis – the number of registered workers had grown by 4.8% in 2006 already –, it contrasts with the drop of 1.9% observed in the number of informal workers this year.

Besides the job formalization aspect, the Brazilian labor market has been showing other unique features, such as: a) although women account for 44% of the labor force in Brazil, they accounted for 63% of all jobs generated during the past twelve-month period ending in February; b) net job generation was only observed during the past twelve months in the population with 11 schooling years or more.

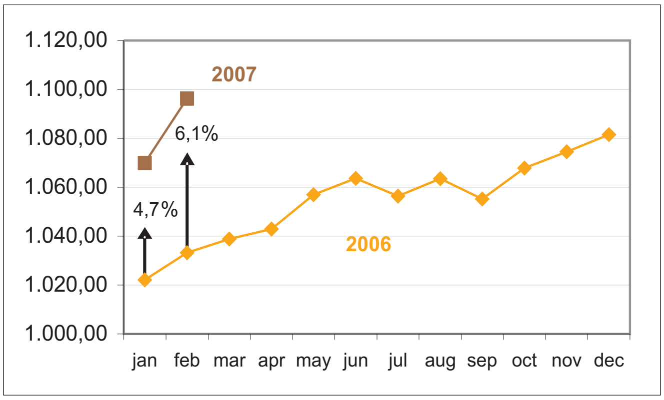
The unemployment rate in February 2007 was 9.9%, as opposed to 9.3% in January. Increases in the unemployment rate during the first quarter of the year are a seasonal phenomenon. In the comparison with February 2006, however, the figures remained virtually stable.

Both employment and the labor force are not expected to change significantly in 2007. According to CNI's Industrial Survey of January 2007, entrepreneurs of the manufacturing industry are not inclined to hire new workers in the first half of the year. Furthermore, the share of people available for jobs (potential entrants in the labor force) in the non-economically active population is dropping.

Wages rise, inflation drops

In February 2007, the real average income usually earned by workers was R$ 1,096.30, up by 2.5% in relation to January (Monthly Job Survey/IBGE). In the comparison with February 2006, it increased even more (6.1%). Real income grows as the inflation drops, because wage readjustments tend to make up for the past inflation – which is higher than the current inflation.

Real average income:
(%) growth rate



Source: PME/IBGE

In the industry, the real payroll grew by 7.0% in the first two months of 2007 as compared to the same period in 2006. In this regard, special mention should be made of a 16.8% increase in the wages paid to workers in food and beverage industries during this period. Wages paid in this sector accounted for one-third of the growth observed in wages paid across the industry during the past twelve months.

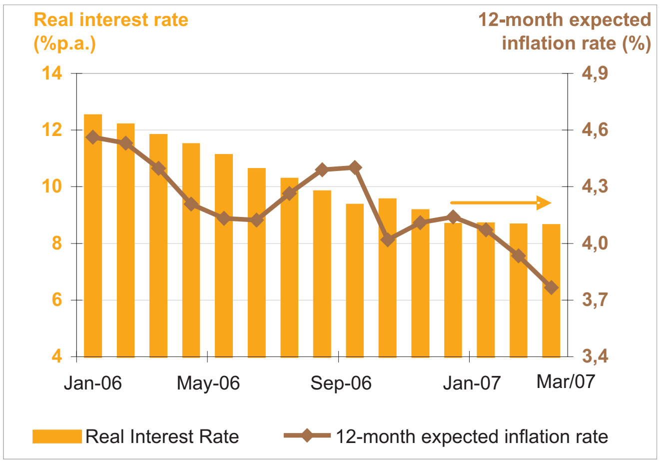
Inflation, Interest Rates and Credit

As the Selic rate and inflation projections fall, real interest rates have become rather stable

Since October of last year, the Expanded Consumer Price Index (IPCA) has been registering twelve-month accumulated variations below 3.5%, over one percentage point below the target set by the Monetary Policy Committee (Copom). In March, the rate was the lowest one in eight years: 2.96%. As a result, at the end of the first quarter, market estimates collected by the Central Bank pointed to an inflation of 3.8% over the next twelve months – the lowest one in the historical series initiated in 2001.

