

The Brazilian Economy

Activity level

Brazilian economic growth accelerated in 2006, particularly in the final two quarters. All of the various sectors posted across-the-board expansion, driven by strong internal demand for both investment products and consumption. The improvement registered by the Brazilian economy reflects effective monetary policy management, targeted at ensuring price stability, while reducing the uncertainties faced by economic agents and thereby stimulating the spending required for sustainable economic growth.

Analysis of demand components indicates strong growth under Gross Fixed Capital Formation (GFCF) compared to household consumption, suggesting renewed confidence in the continuity of economic growth. Family consumption was driven by expanding overall wages, a steadily increasing credit supply and a high level of consumer confidence, all of which are elements that stimulate further sales of consumer durables.

The growing dynamics of the internal market impacted the volume of imports of goods and services which, for the first time in eight years, expanded at a rate greater than exports. Despite this shift, the trade balance achieved a record surplus, mainly as a result of higher prices for Brazilian exports.

Gross Domestic Product

According to figures released by the Brazilian Institute of Geography and Statistics (IBGE), Gross Domestic Product (GDP) registered real growth of 3.7% in 2006, the 14th consecutive year of positive economic expansion. At current values, GDP reached R\$2,322.8 billion at market prices.

The performance of the internal market was a determining factor underlying 2006 GDP growth, considering that the external sector made a negative contribution of 1.4 p.p. Internal demand accounted for 4.8 p.p. of GDP growth, with positive expansion in all sectors. Here, particular emphasis should be given to the farm sector, services and to mining and construction, in industrial sector.

When one considers quarterly GDP growth in 2006 – always on a quarter-on-quarter basis utilizing seasonally adjusted data – the first quarter showed growth of 1.6%, mainly as a consequence of the process of economic recovery initiated in the second half of 2005. Using this basis of comparison, the farm sector showed growth of 2.2%, reflecting suitable climatic conditions that had a strongly positive influence on the corn and soybean crops. Industry expanded 1%, particularly in light of the relative dynamics shown by the sector of consumer durables, a performance that was not repeated in the categories of capital goods and intermediate goods, which turned in relatively stable performances in the period. The service sector expanded 1.7%, reflecting the performances of other sectors of the economy.

Table 1.1 – GDP at market prices

Year	At 2006 prices (R\$ million)	Real change (%)	Implicit deflator (%)	At current prices ^{1/} (US\$ million)	Population (million)	Per capita GDP		
						At 2006 prices (R\$)	Real change (%)	At current prices ^{1/} (US\$)
1980	1 302 591	9.2	92.1	237 772	118.6	10 986	7.0	2 005
1981	1 247 230	-4.3	100.5	258 553	121.2	10 290	-6.3	2 133
1982	1 257 582	0.8	101.0	271 252	123.9	10 151	-1.3	2 190
1983	1 220 735	-2.9	131.5	189 459	126.6	9 645	-5.0	1 497
1984	1 286 655	5.4	201.7	189 744	129.3	9 953	3.2	1 468
1985	1 387 645	7.8	248.5	211 092	132.0	10 514	5.6	1 599
1986	1 491 579	7.5	149.2	257 812	134.7	11 077	5.4	1 915
1987	1 544 232	3.5	206.2	282 357	137.3	11 250	1.6	2 057
1988	1 543 305	-0.1	628.0	305 707	139.8	11 038	-1.9	2 186
1989	1 592 074	3.2	1 304.4	415 916	142.3	11 188	1.4	2 923
1990	1 522 819	-4.3	2 737.0	469 318	146.6	10 388	-7.1	3 202
1991	1 538 504	1.0	416.7	405 679	149.1	10 319	-0.7	2 721
1992	1 530 141	-0.5	969.0	387 295	151.5	10 097	-2.2	2 556
1993	1 605 496	4.9	1 996.1	429 685	154.0	10 426	3.3	2 790
1994	1 699 464	5.9	2 240.2	543 087	156.4	10 864	4.2	3 472
1995	1 771 246	4.2	93.9	770 350	158.9	11 149	2.6	4 849
1996	1 809 337	2.2	17.1	840 268	161.3	11 216	0.6	5 209
1997	1 870 407	3.4	7.6	871 274	163.8	11 420	1.8	5 320
1998	1 871 068	0.0	4.2	843 985	166.3	11 254	-1.5	5 077
1999	1 875 822	0.3	8.5	586 777	168.8	11 116	-1.2	3 477
2000	1 956 599	4.3	6.2	644 984	171.3	11 423	2.8	3 766
2001	1 982 291	1.3	9.0	553 771	173.8	11 404	-0.2	3 186
2002	2 034 982	2.7	10.6	504 359	176.4	11 537	1.2	2 859
2003	2 058 316	1.1	13.7	553 603	179.0	11 500	-0.3	3 093
2004	2 175 893	5.7	8.0	663 783	181.6	11 983	4.2	3 655
2005	2 239 941	2.9	7.5	882 729	184.2	12 161	1.5	4 793
2006	2 322 818	3.7	4.3	1 067 325	186.8	12 437	2.3	5 715

Source: IBGE

^{1/} Estimates obtained by the Banco Central do Brasil dividing the GDP at current prices by the annual average buying rate of exchange.

The less favorable second quarter situation resulting in a 0.5% decrease in GDP for the period. Industrial sector output dropped 1.7%, while the farm sector and service sector posted respective growth rates of 0.04% and 0.1%.

Table 1.2 – GDP – Quarterly growth/previous quarter – Seasonally adjusted

Itemization	2006			
	I	II	III	IV
GDP at market prices	1.6	-0.5	2.6	0.9
Crop and livestock sector	2.2	0.0	7.6	-1.5
Industrial sector	1.0	-1.7	3.1	1.2
Service sector	1.7	0.1	1.1	0.9

Source: IBGE

In the third quarter of the year, GDP showed vigorous recovery. The 2.6% increase registered in the period reflected growth in the crop/livestock sector, 7.6%; industry, 3.1%; and services, 1.1%. The recovery process that began in that quarter continued into the subsequent period, albeit at a lesser pace, as GDP expanded 0.9%. The major element underlying this performance was a reduction of 1.5% in crop/livestock sector production, impacted mainly by the wheat crop; coupled with increases of 1.2% in the industrial sector and 0.9% under services.

