



conomic Report

Year 6 - No. 2 - April/July 2004

Optimism with Growth Must Not Hamper Attention to Long-run

The close of the first semester of 2004 saw the consolidation of a positive set of circumstances for the economy. Led by exports, but with a growing participation of domestic demand, the economy overcame the difficulties of 2001/2003 and will register approximately 4% growth by year-end. This has come about in spite of the less favorable external scenario resulting from the sustained high of international oil prices and initiation of the raising of US interest rates.

Indeed, the economic performance of the first half of this year has come as rather a surprise. The GDP has grown for the last three quarters at annual rates of more than 4% - a similar momentum to that registered between the end of 1999 and 2001 before the outbreak of the domestic electrical energy crisis. Most importantly, the growth is taking place in hand with the generation of expressive foreign trade surpluses - which will exceed US\$28 billion this year. Also worthy of underline is the fact that it is not jeopardizing the external accounts and is reducing the Country's external vulnerability.

The labor market, which is traditionally one of the last markets to react to the retaking of activity, already shows unquestionable signs of improvement. There is an ongoing systematic growth of employment in place in the interior, most closely to the agrobusiness and export sectors; but also (according to the last IBGE survey) in the metropolitan regions as evidenced by the now visible signs of growth of employment and retreat of the unemployment rate. In hand with the gradual recovery (in the margin) of real family income, the conditions are being created for an endogenous sustenance of domestic demand.

Inflation flags an alert. The greatest cause of the decline of consumption in the last two years was the deterioration of real family income brought about by the heating up of inflation. It is crucial for the continuity of the recovery of income that the perennialization of the transitory inflationary pressures stemming from the hike of international oil prices and depreciation of the foreign exchange rate be impeded. In these terms, the reaffirmation of the long-term commitment with reduced inflation laid out in the National Monetary Council's definition of the 2006 inflation target - whereby it maintained the same 4.5% per annum level of 2005 - represents a positive.

Nevertheless, it is somewhat intriguing that, after ten years of the Real Plan, inflation still stands at the centrepoint of attentions and that the anti-inflationary action imposes costs in terms of lower growth. This is a frustration that has not been overcome: if, on the one hand, the end of superinflation brought

a broadening of the horizons, on the other, it has still not managed to generate the desired growth.

The return to a trajectory of sustained and vigorous growth crucially depends upon investment. It is the leverage for the increase of productivity and continuous increase of the potential product. The fiscal crisis does not permit a greater role of public investment in the retaking of sustained growth, the private sector will therefore have to perform a critical and strategic role in this process.

Various factors have impeded and still impose difficulties on this process. The fiscal adjustment by means of the raising of the tax load, the low level of domestic saving, external vulnerability, elevated cost of capital and low degree of financial intermediation, and absence of an institutional environment favorable for investment and production have interacted over the course of the last ten years to create cycles of instability that have had negative effects on investment and growth. Advances in some areas have been offset by setbacks in others, accordingly damaging growth.

Without minimizing the role of the other restrictions, the increase of the tax burden - by means of poor quality taxes that burden companies' competitiveness and inhibit investment - is the biggest cause of the low growth rate presented by the Brazilian economy in the post-Real period.

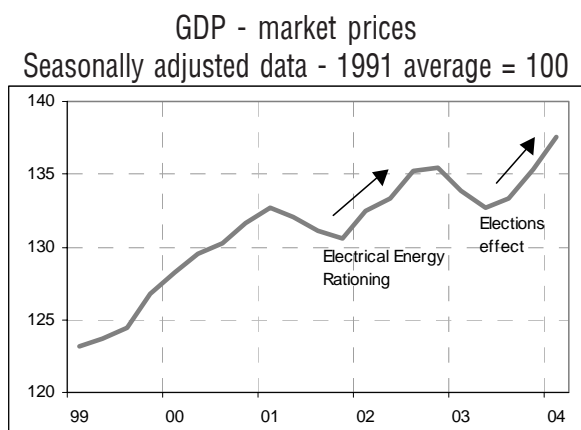
In the same way that inflation laid a haze on the long term horizon of private economic agents, it also viabilized the latent disequilibriums present in public budgets. To cope with the elimination of superinflation and to remove doubts in relation to the trajectory of the public debt, the potential excess spending was dealt with an increase of the tax load. The result is the more than ten percentage point hike of the tax load in the last ten years.

An understanding of this origin is a crucial step for a reduction of the burden through a rationalization and improvement of the quality of public spending that seeks to implement in the public sphere the efficiency and productivity that have been the driving force of the recent performance of the Brazilian economy led by the private sector. This is the lesson that we ought to take from the recent experience.

In summary, it should be recognized that part of the current growth bears some characteristics of a cyclical recovery. Our challenge is to make this growth sustained and permanent, providing the conditions for an intensification of private investment and avoiding that the current growth be transformed into a mere breeze of recovery that once again ends up frustrating the Country.

Improved outlook for vigorous economic growth in 2004

The GDP has grown for the last three quarters at an average rate of more than 4% per annum. The momentum of this growth is equivalent to that in place in 2002 prior to the presidential elections. The advantage of the current situation over that of two years ago is that the recovery of economic activity is signaling that it will be more long-lasting. Until now, there have been no signs of a cooling off of its uptrend. On the contrary, the macroeconomic indicators – primarily those linked to the external sector – are proving quite robust indeed.



