April | 2012

Monthly Economic Outlook

VotorantimAsset

Brazilian Industrial Activity Remains Weak

Unfortunately it appears that 2012 will be another year of negligible industrial growth

The accompanying graph illustrates the weakness of Brazilian industrial production at the beginning of 2012, which even in light of robust domestic demand has been unable to gain momentum. While retailers have managed to register a cumulative growth of 26.5% since the onset of the international financial crisis in September of 2008, the graph shows that Brazil's industrial production is still lagging 3.0% behind its pre-crisis level. In a scenario where the difficulty of our industrial production competitiveness has become increasingly evident, the government has taken some measures in an effort to stimulate this sector.

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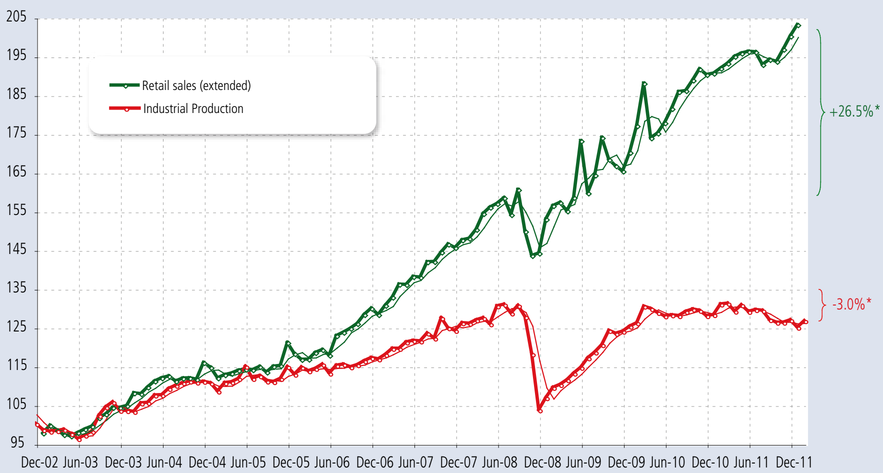
IBGE: Retail Sales x Industrial Production
Seasonally ajusted monthly series (index base 2003=300)



* The accumulated change compared to the level of 3Q08.
Sources: IBGE.

In 2009 the international financial crisis provoked a sharp 9.7% drop in Brazil's industrial production. This was followed by an 11.8% increase in 2010, which was only enough to recover from that fall, and a subsequent growth rate of merely 0.3% in 2011. With the decline in growth recorded during the first few months of this year, the carry-over effect (hypothetical continuance of current levels of production) is pointing to a contraction of 1.7% in 2012. Some specific factors (such as the reduction of excessive inventories in important sectors like the automotive industry) which hindered industrial production at the outset of 2012 should be reversed in coming months, but it will be difficult for the recovery that is projected for the end of 2012 to raise production in this sector above 1% for the year.

Due to growing concern over weak industrial production, the government announced the following a set of eight different measures at the beginning of April: proactive foreign exchange controls; new tax measures; stimulation of domestic production (through governmental procurement); financing for foreign trade; trade protection; incentives for the communications sector; credit measures (via BNDES); and the implementation of a new regime for the automotive sector. The measures which should have the greatest impact on industrial activity, are the tax measures with the exemption of the charge of the employer share of social security for 15 industrial sectors, and the credit measures with the new contribution of R$45 billion that the Treasury will allocate to the National Bank for Economic

Development (BNDES). When combined with the reversal of aforementioned specific factors that hampered industrial production at the outset of 2012, these stimulus measures should contribute to a moderate recovery of industrial activity over the coming months.

On the other hand, even with the government's promised "proactive foreign exchange controls, it will be difficult to keep the Real from appreciating over the next few years (see the second graph). The Central Bank continues its policy of purchasing dollars to add to Brazil's international reserves, but foreign exchange inflows should continue to be robust, due either to a still relatively high trade surplus, or to the robust inflows of foreign direct investment or portfolio investment. Therefore it still seems essential that Brazil continue to confront the challenges that limit the competitiveness of its domestic industry, tackling the known problems of its infrastructure deficiencies, the quality of its workforce, and its tax structure, among others.

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Effective exchange rate for the Brazilian Real
Exchange rate between Brazil and its 15 top trading partners, adjusted by production costs which were measured by their respective consummer price indexes

Source: Banco Central.