Once again, a sectoral analysis of GDP in 2006 indicated that the growth process had disseminated into other areas of the economy. Crop/livestock activity expanded 4.1% in the year, the 16th consecutive year of positive growth, with 3.6% expansion in grain output resulting from an 8.4% gain in productivity and a 4.4% cutback in the area under cultivation.

Industrial sector growth reached 2.8% in 2006, once again reflecting positive performances in all of the various subsectors. Manufacturing expanded 1.6% in the year, with output growth in all of the different use categories, but particularly under consumer durables and capital goods. For the third consecutive year, the building industry expanded 4.6%, while production and distribution of electricity, gas and water increased 3.3%. Furthermore, it is important to stress 6% expansion in the mining industry, achieved basically through increased output of iron ore, 10.9%, and petroleum, 5.6%.

The service sector expanded 3.7% in 2006, reflecting positive performances in all of the various segments, with emphasis on financial institutions, 6.1%; commerce, 4.8%; real estate activities and rentals, 4.3%; transportation, storage and postal services, 3.2%; and education and public health services, 3.1%.

Table 1.3 – GDP real change rates – Under the prism of production

Percentage			
Itemization	2004	2005	2006
GDP	5.7	2.9	3.7
Crop and livestock sector	2.3	1.0	4.1
Industrial sector	7.9	2.2	2.8
Mineral extraction	4.3	9.8	6.0
Manufacturing	8.5	1.1	1.6
Building	6.6	1.2	4.6
Production and distribution of electricity, gas and water supply	8.4	5.0	3.6
Service sector	5.0	3.4	3.7
Commerce	7.5	3.5	4.8
Transportation, storage and postal services	5.9	4.3	3.2
Information services	5.5	4.3	2.3
Financial intermediation, insurance, complementary pension system and related services	3.7	6.5	6.1
Other services	5.4	3.4	2.6
Real estate activities and rent	3.9	4.1	4.3
Public administration, health and education	3.8	1.0	3.1

Source: IBGE

Viewed under the prism of demand, analysis of GDP shows internal market recovery, contributing 4.8 p.p. to annual product growth, against -1.4 p.p. for the external sector. Strengthening of the internal market reflects the benign macroeconomic scenario, as reflected in rising real income, expanding credit and improved expectations. In this framework, household consumption expanded 4.3%; and government consumption increased 3.6%, while investments rose 8.7%. Exports continued on the growth trajectory begun in 1996 and expanded 4.6% in the year, while imports moved upward 18.1%, in response to the uptick in the pace of economic activity as a whole.

Table 1.4 – GDP real change rates – Under the prism of expenditure

Percentage			
Itemization	2004	2005	2006
GDP	5.7	2.9	3.7
Family consumption	3.8	4.7	4.3
Government consumption	4.1	1.9	3.6
Gross Fixed Capital Formation	9.1	3.6	8.7
Exports of goods and services	15.3	10.1	4.6
Imports of goods and services	14.4	9.3	18.1

Source: IBGE

Table 1.5 – Gross Domestic Product – At current value

In R\$ million

Itemization	2003	2004	2005	2006
Gross Domestic Product at market prices	1 699 948	1 941 498	2 147 944	2 322 818
Under the prism of production				
Crop and livestock sector	108 619	115 194	104 556	102 891
Industrial sector	409 504	501 771	561 807	617 965
Service sector	952 491	1 049 293	1 185 159	1 278 771
Under the prism of expenditure				
Final consumption expenditure	1 382 355	1 533 895	1 727 168	1 865 142
Family consumption	1 052 759	1 160 611	1 296 467	1 402 135
Government consumption	329 596	373 284	430 701	463 007
Gross Capital Formation	268 095	332 333	343 600	389 428
Gross Fixed Capital Formation	259 714	312 516	349 463	390 134
Changes in inventories	8 381	19 817	-5 863	-706
Exports of goods and services	254 770	318 892	324 949	340 409
Imports of goods and services (-)	205 272	243 622	247 773	272 160

Source: IBGE

Table 1.6 – Gross capital formation (GCF)

Percentage

Year	Share in GCF			Changes in inventories	At current prices	
	Gross Fixed Capital Formation (GFCF)				GFCF/GDP	GCF/GDP
	Building	Machines and equipments	Others			
1995	44.5	48.9	8.3	-1.6	18.3	18.0
1996	48.2	43.5	7.3	1.0	16.9	17.0
1997	49.5	43.1	7.0	0.3	17.4	17.4
1998	51.9	40.8	6.9	0.3	17.0	17.0
1999	50.6	37.2	7.8	4.4	15.7	16.4
2000	45.7	39.3	7.1	7.9	16.8	18.3
2001	43.9	43.3	7.3	5.5	17.0	18.0
2002	47.8	44.8	8.5	-1.2	16.4	16.2
2003	42.8	45.3	8.7	3.1	15.3	15.8
2004	41.1	45.0	7.9	6.0	16.1	17.1
2005	44.2	49.2	8.3	-1.7	16.3	16.0
2006	16.8	16.8