Exports have increased 5.7% in each of the last two quarters, which works out at an average annual growth rate of close to 25%. Household consumption, however, has not displayed the same vigor. Its timid 0.3% growth in the first quarter of 2004 compared to the first quarter of 2003 puts the capacity for sustainability of the GDP growth in stalemate. In other words, the question is how the GDP can grow sharply if its biggest component – household consumption – remains apathetic.

It is worth highlighting, however, that the timid growth of family consumption already represents an advance as it comes on the heels of a period that accumulated a 6% retraction. Furthermore, the income generated by exports is stimulating the recomposition of internal demand. The most recent consumption indices signal such growth.

Retail sales grew 9.9% in April in relation to the same month of last year. The performance of the durable goods segment takes the limelight with a more than 30% hike of furniture and home appliance sales and 13.3% growth of automobile sales. Data from sectoral associations confirm the IBGE results. According to Anfavea (the National Association of Car Manufacturers), new automobile licensing increased 15.2% in May in comparison to the same month of last year. Similarly, home appliance sales climbed more than 30% in the first quarter of this year versus first quarter 2003 (according to Eletros). Most impressive of all, audio-visual equipment sales skyrocketed more than 60% in the same quarterly comparison.

The sales hike of higher value-added products has come on the back of the expansion of credit. The volume of credit operations with free resources accumulated 20% expansion in

the twelve months through May of this year. In-house store financing of purchases has also increased, as indicated by the 7% increase in the number of credit worthiness checks made to the SPC (Credit Protection Service) in the first five months of 2004 compared to the same period in 2003.

According to CNI data, exports led industrial sales to register 17.9% growth in April in relation to the same month of last year, thereby accumulating 13.6% growth in the first four months of 2004 compared to the same period of 2003.

In relation to industrial production, manufacturing initiated its recovery process as of the third quarter of 2003 when production had fallen 3% in relation to the same period of the previous year. In April of this year it already registered 7.1% growth compared to the same month of 2003.

The forecasts for industry in 2004 are, thus, optimistic. Should we adopt a rather conservative hypothesis whereby the seasonally-adjusted level of industrial production registered in April remain stable for the remaining months of 2004, we will already see 4.6% manufacturing growth and 4.0% overall industrial growth this year. These numbers therefore represent the floor of the growth estimates of industrial production in 2004.

In relation to investment, the forecasts continue to be positive. Firstly, the increase of industrial production, and accordingly of installed capacity utilization, signals that the arrival of investment resources is unlikely to be much delayed. At the same time, the less agitated macroeconomic scenario than in 2003 also represents a positive factor. In terms of investment credit, it should be highlighted that BNDES disbursements year-to-date through May of this year were already 54% up on the same period of 2003. The industrial segment registered 60% growth of such resources, with noteworthy participations of the transport materials and mechanicals segments.

Estimates for GDP 2004 (% growth)

GDP (supply)		GDP (demand)	
Agriculture	5.7	2.5	Household Consumption
Industry	4.8	2.0	Gov't Consumption
Services	2.3	6.5	Gross Fixed Capital Formation
GDP - basic prices	3.8	17.5	Exports
Taxes	5.0	15.0	(-) Imports
GDP	4.0		GDP

Source: CNI

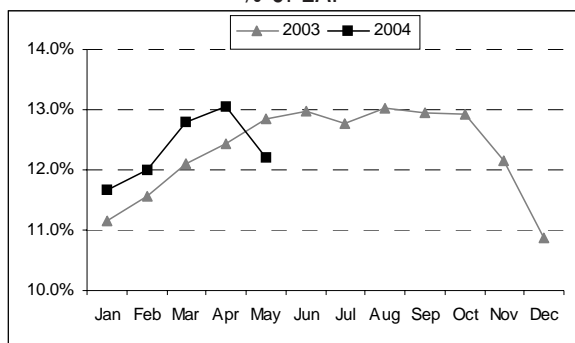
In summary, the Brazilian economy is currently presenting good performance indices that enable a 4.0% of GDP growth forecast for 2004.

Decline of unemployment in May may not be indicative of a trend

The unemployment rate retreated to 12.2% in May from the 13.1% registered in the previous month. This atypical movement for this time of the year resulted from a combination of two factors: the 0.8% increase of the employed population, and 0.2% retreat of the number of persons seeking employment. Nonetheless, the average unemployment rate year-to-date through May still stood 0.3 percentage points above the average of the same period of last year at 12.3%.

On the one hand, the increase of occupation in May was concentrated in São Paulo and primarily sustained by the opening of 67 thousand workposts in the public sector. On the

Unemployment rate: 2003 and 2004 % of EAP



Source: IBGE

other hand, the decline of the EAP (economically active population) is associated with the fact that part of the population has given up looking for employment, based on the negative prospects offered by the labor market. The number of persons available for work, but who had not taken effective measures to be employed, increased by 150 thousand in May in relation to April to 2.8 million. This segment of the population is probably waiting for a positive signal from the labor market in order to start looking for employment once again and, accordingly, be reincorporated in the EAP. There are no reasons, therefore, to suppose that the decline of the unemployment rate in May constitutes a trend.