Despite this very safe margin, the Copom decided in April to continue to reduce the Selic rate at the same pace: 0.25% at 45-day intervals. As a result, the basic nominal rate hit the mark of 12.50% a year. Although this is a record level, it is still very unfavorable to the competitiveness of the domestic industry, particularly in a scenario marked by continued appreciation of the exchange rate. Also worrying is the fact that estimates of real interest rates are pointing to an interruption in the downward path observed during 2006 and have already begun to register somewhat stable rates in 2007 – at a level of about 8.5% a year, if the estimated inflation is deducted from the nominal Selic rate, or about 7.8% a year, considering the 360-day DI swap rate. Brazil continues to be the country with the highest real basic interest rates in the world – about two percentage points higher than Turkey´s.

Real interest rates and expected inflation



Source: Banco Central do Brasil.

Regulated prices and prices of tradables pull down IPCA inflation

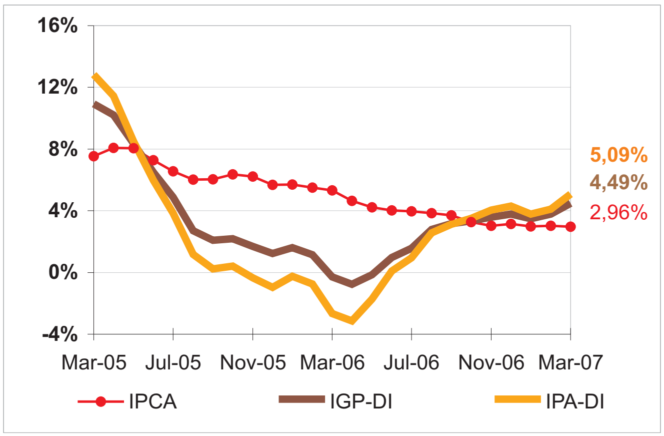
In the first quarter of the year, the IPCA index rose by 1.26%, less than in the same period of 2006 (1.44%). Eight of the nine subgroups making up the index had lower variations in the first quarter of this year than in the same period last year. The sharpest drops in relation to 2006 were those registered in the Transportation and Education subgroups (3.45% to 0.91% and 5.78% to 3.58%, respectively). The Food and Beverages subgroup was the exception: rise of 2.62% in the first three months of 2007 as opposed to the drop registered in the same period last year (-0.41%).

When the IPCA is broken down into market and regulated prices, it can be seen that its drop early this year was largely determined by the behavior of regulated prices. This subgroup rose by 0.60% in the first three months of 2007, much less than the 1.69% rate observed in the same period of 2006. Market prices rose by 1.32% and 1.56% in the first quarters of 2006 and 2007, respectively. It should also be noticed that the contrast is once more significant when the index is broken down into tradable and non-tradable goods: rise of 0.33% and 2.71% in 2007, respectively – suggesting that the exchange rate still plays a major role in controlling the inflation.

In the twelve-month period ending in March, the General Price Index-Internal Availability (IGP-DI) and its main component, the Wholesale Price Index-Internal Availability (IPA-DI), rose by 4.49% and 5.09%, respectively – both exceeding the IPCA. The recovery of wholesale prices during the past twelve months can be mainly attributed to agricultural products, whose prices increased by 12.83% up till March. The prices of industrial goods, in turn, increased by 2.75% during the same period.

Inflation

12-month rates (%)