Source: IBGE

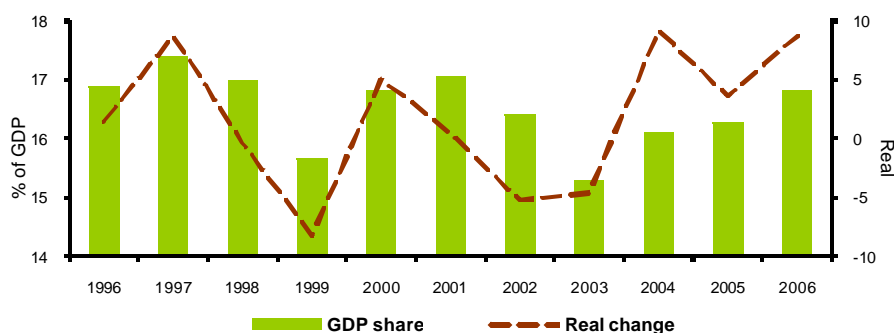
Investments

According to IBGE's National Quarterly Accounts, the 8.7% increase in Gross Capital Formation (GCF), the third consecutive positive annual result, reflected positive performances on the part of building industry inputs and capital goods

production. This pace of growth was more than double that of GDP, and clearly aided in raising the participation of GFCF in GDP from 16.3% in 2005 to 16.8% in 2006.

Production of building industry inputs expanded 4.5% in 2006, against 1.3% in the previous year. This acceleration reflected the performance of the building industry, clearly compatible with the improved macroeconomic environment. Output of capital goods, another important investment indicator, increased 5.7%, compared to 3.6% in 2005. Based on seasonally adjusted data, this growth was particularly strong in the second half of the year, when expansion came to 5.5% compared to the previous half-year period.

Graph 1.1
Gross Fixed Capital Formation



Source: IBGE

Table 1.7 – Selected capital goods production

Itemization	Percentage change		
	2004	2005	2006
Capital goods	19.7	3.6	5.7
Industrial	18.1	-2.2	5.3
Serial	20.2	-2.2	5.1
On an order basis	-6.6	10.4	6.9
Agricultural	6.4	-37.7	-16.5
Agricultural parts	-7.5	-69.0	-38.9
Building	38.0	32.0	8.2
Electric energy	12.5	28.5	22.2
Transportation	25.6	6.6	-1.6
Mixed	14.8	3.4	11.6

Source: IBGE

Capital goods production registered across-the-board growth in all segments, with the exception of transportation equipment and those closely associated to the crop/livestock sector. In this framework, production of parts and farm machines and equipment diminished 38.9% and 16.5%, respectively, reflecting the income decline that occurred in the agricultural sector. In the opposite sense,

output of capital goods targeted to the sectors of electricity, construction and industry expanded 22.2%, 8.2% and 5.3%, respectively. It is important to highlight that, in the final quarter of 2006, there was a significant increase at the margin in the output of goods targeted to the industrial sector, with growth of 5.2% over the previous period, based on seasonally adjusted data.

To some extent, the performance of industry was associated to downward movement in the Long-Term Interest Rate (TJLP), which is utilized as the indexing factor for financing contracted with the National Bank of Economic and Social Development (BNDES). This index declined 2.9 p.p. in 2006, closing the year at 6.85%. It should be emphasized that the change in the TJLP resulted from reductions in all quarters of the year.

Industrial output indicators

In 2006, according to IBGE's Monthly Industrial Survey – Physical Production (PIM-PF), industrial production expanded 2.8% in 2006, reflecting combined growth of 7.4% under mining and 2.6% in manufacturing. The evolution of industrial output in the different quarters of 2006 was relatively homogeneous, with positive growth results in all quarters, when compared both to the previous quarter and to the corresponding quarter of 2005.

Table 1.8 – BNDES disbursements^{1/}

In R\$ million

Itemization	2004	2005	2006
Total	39 834	46 980	51 318
By sector			
Manufacturing industry	15 539	23 104	25 734
Commerce and service	17 122	19 479	20 704
Crop and livestock	6 930	4 059	3 423
Extraction industry	243	338	1 458

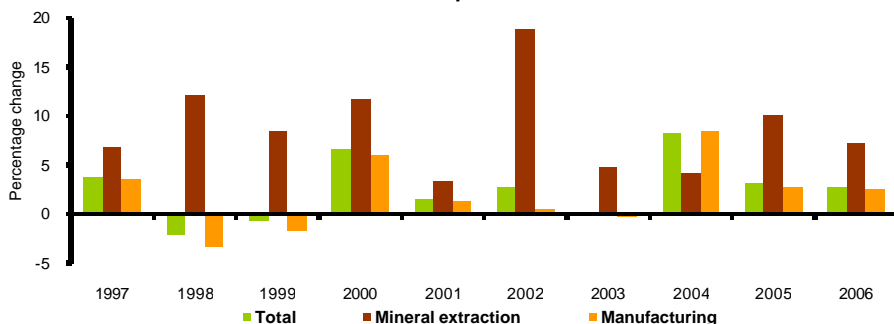
Source: BNDES

^{1/} It includes BNDES, Finame and BNDESpar.

Iron ore mining expanded 10.9% in the year, and represented the major factor underlying industrial growth. Oil and natural gas extraction posted cumulative growth of 5.1% in 2006, stressing that new oil drilling platforms were inaugurated during the course of the year, expanding the sector's productive capacity, with highly positive impacts on potential short-term supply.

The performance of manufacturing reflected increases in the production of office machinery and computer equipment, 51.6%; medical-hospital, optical and other instruments, 9.4%; electric machines, apparatuses and equipment, 8.7%; and furniture, 8.4%; while the segments of wood, apparel and accessories, and footwear and leather products registered declines of 6.8%, 5% and 2.7%, respectively.