2004 is thus being marked by a gradual recovery of industrial employment. According to the IBGE's Monthly Survey of Employment and Wages (*PIMES*), industrial employment grew at an average monthly rate of 0.3% in the first four months of this year. The CNI Industrial Indices also registered a 0.3% monthly increase of industrial occupation in this period and the growth trend of industrial employment is also corroborated by the generation of 288 thousand workposts formally registered in manufacturing in that period according to the Labor Ministry's General Register of Employed and Unemployed Persons (*Cadastro Geral de Empregados e Desempregados - Caged/MTE*). The expectation for the coming months is that the heating up of economic activity will continue this slow, but continuous, pace of generation of industrial employment.

PRICES, WAGES AND EXCHANGE RATE

Well-behaved inflation precedes seasonal increase of administered prices

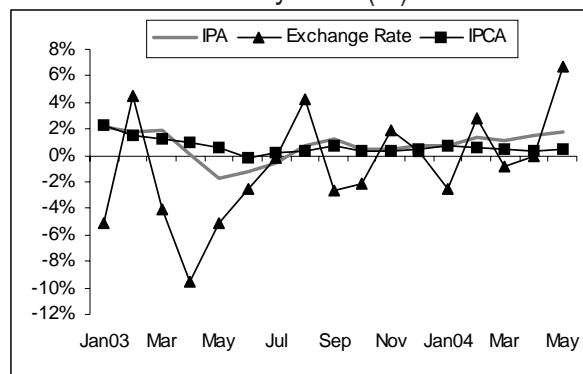
2004 brought with it a consolidation of the decline of inflation following the price hikes that accompanied the shift of power at the end of 2002. However, doubts arose in the second quarter as to the possibility of a spiking of prices. The depreciation of the foreign exchange rate, allied with the pressures from the sustained hike of international oil prices and other commodities and potential deleterious effects on internal prices provoked a shift of market expectations in relation to the trajectory of inflation this year. The coming three months mark a period of expected higher inflation resultant from the concentration of readjustments of administered prices; this characteristic may at first sight somewhat confuse unexpected increases (which accordingly divert inflation from its trajectory) with expected hikes. The increase of inflation is in line with expectations and does not, therefore, characterize a spiking of prices.

IPCA measured inflation was well behaved in May, in spite of the small increase registered in the period. The rate closed the month at 0.51% - versus 0.37% in April. The upward pressure came from foodstuffs (which suffered from bad weather), fuels (particularly alcohol), and new and used automobiles. Further upward pressure was exerted by medicine prices - the increase of which had already been noted in the April Index following the 5.7% hike authorized by the Chamber of Medicine. The June IPCA-15 registered practically the same level as the full-month IPCA for May (0.56%) as the pressure from foodstuff and fuel prices remained unabated. The IPC-S, calculated by the FGV, for the week ending June 22 registered 0.83%, slightly higher than the previous week's index.

The measures of core IPCA inflation remained practically unchanged. The core as calculated by the CNI by means of the exclusion of administered prices and "in natura" foodstuffs registered 0.69% in May compared to 0.64% in April. Similarly, core IPCA inflation calculated by the Central Bank by means of the unsmoothed trimmed averages methodology exhibited a 0.34% rate in May - just 0.02 percentage points below the April rate. Although they are stable, the core rates remain relatively high and resistant to fall.

The hike in monthly inflation rates registered in the first five months of 2004 was centered in wholesale. The IGP-DI accumulated a 5.6% increase as a result of the 6.7% hike of the IPA; while the IPCA registered just 2.75%. The standouts in the industrial sectors were metallurgy, mineral extraction, and electrical and mechanical materials, which suffered the direct impact of the increase of commodity prices on the international market. The greatest pressure in May was exerted by agricultural prices, which jumped from a mere 0.8% inflation to 2.7%. The June IGP-M registered 1.38%. Wholesale prices were still the highlight with a 1.73% rate. The hike of fuel prices (with a 0.2 percentage points impact) was already captured by this index.

Exchange Rate, IPCA and IPA Monthly rates (%)



Sources: Central Bank, IBGE and FGV

The IPA showed no impact from the more than 6% depreciation of the foreign exchange rate in May, even though this index normally reflects such currency variations immediately. The recent delinking of the IPA from the IPCA was related to the commodities shock and, more recently, to the hike of foodstuff prices, and not to the dollar. The dollar appreciated much more sharply against the real in 2003, yet this was not translated in the same proportion into the increases of wholesale inflation rates.