Sources: IBGE and FGV

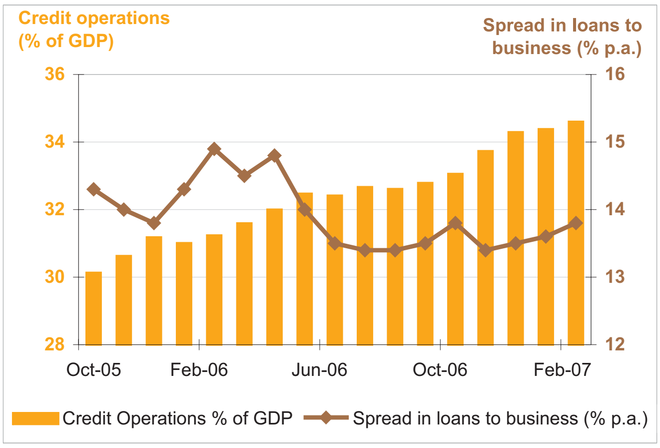
However, when the IPA is broken down into production stages, the most remarkable aspects of the recent dynamic of wholesale prices stand out: the prices of raw materials increased by 15.28% in the twelve-month period ending in March, while those of intermediate goods (3.21%) and final goods (0.70%) experienced much lower variations. This disparity reinforces the thesis that the production sector is intensely adapting itself to changes in the composition of aggregate demand in recent years – with a likely compression of profit margins in certain final-good sectors. In any case, the dynamic of wholesale prices seems to be leveling off already, with the prices of final goods up by 0.55% and the prices of raw materials down by 0.80% in March.

Credit on the rise, but spread doesn't fall

The balance of credit operations of the financial system hit the mark of 34.6% of GDP in February – an estimate to be reviewed late in April, when new GDP estimates will be used in the calculation. Total credit with non-earmarked resources rose from 21% of GDP in February 2006 to 23.6% in February 2007, while the balance with earmarked resources increased from 10.3% to 11% of GDP. Industry's participation in the total balance of operations remained stable at about 22%.

Despite the marked increase in credit operations, the average spread paid by businesses in operations with non-earmarked resources has been oscillating around 14% since September of 2005 – when the Selic rate reduction cycle began. Because the average interest rate paid by businesses dropped from 33.3% to 26% a year during the same period (February), the spread already accounts for over half (54%) of the actual rate paid by companies to banks.

Credit operations (%) and spread in loans to business (% p.a.)



Source: Banco Central do Brasil.

As for earmarked credit, the positive aspects are the continued recovery of real estate credit, leaving behind years of stagnation, and the recent performance of BNDES (National Economic and Social Development Bank) – despite the interrupted reductions in the long-term interest rate and the fact that it remained at 6.5% a year in the first half of the year. The total disbursement of the Bank in the twelve-month period ending in March 2007 hit the mark of R$ 56.7 billion, 28% more than in the previous twelve months. Disbursements to the industry increased by 45% on the same comparison basis.

Projections for 2007

The Selic rate is expected to continue to drop slowly throughout the year, from its current level of 12.50% a year to 11.25% at the end of 2007. Such "parsimony" will translate into an inflation of about 3.8% during the year as measured by the IPCA, once again below the target set by the National Monetary Council (4.5%). The General Price Index (IGP) will in turn continue to register annual variations of about 4.5% in the medium term.

Fiscal Policy

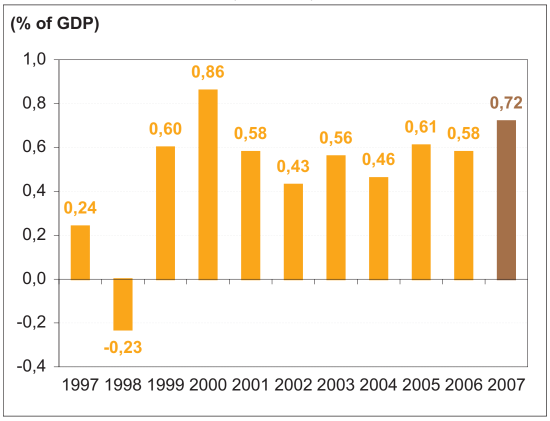
Higher primary surplus target for federal state enterprises poses fiscal risks

The cut in spending provided for in the 1st Financial Programming Decree was insufficient to ensure the Central Government's primary surplus target established in the Budget Guidelines Law (LDO). As a means to make up for the insufficient financial programming, the primary surplus target set for federal state enterprises was raised from 0.63% to 0.72% of GDP – considering the new GDP series already. On the other hand, the target of the Central Government was reduced from 2.01% to 1.92% of GDP, if we consider the total use of resources earmarked for the Pilot Investment Project (PPI), estimated at R$ 4.6 billion (0.18% of GDP).