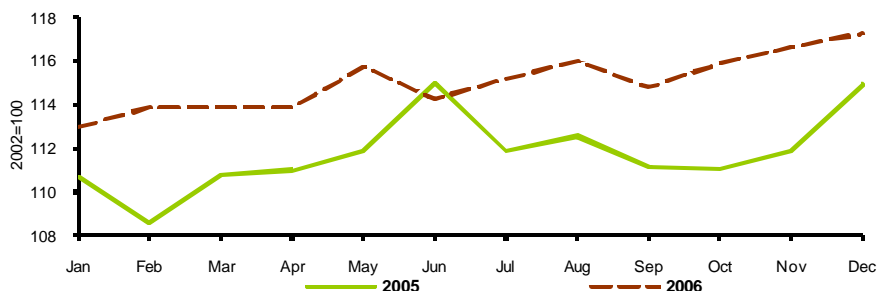
Graph 1.2
Industrial production



Source: IBGE

Annual industrial activity growth in 2006 was led by the categories of consumer durables and capital goods, with respective growth rates of 5.8% and 5.7%. With respect to capital goods output, emphasis should be given to the performance of the sectors of office machines and computer equipment, as well as electric machines, apparatuses and equipment. Parallel to this, production of this category targeted to the electrical energy sector expanded 22.2%, while that channeled to agriculture declined 16.9%, clearly reflecting the falloff in farm income and a 26.9% drop in exports of farm machinery in 2006.

Graph 1.3
Industrial production
Seasonally adjusted data

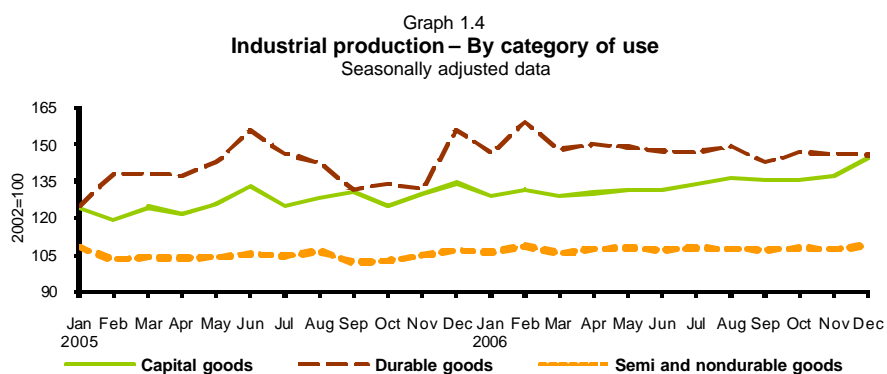


Source: IBGE

With the good performance achieved by mining, output of intermediate goods expanded 2.1% in the year, despite reductions of 6.3% in the output of metal products and 1% under other chemical products. Production of semi-durable and

nondurable consumer goods increased 2.7% in 2005, with emphasis on growth in the segments of beverages, 7.7%; oil refining and alcohol production, 6%; tobacco, 5.3%; and pharmaceuticals, 5.1%.

Among the 27 activities surveyed by the IBGE, 20 registered positive growth in 2006, indicating a more homogeneous process of industrial growth than in the preceding year, when a total of 17 industrial activities posted positive growth results. Nonetheless, industrial growth was heavily concentrated, as is evident in the fact that just eight activities¹ accounting for 40% of the Brazilian industrial structure were responsible for approximately 80% of annual growth in industrial output. The other 12 activities that posted positive growth during the year made a much more modest contribution to expansion of the industrial sector in general, while output of electronic equipment, communications devices and equipment remained stable. The six activities that registered negative growth in 2006 were responsible for a reduction of 0.3 p.p. in the annual rate of industrial output growth.



In 2006, agribusiness expanded 1.6%, compared to a 1% reduction in the previous year. Though climatic conditions were more favorable and, therefore, contributed more significantly to the performance of agriculture-related sectors, such other factors as exchange appreciation, the end of the import tax on pesticides, together with animal health problems in the cattle sector, were determining factors underlying the reductions registered in segments associated to livestock farming, especially the grouping of insecticides, herbicides and other products designed for farm use.

According to the National Association of Automotive Vehicle Manufacturers (Anfavea), production of the automobile sector reached 2.6 million units in

¹/ Office machines and informatics equipment; mining; machinery and equipment; electric apparatuses and machines; food; beverages; basic metallurgy and pharmaceuticals.

2006, up 3.3% over the previous year, while production of farm machines fell 12.9%. Overall sales of automotive vehicles expanded 5.1% in the year, registering growth of 11.1% in internal sales and a 5.8% decline in sales targeted to the foreign market.

Table 1.9 – Industrial production

Itemization	Percentage change		
	2004	2005	2006
Total	8.3	3.1	2.8
By category of use			
Capital goods	19.7	3.6	5.7
Intermediate goods	7.4	0.9	2.1
Consumer goods	7.3	6.0	3.4
Durable	21.8	11.4	5.8
Semi and nondurable	4.0	4.6	2.7

Source: IBGE

With regard to regional performances of industrial output, it is important to note 14.2% annual growth in the state of Pará, led by products typical of the export sector. Industries in the state of Ceará, driven by the sectors of textiles, chemical products and electric machines, apparatuses and equipment, together with those of Espírito Santo, the site of dynamic activity in the segments of petroleum production and food and beverage output, turned in the second and third best performances of the year, with respective rates of 8.2% and 7.6%. Industries from the states of Pernambuco, 4.8%, Minas Gerais, 4.5%, Bahia, 3.2%, and São Paulo, 3.2%, registered annual growth rates above the national average, while those located in the states of Goiás, Rio de Janeiro and Santa Catarina ended the year with respective rates of 2.4%, 1.9% and 0.2%.

Moving in the opposite direction, production in the state of Amazonas dropped 2.2%, followed by the states of Rio Grande do Sul, 2%, and Paraná, 1.6%. The decline in the production of cell telephones and radios, chemical products and oil refining and alcohol production were the major factors underlying the negative results registered in Amazonas, while the performance of industry in Rio Grande do Sul reflected a reduced pace of activity in the segments of machines and equipment, metal products and leather and footwear articles. In the state of Paraná, the result was generated by a negative performance in the sector of automotive vehicles, to some extent provoked by strikes that occurred in the industry during the month of September.