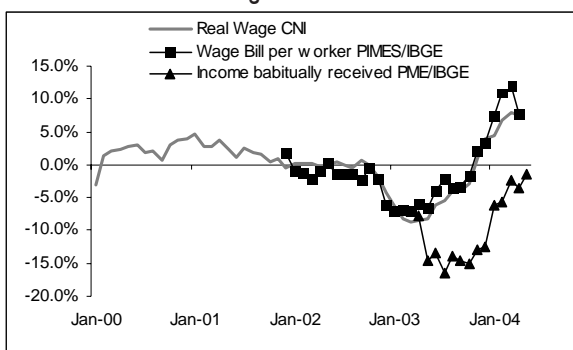
In spite of the well behaved scenario in terms of inflation rates observed year-to-date through May, the indices for the coming months will suffer pressure from already expected sources: the hikes of administered prices characteristic of the July-August

period, such as telephone and electrical energy tariffs. However, the intensity of these readjustments, particularly of telephone tariffs, are likely to cause some surprise. Another pressure, this one unexpected, is the 10.8% hike as of mid-June of gasoline prices at the Petrobras refineries provoked by the recent increase of international oil prices. According to Government estimates, this will represent a 4.5% price increase for the consumer and will have a subsequent impact on the IPCA of some 0.2 percentage points (spread over the months of June and July).

Accumulated 12-month IPCA inflation through May registered 5.15%, its lowest rate since the second semester of 1999. June will see an increase of accumulated IPCA inflation, given that this year's rate for that month will be higher than that of June 2003, and this uptrend in the 12-month result ought to be maintained in July - also due to exceptional events that occurred in that month last year (related to the discussion over and breaking into installments of some administered prices).

The first four months of 2004 were marked by a strong recovery of **wages**. The CNI's Index of the Real Average Wage in Manufacturing grew 6.7% in the period January through April in relation to the same period of last year. The strong decline of wages in the first semester of 2003 exacerbates the sharp growth registered in 2004 as it provides a very depressed basis of comparison. The IBGE's Monthly Survey of Industrial Employment and Wages (*PIMES*) shows an even stronger 9.5% increase in this period of comparison. On the other hand, the IBGE report still shows no wage growth at all in 2004 for the economy as a whole. The habitually received income of employed persons fell 3.9% in the first five months of the year (based on monthly averages). Nevertheless, this does represent a slowdown of the deterioration. Comparison with the same month of the previous year shows successively smaller reductions; May of this year registered a 1.4% decay year-over-year whereas October of 2003 had presented a 15% drop. There is also some differentiation in terms of economic activity. Industry as a whole, commerce and domestic services already show wage growth on this same basis of comparison.

Average Real Wage Indicators
YOY growth rates



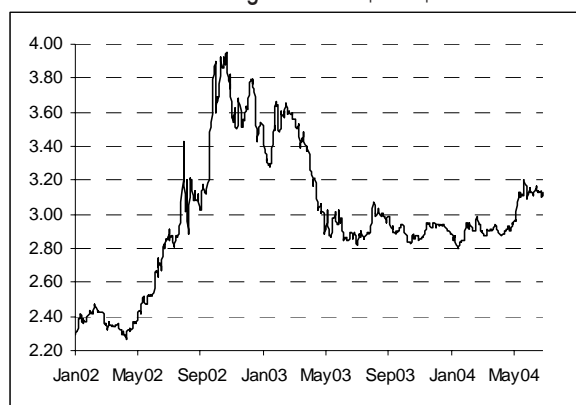
Sources: CNI and IBGE

The relative stability of the **foreign exchange rate**, which had oscillated around the R\$ 2.90/US\$ level for the last eleven months, was interrupted in May when the real initiated a rapid depreciation process. The exchange rate broke the R\$3.00 level in the second week of that month to reach R\$3.20/US\$ by May 21 - its highest rate of the previous twelve months. The average rate for May ended up at R\$3.10/US\$, representing a 6.7% depreciation in relation to the previous month's average. The

Brazil Risk, which is represented by the spread of the C-bond over US Treasuries, rose approximately 200 basis points in May, after having stabilized at around the 600 basis points level in the period February through April.

The shift in the foreign exchange rate is primarily rooted in the international scenario. Tighter international liquidity, uncertainties as to the intensity of the increase of US interest rates, and the sustained hike of international oil prices were the main driving factors for this change. The consequences were, on the one hand, an increase of the uncertainties and, accordingly, demand for hedge, and, on the other, a reduction of the offer of external capital. June saw a cooling off of the pressure exerted on the foreign exchange rate but this was insufficient to enable a return to the level prevailing in April. The depreciation of the local currency slowed to 1% in June and the Brazil Risk retreated to 660 basis points just four days before the end of the month.

Exchange Rate R\$/US\$



Source: Banco Central

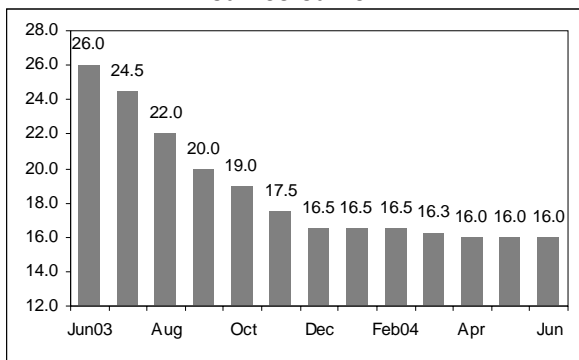
In hand with the depreciation of the nominal foreign exchange rate, the real foreign exchange rate also registered a sharp deterioration in May in relation to the previous month. The real-dollar parity rate depreciated 6.8% after discounting the effects of Brazilian and US inflation. The gain in competitiveness provided by the shift in the foreign exchange rate was less strong in the European, Latin and Japanese markets. The real effective foreign exchange rate, which takes into account a basket of the currencies of Brazil's main trade partners, depreciated 5.3% in the period, thereby returning to the level in place in December of last year.