The higher primary surplus portion under the responsibility of federal state enterprises enhances the risk of non-compliance with the primary surplus target. After all, during the past ten years, they only managed to achieve a primary surplus of 0.72% of GDP or higher once, in 2000.

Federal state enterprises: Primary surpluses

(% of GDP)



Source: BCB Obs.: 2007 figure is the target set on 1st. Financial Programming Decree

Furthermore, the new target entails a significant increase in the surplus of federal state enterprises, which in 2006 was 0.58% of GDP. Given the relevant role state enterprises will be playing in relation to the investments anticipated in the PAC, the primary result can be expected to decrease, at least initially.

Higher tax collection leads to a higher primary surplus

If on the one hand the surplus target set for state enterprises gives rise to concerns, on the other hand the primary result achieved during the first two months of the year enhances the confidence that the target set by the Central Government will be achieved. In January and February, the primary surplus amounted to R$ 15.1 billion, against R$ 7.6 billion in the same period in 2006.

The real growth of 11.0% in net revenues played a key role in ensuring this result and the factors explaining it are not isolated. Namely: a) a higher collection of Corporate Income Tax (IRPJ) and of the Social Contribution on Net Profits (CSLL) as a result of the higher profitability of companies in the last quarter of 2006; b) dividends paid by Petrobrás to the Federal Government, which doubled in relation to the first two months of 2006; c) higher collection of social security contributions as a result of growth in total earnings.

In turn, the small growth in real spending of the Central Government (0.66%) is explained by factors which are not expected to subsist. The real drop of 5.0% in fixed expenses and capital expenditures is largely due to a disbursement of R$ 1.5 billion in January 2006 to capitalize the Emgea state enterprise, without any counterpart in the first two months of 2007. However, expenses amounting to R$ 1.9 billion are anticipated for the same purpose until the end of the year, which will only be slightly lower than in 2006 (R$ 2.1 billion).

The spending with the social security system (3.3%) and staff (2.2%) dropped as a result of the lower amount actually paid off of bonds originally issued to finance payments determined in court sentences. Because of the uncertain nature of these expenses, it is impossible to tell how they will behave up to the end of the year.

The balance of the Central Government account contributed to the significant increase observed in the consolidated public sector primary surplus, which rose from R$ 7.8 billion in the first two months of 2006 to R$ 20.1 billion in the same period this year. However, improvements were also registered in the primary surplus of regional governments, which increased from R$ 3.8 billion to R$ 6.4 billion, and of local state enterprises, the primary deficit of which dropped from R$ 2.6 billion to R$ 800 million.

The combination of a higher primary surplus and a lower spending with interest payments led to improvements in broader fiscal indicators. The nominal deficit amounted to R$ 4.8 billion in the first two months of 2007, against R$ 23.5 billion in the same period in 2006. The debt/GDP ratio continued on a downward path, dropping from 44.9% of GDP in December 2006 to 44.7% in February of this year.

Lower primary surplus in 2007 is not expected to prevent a drop in the nominal deficit and in the debt/GDP ratio

The upward trend of the primary surplus observed in the first months of this year is not expected to continue until December. The Central Government may register a primary surplus of 1.93% of GDP if no changes are made in the PPI. Although this result ensures compliance with the target, it is lower than the 2.14% of GDP surplus registered in 2006. This reduction may be even more pronounced if the spending contemplated in the PPI is raised to R$ 11.3 billion. In this case, if the funds are actually used, the primary surplus of the Central Government would close the year at 1.66% of GDP.

If federal state enterprises and regional governments manage to meet their primary surplus targets – 0.72% and 0.98% of GDP, respectively –, the public sector will have a primary surplus ranging between 3.36% of GDP, if the PPI spending is increased, and 3.63% of GDP. In both cases, a drop in relation to the result in 2006 (3.88% of GDP) would be observed.