According to the National Confederation of Industry (CNI), real industrial sales expanded 1.7% in 2006. In a context of exchange appreciation, it should be stressed that these indicators should be viewed with caution, since real sales may

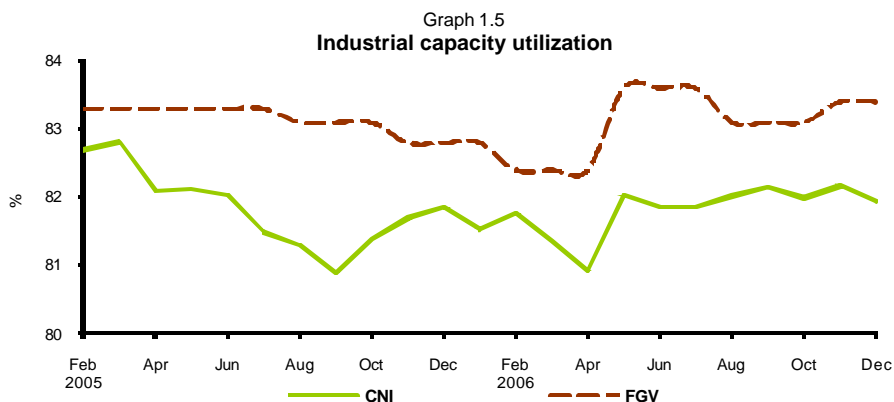
have been underestimated, considering that, on being converted into real, the value of the share channeled to the export market will, for the most part, reflect exchange variation. In relation to labor market indicators in the industrial sector, CNI registered increases of 2.2% in the employment level and 1.8% in hours worked.

According to the Foreign Trade Studies Center Foundation (Funcex), the volume of exports of semi and manufactured goods showed growth of 3.5% and 2.1%, respectively, in 2006. This performance was more modest than in previous years, as evident in the fact that the corresponding rates in 2005 were 6.3% and 11%; and in 2004, 7.2% and 26.1%, respectively, and, to some extent, reflected the trajectory of exchange rate appreciation that occurred as of the second half of 2003.

As measured by the CNI, the average level of Utilization of Installed Capacity (UIC) reached 81.8% in 2006, remaining at the previous year's level. In the same sense, data released by the Getulio Vargas Foundation (FGV) indicated a marginal reduction in UIC from 83.5% in 2005 to 83.3% in 2006. These results suggested the existence of a low level of risk of inflationary pressures consequent upon supply shortages over the short-term.

A breakdown of FGV's UIC according to use categories shows increases of 3.3 p.p. and 0.6 p.p. in the level of utilization of installed capacity in the building materials industry and capital goods industry, respectively. On the other hand, reductions of 0.9 p.p. and the 0.2 p.p. occurred in the consumer goods and intermediate goods industries, in that order.

The evolution of industrial production in 2006 was consistent with expectations regarding the level of economic activity as released in the November 2005 Manufacturing Industry Survey – Special Questions, carried out by the FGV. As released in November 2006, expectations for 2007 are considerably more



favorable than in the previous year and suggest continuation of the growth process under way in the industrial sector.

Table 1.10 – Industrial capacity utilization ^{1/}

Percentage			
Itemization	2004	2005	2006
Manufacturing industry	82.4	83.5	83.3
Consumer goods	78.4	81.2	80.1
Capital goods	79.3	81.4	82.0
Building material	82.3	81.8	85.1
Intermediate goods	87.3	87.5	87.3

Source: FGV

^{1/} Quarterly survey. Average in the year.

Commerce indicators

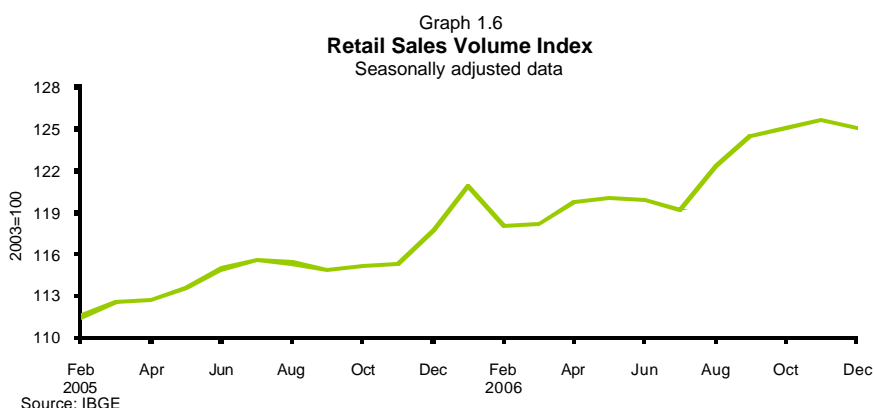
Retail activity indicators showed positive results in 2006. According to the Monthly Retail Trade Survey (PMC), released by the IBGE, the Retail Sales Volume Index expanded 6.2% in 2006 and continued the trend toward annual growth initiated in 2004. Just as occurred in the previous year, sales registered across-the-board growth with the exception of fuels and lubricants, which declined 8% in the year. Sales in the segments of furniture and home appliances and hypermarkets, supermarkets, food and beverage products and tobacco expanded 10.3% and 7.6%, respectively, while those involving automobiles, motorcycles, parts and spares, and building materials, which are not included in the restricted index, expanded 7.2% and 4.7%, respectively. The Expanded Retail Sales Volume Index, which incorporates these two segments, expanded 6.4% in the year.

Retail sales increased in 26 states, posting negative growth only in Mato Grosso, 9.9%, as a consequence of income losses in the crop/livestock sector. The strongest increases occurred in Roraima, 30.1%; Acre, 27.5%; Amapá, 23.6%; Alagoas, 18.7%; and Tocantins, 17.5%, the states in which federal government assistance programs have had their greatest impact on the population's income.