MONETARY POLICY

Less room for reduction of the Selic

The monetary policy in 2004 has been marked by the rather conservative stance adopted by the Central Bank in the reduction of the Selic basic interest rate. The base rate - which was reduced by 9.5 percentage points between June and December of 2003, from 26% to 16.5% per annum - was maintained at 16.5% until March of this year. The resurgence of inflation at the end of 2003 - when the IPCA variation jumped from 0.29% in October to 0.52% in December and 0.76% in January 2004 - and the determination to achieve the 5.5% inflation target for 2004 led the Central Bank's Monetary Policy Committee (Copom) to interrupt the downtrend of the base rate initiated in June of last year. The Copom reduced the Selic by 0.25 percentage points in

Selic Target set by Copom (% per year) Jun'03-Jun'04



Source: Copom

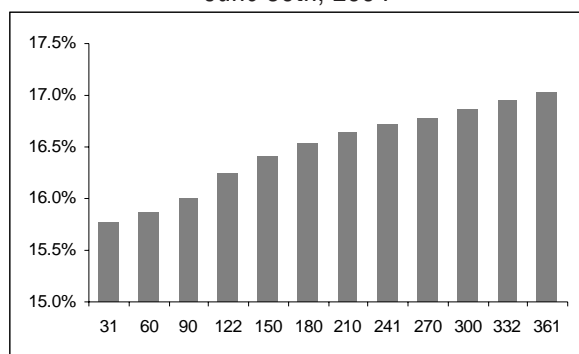
both March and April, resulting in a total decline of just 0.5 percentage points in the first semester.

The recent turbulence in the external scenario have generated a volatility in the short-run that will tend to increase the uncertainty in relation to future inflation. Among the external factors, two are of special interest to the Copom for the determination of interest rates: the trajectories of US interest rates and international oil prices. The increase of US interest rates has a direct relation on the raising of external resources and level of investments in Brazil, particularly in a scenario of low international liquidity such as that in place at the present. The end of June saw the long-awaited increase of the Fed Funding Rate. It ended up in line with expectations at a 0.25 percentage point hike but, in any case, there is still some uncertainty as to the Fed's next moves.

International oil prices reached their highest levels in 21 years in the first week of June; US\$42.33/barrel. Even though the subsequent 10.8% increase of domestic gasoline prices later in the month was in line with the Copom's expectations, there are some uncertainties in place in terms of the decline of international prices and its repercussions on internal prices. The current 2004 inflation forecast stands at around 7%, approximately 1.5 percentage points above the centre of the target established by the Central Bank. The room for a reduction of the basic lending rate has thus diminished, although a retaking of the cuts is still expected for the second semester.

The effective Selic rate fell in all of the months of the first semester, from 16.3% in January to 15.7% in May. The benchmark 360-day fixed-rate swap, which serves as a proxy for long-term interest rates, rose from 15.4% in March to 17.6% in June. The reduction of the uncertainties as to the future of the basic lending rate led the yield curve to assume a positive slope

Yield Curve - Fixed Rate Swap (% p.y.) June 30th, 2004



Source: Central Bank

as of May. The reduction of banking spread in May can be seen as a positive factor - even though the Country still has the biggest banking spread in the world. The average spread on free funds slipped 1.8 percentage points in relation to April to accumulate a 2.8 percentage points decrease year-to-date.

The monetary base recovered from a period of downtrend in the first two months of this year to register growth of approximately 2% in April and 0.8% in May. The accumulated growth in the last twelve months amounted to 3.6% at end-May. The advance in May was caused by the 0.5% increase of the balance of paper money issued and 1.4% growth of bank reserves. The Means of Payment in the restricted sense (M1) rose 2.4% in May to R\$102.6 billion to accumulate 20.6% growth in the last twelve months. The M1 to GDP ratio stood at around 6% in the first five months of this year. The Means of Payment in the broadest sense (M4) maintained the level attained in its second semester 2003 upswing at around 61% of the GDP in the first five months of this year. Moreover, M4 grew 21.2% in the twelve months through May, primarily reflecting the recovery of credit operations within the financial system (whereby credit operations with free funds registered approximately 3.6% growth in May in relation to April).

In summary, we may expect continuity of the basic lines that characterized monetary policy in the first half of this year, with a small and gradual reduction of the basic interest rate in the second semester. Less favourable external conditions and internal cost and demand pressures - along with the confirmation of the 4.5% inflation target for each of the next two years - contribute to the likelihood of a 15% or so level for the Selic by year-end, just 1 percentage point below the current level. This would correspond to an approximately 8% real interest rate at the end of 2004.