Public Sector Fiscal Balance
(% of GDP)

Results	Jan-Feb/06	Jan-Feb/07	Jan-Dec/07*
Nominal deficit	6,60	1,25	2,48
Interest payments	8,79	6,49	5,84
Primary deficit	2,19	5,24	3,36
Net Debt/GDP	44,9 (dec/06)	44,7 (feb/07)	43,9 (dec/07)

Source: Banco Central do Brasil (+) surplus (-) déficit * CNI estimates, assuming expanded PPI

Even with a lower primary surplus, the lower spending with interest payments and the faster GDP growth will lead the nominal deficit and the debt/GDP ratio to close the year at a lower level than in 2006. We expect to see the nominal deficit drop from 3.01% to 2.21% of GDP, if the spending contemplated in the PPI is increased, or to 2.48% of GDP otherwise. As for the debt/GDP ratio, it is expected to drop from 44.9% to 43.6% or to 43.9% of GDP, provided that changes are made to the PPI as well.

Budget Guidelines Law for 2008 provides for a small rise in the primary surplus target and a stable federal tax load

According to the Budget Guidelines Law for 2008, there will be no significant changes between the federal budgets of 2007 and 2008. The primary surplus target for the Central Government and its state enterprises was slightly increased, from 2.82% of GDP to 2.85% of GDP. These changes become a little more significant if we take into account the surplus composition, as the target assigned to the Central Government was expanded by 0.1% of GDP and the one assigned to federal state enterprises was reduced by 0.07% of GDP.

As for investments, the funds which can be spent under the PPI will amount to 0.45% of GDP, a similar amount to the one planned for 2007. The total volume of investments was also preserved at 1.07% of GDP, a percentage that will also be reached in 2007 if the spending contemplated in the PPI is expanded.

Finally, no significant increase is expected in the federal tax load, which according to the 1st Financial Programming Decree of 2007 will amount to 23.72% of GDP. For 2008, the Budget Guidelines Law estimates a gross federal tax collection of 23.76% of GDP.

Exchange rate and Foreign Sector

Exchange rate close to R$ 2.00/US$ 1

The high US trade deficits (about US$ 900 billion in 2006) have led to a depreciation of the dollar throughout the world. In Brazil, this phenomenon is even more intense. Between December 2006 and April 2007 (up to the second week), the real appreciated by 5.5% in relation to the US dollar.

The domestic currency could not behave in any other way: the two main domestic factors leading to the appreciation of the real in 2006 – a significant trade balance and a big difference between Brazilian interest rates and those in the rest of the world – are still active in 2007. Despite the appreciation of the real, the trade balance is expected to remain high, albeit lower than the one observed in 2006.

The difference between interest rates in Brazil and those in rest of the world is expected to remain high. The practice adopted by the Central Bank to reduce interest rates gradually is compensated by a lower expected inflation, keeping Brazilian real interest rates the highest in the world. There is also a perception of a lower risk, as external solvency indicators keep getting better and the so-called country risk dropped to a new historical low (152 points). In this scenario, Brazilian assets continue to be highly attractive: they offer a high real profitability, with decreasing risks. As a result, foreign resources keep coming in, leading the real to appreciate in relation to the US dollar.

Nominal exchange rate R$/US$ (Average daily quotes) e country-risk (EMBI+)

Source: Banco Central do Brasil

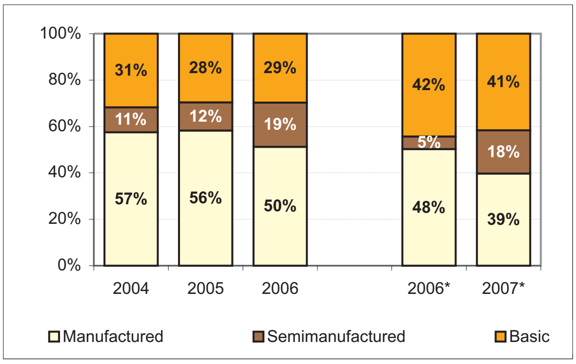
Basic products account for most of the growth observed in exports in 2007

In the first quarter of this year, exports totaled US$ 33.9 billion, up by 15.4% from the first quarter in 2006. Despite the continued appreciation of the real, the growth rate of accumulated exports in twelve months remained at a level between 15% and 16% in the first three months of 2007.