Nominal Sales Revenues expanded 7.3% in 2006, resulting from increases of 6.2% in the volume of sales and 1% in the prices of tradables at the retail level. In all segments of the retail trade sector, except fuels and lubricants, annual growth in nominal revenues was greater than average growth of 4.2% in the Extended National Consumer Price Index (IPCA), which is calculated by IBGE. In this context, particular mention should be made of vehicles, motorcycles, parts and spares, 7.6%; furniture and home appliances, 7.3%; and fabrics, apparel and footwear, 7.2%.

Statistics released by the São Paulo Trade Association (ACSP) on the number of consultations with the Credit Protection Service Center (SCPC) and the Usecheque system corroborated the growth trend in retail sales. These indicators rose 3.3% and 5.6%, respectively, compared to 2005.

The 2006 increase in default levels was compatible with expanding sales, just as had occurred in the preceding year. The indicator that measures the ratio between checks returned due to insufficient backing and total checks cleared increased 6.5% nationwide during the year, while defaults in the São Paulo Metropolitan Region (RMSP), measured by the ACSP, climbed to 5.3%, compared to 5% in 2005.



The results of the survey that evaluates consumer expectations suggest that retail sales will continue expanding in 2007. The Consumer Confidence Index (ICC), released by the Trade Federation of the State of São Paulo (Fecomercio SP), registered growth of 10.4% in the final quarter of 2006, compared to the corresponding period of the previous year. This result was a consequence of increases of 7.9% in the Current Economic Conditions Index (Icea), which accounts for 40% of the general index, and 12% of the Consumer Expectations Index (IEC).

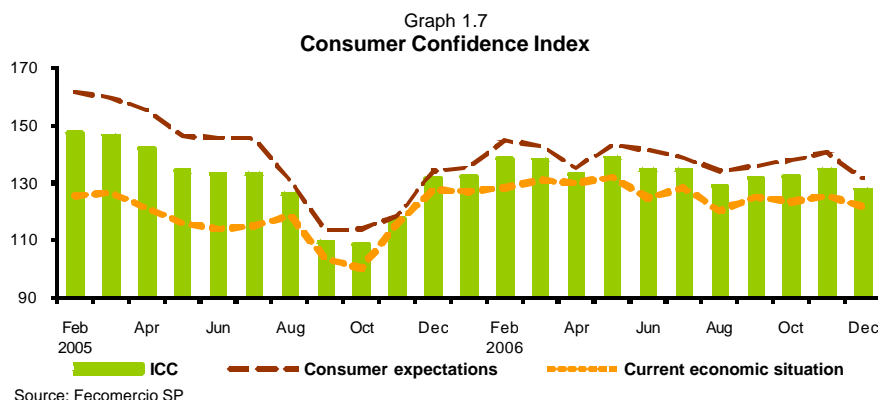
The National Confidence Index (INC), which is released by the ACSP, reached 140.8 points in December 2006 on a scale that extends from zero (absolute pessimism) to 200 (absolute optimism) and surpassed the corresponding result in 2005 by 20.7%. The INC posted growth in all regions of the country, particularly in the North/Central West, 26.8%, and the Southeast, 23.5%.

Crop/livestock production indicators

According to IBGE's Systematic Farm Production Survey (LSPA), the 2006 grain harvest reached 116.6 million tons. Annual growth of 3.6% reflected a 4.4% cutback in the area under cultivation and growth of 8.4% in average productivity.

Production in the southern region expanded 24.4% and that of the Central West declined 6.4%, accounting for respective levels of approximately 41.4% and 34% of the total national harvest.

National soybean output closed at 52.2 million tons, up 2.1% in annual terms. Average yield expanded 6.7%, while the area under cultivation dropped 4.3%, reflecting the impact of the drought that marked the early part of the year, coupled with the excessive rainfall that fell during the harvest. These phenomena gave rise to outbreaks of fungi, such as Asian rust, in important producer regions.



The corn harvest totaled 42.5 million tons, for growth of 21% in the year. The area under cultivation expanded 9.2%, while average productivity increased 10.2%, clearly evincing the excellent performance of the crop in the southern region of the country, particularly during the first harvest.

Rice production declined 13% in 2006 and closed at 11.5 million tons. This result was a consequence of a 24.2% reduction in the area harvested, reflecting both unattractive market prices and 14.8% growth in average productivity.

The wheat harvest totaled 2.4 million tons. The annual reduction of 49.1% resulted from cutbacks in the area harvested, 34.6%, and average productivity, 22.1%. This performance reflected both unattractive prices at the producer level and difficulties experienced during marketing of recent harvests, particularly as a result of insufficient funding and climatic adversities in the major producer regions.

In 2006, the bean harvest expanded 13.1% and totaled 3.4 million tons, with increases of 7% in the area harvested and 5.6% in average productivity. Production during the first harvest (rainy season harvest) and the second harvest increased 11.2% and 26%, respectively, with growth of 4.2% and 12.6% in the area harvested, and 6.8% and 11.9% in average productivity, following the same order.

Coffee production reached 2.6 million tons, up 21.2% in the year. The area harvested remained practically unaltered, and average productivity increased 20.8%, primarily as a result of the biannual nature of the crop (full harvest year) and favorable climatic conditions, together with attractive international market commodity prices. Taken together, these factors encouraged investments in this activity.

Table 1.11 – Agricultural production – Major crops

Million tons		
Products	2005	2006
Grain production	112.6	116.6
Cotton seed	2.3	1.8
Rice (in husk)	13.2	11.5
Beans	3.0	3.4
Corn	35.1	42.5
Soybeans	51.1	52.2
Wheat	4.7	2.4
Others	3.1	2.8
Change in grain production (%)	-5.6	3.6
Other crops		
Bananas	6.8	6.9
White potatoes	3.1	3.1
Cocoa (beans)	0.2	0.2
Coffee (manufactured)	2.1	2.6
Sugarcane	422.9	458.0
Tobacco (in leaf)	0.9	0.9
Oranges	17.9	18.1
Cassava	25.7	26.7
Tomatoes	3.4	3.3

Source: IBGE

The sugarcane harvest turned in growth of 8.3% in 2006, with a total of 458 million tons. Average yield and area planted increased 1.4% and 6.8%, respectively, driven by the evolution of international sugar prices and by growing demand for fuel alcohol.