FISCAL POLICY

Government determined with fiscal results

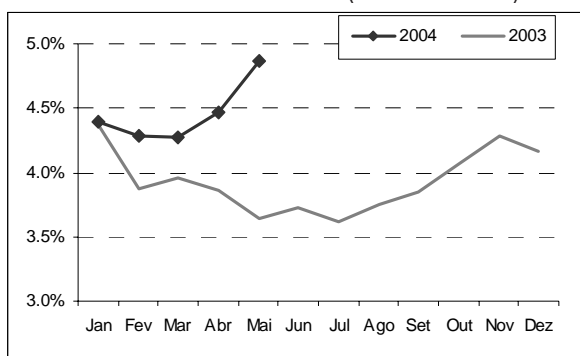
The Consolidated Public Sector presented expressive results in March, April and May. The primary surplus accumulated R\$38.3 billion in the first five months of the year, exceeding by R\$5.7 billion (17%) the level agreed with the IMF for the first semester - a month in advance. The accumulated year-to-date through May primary surplus stands at 5.87% of GDP. This compares to an accumulated primary surplus of R\$37 billion in the same period of 2003, corresponding to 5.73% of the GDP of the period.

This result may be understood as a determination - perhaps even exaggerated - of the Central Government to make it clear that it will stick to the fiscal austerity. The central government is responsible for almost 80% of this surplus and there is no reason to imagine that it intends to break loose from this commitment. It recently presented a restrictive 2005 Budgetary Guidelines Law (*Lei de Diretrizes Orçamentárias*) to Congress and showed firmness in the definition of the new value for the minimum wage, in spite of the fact that 2004 is an election year and also conscious of the political burden associated with its stance. This does not mean to say, however, that the IMF Agreement until the end of this year, of R\$71.5 billion, will be easily achieved. A small exercise shows that there is little room for slips: if we substitute the values for the remaining months of this year with the same values obtained in 2003, the government will not fulfill the Agreement, falling short by some R\$4 billion.

The increase of the federal tax load is, undoubtedly, one of the main explanations for this result. Gross collection in the first five months of this year represented 20.8% of GDP, compared to 20.3% in the same period of 2003. Record high collections were registered in March, April and May, greatly exceeding not only the values of last year but also the historical values for each month. Thus, the increase cannot be solely ascribed to the reheating of the economy.

Part of this increased collection should be attributed to the Cofins. A new levying methodology came into effect for the surcharge as of March and its effects became apparent as of that month. The increase in gross tax collection in the months of March and April amounted to 18% in relation to the previous month. May collection, which saw the initiation of the direct levy of PIS and Cofins over imported goods and services, jumped 37% (R\$1.8 billion at constant prices) in relation to the same month of 2003. Thus, Cofins, which represented approximately 3.64% of the GDP in May 2003, now represents 4.87% of the GDP.

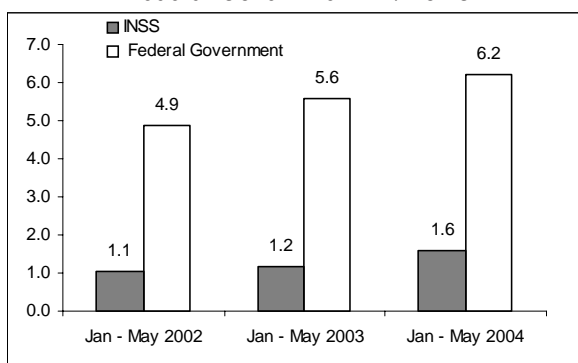
Collection of the Cofins (% of the GDP)



Source: Prepared by CNI on SRF data

The rigorous attitude is not repeated with the same intensity when it comes to government spending. Total central government expenses increased 13% year-to-date through May in relation to the same period of last year. Servicing expenses rose 22% in real terms, while spending with social security (INSS) benefits climbed 14%. On the other hand, spending with personnel rose just a marginal 1.4%. However, there are ever-growing pressures for wage increases for civil servants. In the same way, social security spending continues to exert strong pressure on the results of the government, which finds itself obliged to obtain increasingly better results for the fiscal adjustment. The accumulated year-to-date deficit reached R\$10.2 billion, equivalent to 1.57% of the GDP (compared to 1.30% registered in the same period of last year). The deficit accumulated R\$28 billion in the 12-months through May of this year. It is clear that the Social

Deficit of the INSS and Surplus of the Federal Government - % of GDP



Source: STN

Security Reform has not solved the problem of the deficit and much more remains to be done in this area. Furthermore, the constitutionality of the measure that schedules the levying of social security contributions over the retired – which would represent a further R\$625 million for the Government treasury – will be judged by the Supreme Court in August.

Even the net public sector debt to GDP ratio, which had been describing a slight downtrend through the course of this year, rose to 56.8% (R\$946.7 billion) of the GDP in May compared to 56.5% in April. However, the main cause of this negative result was the approximately 6% depreciation of the local currency in the period. Accordingly, it is still possible to hope for an improvement in this ratio by year-end. On the other hand, the Government seeks to continue improving the breakdown of its debt. The participation of Selic-indexed bonds in the Publicly Traded Federal Internal Public Debt fell 1.8 percentage points in May in relation to April to 59.6% of the total – versus 71.37% in May 2003. Running in the opposite direction, there were some small increases in the fixed-rate and dollar-indexed debts (of 0.6 and 0.3 percentage points, respectively).