It should be mentioned that the growth observed in exports is heterogeneous as to product categories. Exports of manufactured products increased by 13.2% in comparison with 2006 (first quarters). However, a clear reversion can be observed in the trend of the exported quantum, which experienced an accumulated hike of only 1.3% in 12 months – much below the 7.4% and 25.5%

registered in the twelve-month period ending in March of last year and in March 2005, respectively. Therefore, the growth registered between the first quarters of 2007 and 2006 can be mainly attributed to prices, which rose by 9% on average.

% contribution on exports growth, classes of products



Source: Secex. Prepared by: CNI * - Jan/Mar

The rise in the exported value of basic products – the category which has been contributing most to export growth in 2007 – can be mainly attributed to the exported volumes: the growth observed in the comparison between the first quarters of 2007 and 2006 amounted to 15%, while prices increased by 7% in the same comparison. The strong foreign demand for basic products exported by Brazil, such as coffee beans, raw petroleum and corn, explains this positive result.

While basic products are being exported in larger volumes, the higher exported value of semi-manufactured products can be almost entirely attributed to prices: they rose by 19% in the comparison between the first quarters of 2007 and 2006, against an increase of only 1% in the exported volume.

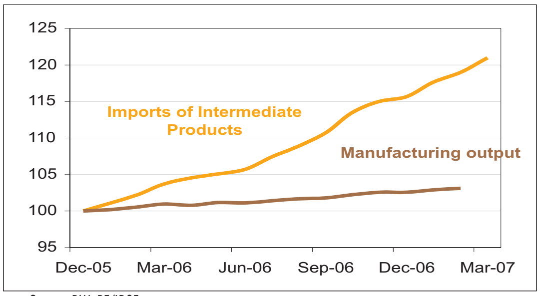
Growth in imported volumes is a generalized phenomenon

The Brazilian imports totaled US$ 25.2 billion in the first quarter of 2007, up by 25.3% from the first quarter of 2006. The quantum increased by 23.3%, while prices rose by only 1.7%. This increase is mainly explained by the higher purchasing power of the real, which stimulates the replacement of domestic goods with imported ones: the significant increase is a general phenomenon, registered in all categories.

As in 2006, consumer goods still account for most of this increase. In this particular category, apart from the higher purchasing power of the real, the effect of the recovery of family income can be felt, which explains the more intense growth. Imports of durables increased by 54% between the first quarters of 2007 and 2006, while those of non-durable consumer goods grew by 27%. Special mention should be made of the imports of pharmaceutical products, household machines and appliances, food products, automobiles, clothes, furniture and other household items.

As compared to the same period in 2006, imports of capital goods increased by 31% in the first quarter of 2007, while imports of raw materials and intermediate goods increased by 20% and those of fuels by 22%. Imports of raw materials and intermediate products increased at rates exceeding those observed in 2006, apparently in response to the level of manufacturing activity. However, as shown in the graph below, the manufacturing production has remained virtually stable, while the imports of these products continue to grow, suggesting that domestic products may have been replaced by similar imported products.

Imports of Intermediate Products
and manufacturing output (2005=100)
12-month moving average



Source: Secex e PIM-PF/IBGE

Imports will increase more than exports, reducing the trade balance

The value of exports is expected to hit the mark of US$ 154 billion in 2007, despite the appreciated real. The lower competitiveness of manufactured products abroad is partially made up for by the high international demand for many products exported by Brazil, particularly basic products.

Imports will grow by 25% in 2007, repeating the significant growth observed in 2006. Therefore, they are expected to hit the mark of US$ 114 billion in late 2007. The appreciation of the real continues to increase the purchasing power of the country and to stimulate the replacement of domestic goods by imported ones. Additionally, the continued recovery of household income and the recovery of the manufacturing activity will provide additional stimulus to imports, particularly of consumer goods, raw materials and intermediate products.

Therefore, despite the appreciation of the real, the trade balance at the end of 2007 is expected to total US$ 40 billion.

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Available data until April 19, 2007.