Table 1.12 – Agricultural production, harvested area and average earnings – Major crops

Percentage change						
Products	Production		Area		Average earnings	
	2005	2006	2005	2006	2005	2006
Grain production	-5.6	3.6	1.2	-4.4	-6.8	8.4
Cotton (seed)	-3.4	-21.3	9.2	-28.6	-10.1	10.2
Rice (in husk)	-0.4	-13.0	5.0	-24.2	-5.1	14.8
Beans	1.6	13.1	-4.9	7.0	6.8	5.6
Corn	-16.0	21.0	-6.6	9.2	-10.6	10.2
Soybeans	3.3	2.1	6.5	-4.3	-3.0	6.7
Wheat	-18.6	-49.1	-15.5	-34.6	-2.6	-22.1

Source: IBGE

Livestock

According to the Quarterly Survey of Animal Slaughters, calculated by IBGE, beef production totaled 6.9 million tons in 2006, for growth of 8.1% compared to the previous year. Poultry output totaled 8.1 million tons, with 2.3 million tons of pork, reflecting respective annual increases of 3.4% and 6.6%.

Table 1.13 – Grain stock – Major crops

Thousand tons			
Products	2003/2004	2004/2005	2005/2006
Grain production			
Rice (in husk)			
Beginning of the year	332.7	1 507.2	2 183.2
End of the year	1 507.2	2 183.2	1 112.4
Beans			
Beginning of the year	264.5	169.7	113.6
End of the year	169.7	113.6	355.3
Corn			
Beginning of the year	8 553.6	7 801.7	3 235.4
End of the year	7 801.7	3 235.4	3 417.6
Soybeans			
Beginning of the year	4 255.0	4 135.2	2 030.1
End of the year	4 135.2	2 030.1	1 144.0
Wheat			
Beginning of the year	399.5	412.0	1 234.1
End of the year	412.0	1 234.1	497.4

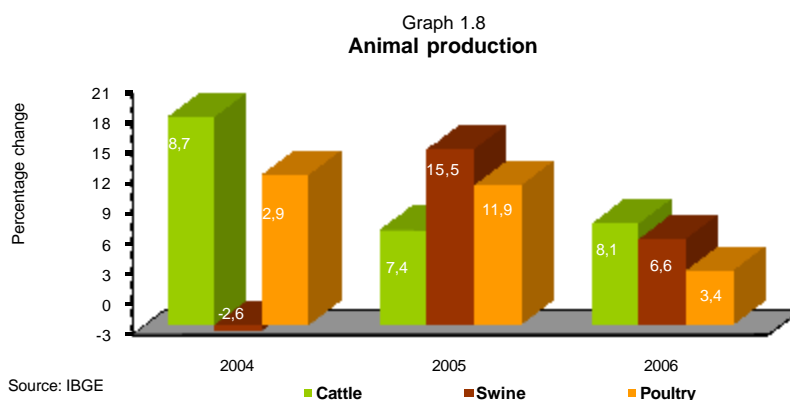
Source: Companhia Nacional de Abastecimento (Conab)

According to the Foreign Trade Secretariat (Secex), subordinated to the Ministry of Development, Industry and Foreign Trade (MDIC), beef exports reached 1.2 million tons, up 12.9% compared to 2005. Foreign sales of poultry and pork totaled 2.6 million tons and 484.2 thousand tons, respectively, reflecting reductions of 6.4% and 16.4% compared to 2005.

Agricultural policy

According to the Agriculture and Livestock Plan (PAP) 2006/2007, released by the Ministry of Agriculture, Livestock and Supply (Mapa), the availability of resources for rural credit totaled R\$60 billion, representing 12% growth compared to the previous agricultural year. Of this total, R\$50 billion were targeted to commercial agriculture and R\$10 billion to family farming.

In the case of commercial agriculture, the resources targeted to current expenditures and product marketing totaled R\$41.4 billion, 25% more than in the previous plan. Of this total, R\$30.1 billion involved resources granted at regulated rates of interest and R\$11.3 billion were granted at market interest rates. Credits targeted to investments added up to R\$8.6 billion, for growth of 23% compared to 2005. Of this total, R\$6.4 billion are expected to meet the needs of programs financed with BNDES resources, reflecting an annual reduction of 30.1%.



In the context of BNDES programs, it is important to mention the inclusion of a line of credit for the financing of used farm machinery in the Program of Modernization of the Farm Tractor Fleet and Like Implements and Harvesters (Moderfrota), together with a cutback in the interest rates applied to this program and to operations through the Special Industrial Financing Agency – Agriculture. At the same time, a specific investment credit line was included in the Crop/Livestock Integration Program (Prolapec), with the objective of supporting implementation of projects aimed at creating integrated systems of crop/livestock farming, with total funding of R\$200 million.

One should further stress that the PAP 2006/2007 also foresaw maintenance of the floor price policy of the major farm products, together with expansion of new agribusiness securities and the rural insurance program.

Productivity

Industrial productivity, defined as the ratio between the index of physical production of the sector, announced by IBGE, and the indicator of hours worked in production, made available by the CNI, increased 0.7% in 2006, compared to a reduction of 1.9% in the previous year. Reductions occurred in seven of the 12 states surveyed, with 5.3% in Amazonas, 3.6% in Rio de Janeiro, 3.1% in Paraná and 2.8% in Bahia, while the most representative growth occurred in Ceará, 8%; Espírito Santo, 7.5%; and Minas Gerais, 5%.