The numbers enable us to conclude that the Government is seeking to undertake a fiscal adjustment by means of a higher increase of its income compared to that of its expenses, although it is notorious that fiscal adjustments through spending reductions are more credible. Furthermore, this option would impose fewer difficulties on economic activity. It is worth recalling, however, that the Brazilian budget is extremely rigid, permitting little room for maneuvers. This flexibility should certainly be a target – albeit just in the long-run – for the Government to improve the quality of the fiscal adjustment.

EXTERNAL SECTOR

Worsening of international liquidity - but exports maintain Balance of Payments under control

The increased uncertainty in the international market and consequent reduction of liquidity negatively affected the Brazilian Balance of Payments, but the performance of exports has been sufficient to minimize such effects. The Current Transactions Balance continues to rise and, in spite of the decline in the net inflow of capital, the external situation of the Brazilian economy continues to be a positive standout.

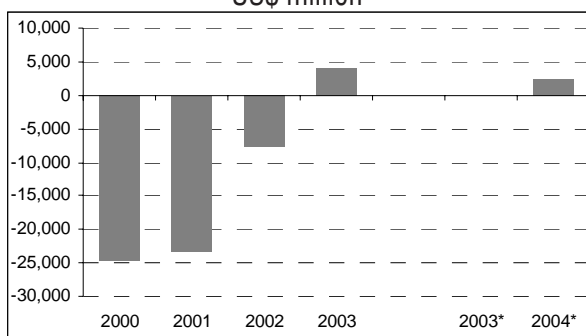
The Current Transactions Account accumulated a US\$2.4 billion surplus between January and May of this year, compared to just US\$43 million in the same period of last year. The performance can be primarily ascribed to the trade balance but the services account also made a positive contribution. The International Travel item still gave no signs of a turnaround from the growth trend of its surplus. On the other hand, the Transports deficit remained relatively flat but already seems to be initiating a growth trend. In the case of the Income account, the outlook is for maintenance of the slight growth trend of its deficit, primarily driven by the hike of the net remittance of profits and dividends. Nothing, however, that will come to overshadow the performance of Brazilian goods exports.

The capital and financing account registered a US\$2 billion deficit in May, resulting in an accumulated US\$600 million deficit in the period January through May. As of March, and particularly in April, this item registered a strong net outflow of portfolio investments. Thus, the accumulated year-to-date through May result of this item registered a negative US\$3 billion, compared to a US\$2.1 billion net inflow in the same period of last year. At the same time, direct investment, which is less affected by short-term market fluctuations, registered a decline in May, although still coming in above the volume registered in the same period of 2003.

The raising of resources has presented some difficulty, as evidenced by the reduction of the rate of rollover of the bonuses, notes and commercial papers issued by the Central Bank. Note, however, that the inflow of medium- and long-term resources has increased - although insufficiently to offset the growth of amortizations. The balance has remained negative in its accumulated year-to-date figures. Notwithstanding, commercial credit has started to grow anew at a quite significant rate, to register a US\$3.6 billion net inflow in the first five months of 2004 (compared to a US\$24 million net outflow in the period January through May 2003).

Brazil's Gross Financing Requirements (amortizations less the Current Transactions Balance) registered an increase in relation to the same months of 2003. Such a performance is due to the growth of amortizations. In any case, the level forecast for year-end (US\$33 billion) is much below the almost US\$60 billion registered at the start of the decade. In summary, in spite of the reduction of international liquidity, Brazil should not face any problems in financing its external obligations

Current Account Balance
US\$ million



YTD through May
Source: Central Bank

Trade account is still the highlight

The Brazilian trade flow continues to grow full steam ahead. After registering a record high level in May, external sales surprised once again in June with yet another record. Imports presented a similar performance, presenting close to 60% growth in relation to June 2003.

Exports amounted to US\$9.3 billion in June, resulting in an average daily value of US\$444.1 million. The June average is 17.5% higher than the previous record (set in May) and 51.2% up on the June 2003 average. Part of this result (US\$500 million of the total) can be ascribed to the regularization of registrations

due to the “according to the book” labor action undertaken by customs officials as part of their protest in support of their wage hike campaign. Nevertheless, even discounting for these regularizations, June still sets a new record.

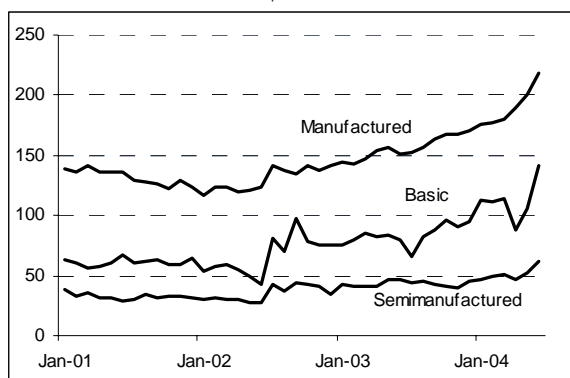
The growth has been striking in all three product classes: basic, semi-manufactured and manufactured. The dynamism of Brazilian exports has been determined both by the price growth of several of the Country's main export commodities and increase of shipped volumes, particularly of manufactured goods.

