May | 2012

Monthly Economic Outlook

VotorantimAsset

Central Bank Expected to Extend Benchmark Interest Rate Cuts until 8.00%

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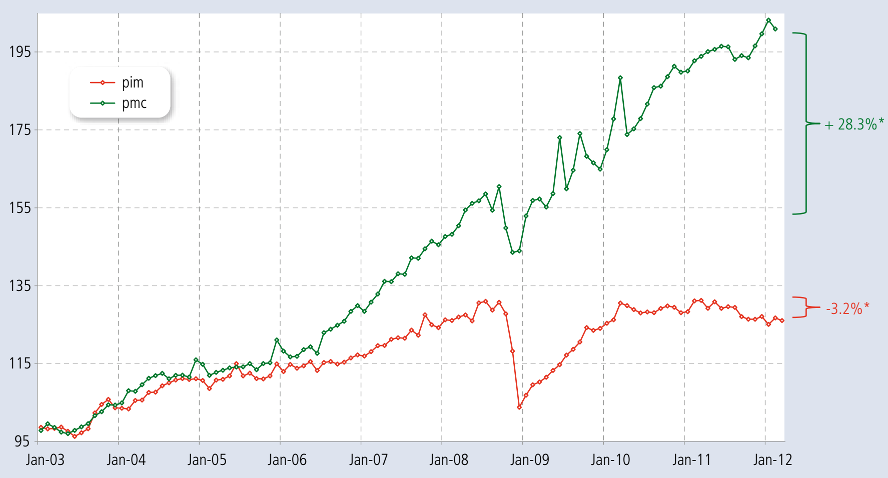
On the 26th of April the Minutes of the last Monetary Policy Committee meeting indicated that any further cuts in the Selic rate from the current level of 9.00% "should be conducted with parsimony." Faced with the slow recovery of the Brazilian economy, this signal has cleared the way for the expectation that future cuts could move the Selic interest rate to its lowest historic level. Two events that occurred on May 3rd caused us to review our outlook regarding the falling interest rate: (i) IBGE's disclosure of Industrial Production performance, which came in well below expectations, and (ii) the official announcement of new rules regarding the rate of return on savings accounts, which were presented by the government precisely to allow the Selic rate to continue to be reduced without provoking negative imbalances between financial instruments.

The first graph illustrates the weakness of the recovery of the Brazilian economy. Even with robust domestic demand, industrial production has not kept pace with that momentum. While retailers managed to register a cumulative growth of 28.3% since the onset of the international financial crisis in September of 2008, the graph shows that Brazilian industrial production is still 3.2% below its pre-crisis level. Contrary to the expectation that there could have been some respite from declining industrial activity during the month of April, after the expressive declines which were registered during the first part of the year, production fell once again reinforcing a scenario in which the competitive difficulties of the Brazilian industrial sector have become increasingly evident. Even with robust domestic demand, it appears that the weakness of industrial production will not allow the Gross Domestic Product to exceed 3% in 2012. However, if the overall performance of the Brazilian economy has frustrated expectations since 2011 (with GDP growth of only 2.7%), it is worth remembering that some sectors of the domestic economy have been able to present good growth. As the result of heated domestic demand, the retail sector has not been the only area that is growing at a reasonable pace, but other economic areas that unlike the production industry have not been hindered by international competition, have also performed well. This has resulted in a labor market that remains strong and an

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.

unemployment rate that continues at its lowest level in the historic series. Consequently, wage increases still remain high and the pressures of growing demand, especially in the service sector, mean that inflation expectations will continue to be under pressure. The second graph shows that the inflation forecasts for next year already exceed the 5.50% level, moving dangerously towards the ceiling of the Central Bank's inflation target. Therefore, we believe it is indeed recommendable that any further cuts in the Selic rate be conducted with "parsimony" so as to avoid the risk of inflation surprises in 2013 that would oblige the monetary authority to reverse its course and start raising interest rates again next year. Our basic scenario contemplates a 50 basis-point cut at each of the next two Copom meetings, bringing the Selic rate to the level of 8.00% in July 2012.

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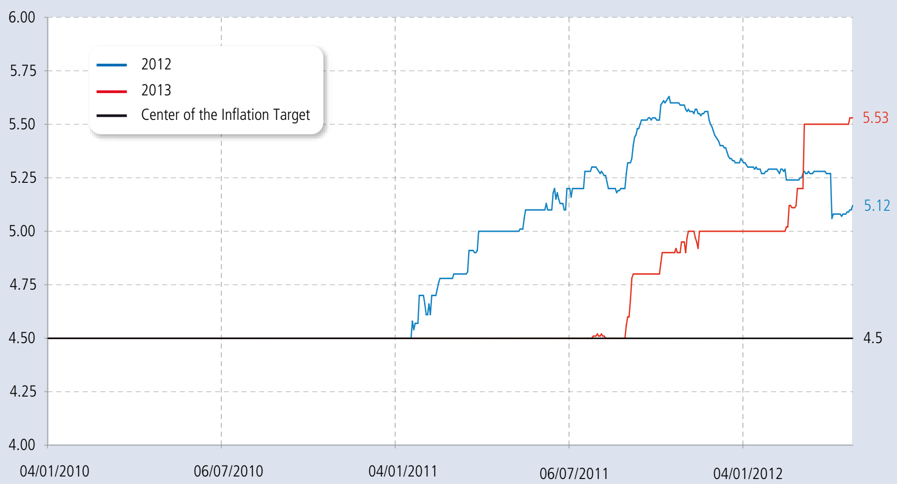
Market Expectation for Inflation (IPCA) in 2012 and 2013



Source: Central Bank of Brazil.