The determinant factor in the case of manufactured goods is the robust growth of the shipped volume and not prices. The seasonally-adjusted average daily value of Brazilian manufactured goods exports has been on an uptrend since the first quarter of 2002. The value for June stood 35.6% above that registered in December of last year and represents the twelfth month running of growth of the seasonally-adjusted average daily value. The *quantum* index of manufactured exports elaborated by Funcex accumulated 21.4% growth in the period January through May of this year in relation to the same period of 2003.

Brazilian imports have been consolidating the recovery process, in line with the retaking of domestic activity. The average daily value of imports reached US\$262.5 million in June, the highest level since September 1998 and 49.2% up on the average for June of last year. The growth of external purchases has also been quite widespread, extending to all categories of use. The average Funcex import *quantum* indices year-to-date through May registered growth for all categories of use – most prominently for fuels, intermediate products and consumer durables, which registered growth rates of 18.8%, 16.6% and 11.5%, respectively.

The maintenance of the strong growth pace of exports has enabled the continuity of the uptrend of the foreign trade balance in spite of the growth of imports. The accumulated US\$15 billion surplus year-to-date through June stands 45% above the level registered at the end of the first semester of last year. The accumulated 12-month surplus has risen to US\$29.5 billion, signaling that year-end surplus may exceed US\$28 billion.

Brazilian Exports
Seasonally adjusted data / Montly Daily Averages
US\$ million



Prepared by CNI

Indicator	Unit	Source	Period		
<i>GDP</i>			3Q03	4Q03	1Q04
total	Year over Year	IBGE	-1,48%	-0,06%	2,67%
Agriculture	% growth	IBGE	-2,80%	4,79%	6,43%
Industry		IBGE	-1,61%	-1,69%	2,88%
Service		IBGE	-0,80%	0,30%	1,23%
<i>Activity</i>			Feb04	Mar04	Apr04
Real Industrial Sales	Year over Year	CNI	1,47%	23,97%	17,92%
Industrial Production (Manufacturing)	% growth	IBGE	1,49%	13,23%	7,14%
Use of installed capacity	%	CNI	79,6%	82,0%	81,3%
			Oct03	Jan04	Apr04
Business Confidence Index	Range from 0 to 100	CNI	55,8	62,4	56,3
			4Q03	4Q04	2Q04
National Consumer Expectation Index	Oct97 = 100	CNI	105,4	100,4	98,1
<i>Employment</i>			Feb04	Mar04	Apr04
Total Employment	Year over Year	CNI	0,17%	0,80%	0,93%
Hours Worked in Production	% growth	CNI	0,10%	8,73%	3,07%
			Mar04	Apr04	May04
Open Unemployment Rate	%	IBGE	12,79%	13,06%	12,21%
<i>Wage</i>			Feb04	Mar04	Apr04
Real Wage	Year over Year	CNI	7,01%	8,81%	8,51%
Real Wage per worker	% growth		7,06%	7,95%	7,51%
<i>Price Indices</i>			May04	YTD	12 month rate
IPCA	% growth	IBGE	0,51%	2,75%	5,15%
IGP-DI	% growth	FGV	1,46%	5,55%	7,98%
IPA	% growth	FGV	1,71%	6,71%	8,77%
Industrial Products	% growth	FGV	1,32%	7,83%	8,18%
<i>Exchange Rates</i>			Jun04	% over Dec03	% over Jun03
Nominal Exchange Rate R\$/US\$	R\$/US\$	Banco Central	3,1283	6,97%	8,53%
			May04	% over Dec03	% over May03
Real Exchange Rate / defl. industrial products price index	1stsemester'94 = 100	CNI	121,59	0,47%	3,62%
<i>Interest Rates</i>			Apr04	May04	YTD
Selic	% per year	Banco Central	15,92%	15,77%	16,10%
Lending rate (fixed rate) to Individuals	% per year	Banco Central	63,30%	62,40%	63,86%
Lending rate (fixed rate) to Companies	% per year	Banco Central	29,90%	30,00%	30,12%
			1Q04	2Q04	3Q04
TJLP	% per year	Banco Central	11,00%	9,75%	9,75%
<i>Public Sector Borrowing Requirements</i>			Mar04	Apr04	May04
Nominal data	% of GDP	Banco Central	4,38%	4,44%	4,09%
Primary data	(latest 12 months)	Banco Central	-4,13%	-4,23%	-4,29%
Total Net Debt	% of GDP	Banco Central	57,27%	56,46%	56,81%
Federal Bonds outside the Central Bank	% of GDP	Banco Central	45,76%	45,49%	43,63%
<i>External Sector</i>			Jun04	YTD	Last 12 months
Exports	US\$ million	Secex	9.327	43.306	83.388
Imports	US\$ million	Secex	5.517	28.250	53.906
Trade Balance	US\$ million	Secex	3.810	15.056	29.482
			May04	YTD	Last 12 months
Current Account	US\$ million	Banco Central	1.478	2.426	6.446
			Mar04	Apr04	May04
Net Foreign Direct Investment	US\$ million	Banco Central	703	381	207

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