Average productivity of the farm sector, understood as the ratio between grain production and area under cultivation, expanded 8.4%. To some extent, this result reflected growth of 3.1% in total demand for agricultural fertilizers which, according to the National Association for Fertilizer Dissemination (Anda), declined 19.5% in the previous year. Another factor that contributed to the rise in productivity was the performance of internal sales of farm machinery, driven mainly by 15.3% growth in sales of wheeled tractors, according to data released by Anfavea. Sales of planters and harvesters dropped 21.4% in the year.

Energy

In 2006, according to the National Petroleum Agency (ANP), oil production, including Liquefied Natural Gas (LNG), expanded 5.6%, compared to 11.3% in the previous year. This result represented the 14th production increase since 1992, with the only decline (0.9%) occurring in 2004. Production totaled 1,809,000 barrels/day, compared to 1,712,000 barrels/day in 2005, closing with the highest daily level of 1,875,000 barrels in December, and the smallest, with 1,716,000 barrels in the month of June. Production of natural gas expanded 0.04% in 2006 and reached 305,000 barrels per day.

Total oil processed at refineries in 2006 increased 0.4%, closing with a total of 1,705,000 barrels per day, reflecting an increase of 0.3 p.p. in the participation of national petroleum, closing at 78.8%. Oil imports increased 0.9% in the year and totaled 358,400 barrels/day, while exports expanded 34%, reaching a level of 366,500 barrels per day, indicating an increase in the production of heavy oil, which Brazilian refineries are not equipped to process in sufficient quantity.

Sales of oil derivatives on the internal market dropped 1.4% in 2006, registering increases in the segments of gasoline, 7.1%; Liquefied Petroleum Gas (LPG), 1.4%; and aviation kerosene, 0.8%. In the opposite sense, sales of aviation gasoline dropped 6.7%; and those of diesel oil fell 6.2%; while fuel oil sales fell

2.2%. Overall consumption of alcohol increased 5.2%, resulting from a 29.2% rise in sales of hydrated alcohol and a 13.7% drop in sales of anhydrous alcohol, which is mixed into the country's gasoline supply. Sales of automobiles utilizing biofuel technology once more played an important role in the increase in alcohol consumption.

Table 1.14 – Apparent consumption of oil derivatives and fuel alcohol

Daily average (1,000 b/d)

Itemization	2004	2005	2006
Petroleum	1 338	1 347	1 328
Fuel oil	93	90	88
Gasoline	295	304	326
Diesel oil	674	674	632
Liquid gas	201	200	203
Other derivatives	75	78	79
Fuel alcohol	173	182	191
Anhydrous	98	101	88
Hydrated	75	80	104

Source: ANP

According to the Energy Research Company (EPE), which is subordinated to the Ministry of Mines and Energy (MME), national consumption of electrical energy expanded 3.4% in 2006, for growth of 4.4% in the commercial segment, 3.8% in the residential segment and 2.7% in industry. Consumption of other unlisted segments, including public lighting, public services and the rural sector, expanded 3.7%.

Table 1.15 – Electric energy consumption^{1/}

GWh

Itemization	2004	2005	2006
Total	317 425	335 905	347 322
By sectors			
Commercial	49 606	52 979	55 312
Residential	78 462	82 722	85 881
Industrial	142 318	150 243	154 315
Other	47 039	49 961	51 814

Source: EPE

^{1/} Self-producers not included.

Employment indicators

Even with the reduced dynamics of the two previous years, the labor market turned in positive results in 2006, with growth in formal employment and recovery in

income levels. The job level continued expanding, though job creation was not sufficient to meet demand, and this was the factor primarily responsible for the slight increase in average unemployment during the year.

According to IBGE's Monthly Employment Survey (PME), which incorporates the metropolitan regions of São Paulo, Rio de Janeiro, Belo Horizonte, Porto Alegre, Salvador and Recife, the average rate of unemployment reached 10% in 2006, surpassing the 2005 level by 0.2 p.p. This result indicated growth of 2.4% in the overall labor force and 2.3% in the number of persons holding jobs, compared to 1.1% and 3%, respectively, in 2005. It should be stressed that the increase in the total labor force was a consequence of both rising demand for jobs during the election period and, particularly, reductions in the number of jobless people, which is characteristic of periods of renewed economic activity and real income gains.

Analyzed under the prism of employment categories and repeating what occurred in the previous year, the sharpest employment growth was registered in the formal sector of the market. Growth of 4.8% in the year contributed to a rise in the number of duly registered employees in the total number of jobholders from 44.3% in early 2005 to 46.1% at the end of 2006. At the same time, the number of self-employed persons expanded 1% in the year, while the overall number of unregistered workers moved in the opposite direction, registering a decline of 0.9%, with the number of employers dropping 1.5%.

The Employment and Unemployment Survey (PED), which is carried out by the State Data Analysis System Foundation (Seade) and the Interunion Department of Statistics and Socioeconomic Studies (Dieese), showed a reduction of 1 p.p. in the 2006 unemployment rate in the Metropolitan Region of São Paulo, dropping to a level of 15.9%. Hidden unemployment resulting from a high level of precarious labor conditions declined 0.9 p.p. to 3.9%, while open unemployment diminished 0.1 p.p., dropping to a level of 10.4%.

According to the Ministry of Labor and Employment's (MTE) nationwide General File of Employed and Unemployed Persons (Caged), 1,229,000 jobs were created in 2006, against 1,254,000 in 2005 and 1,523,000 in 2004. The largest number of jobs was created in the service sector, 522,000 openings, followed by commerce and manufacturing, with 337,000 and 250,000 new jobs, respectively. It should be stressed that, just as occurred in 2005, the highest rate of job growth occurred in the building industry, with 7.3%, reflecting creation of 86,000 new positions.

Calculated by the CNI in 12 states (Amazonas, Ceará, Pernambuco, Bahia, Goiás, Espírito Santo, Minas Gerais, Rio de Janeiro, São Paulo, Paraná, Santa Catarina

and Rio Grande do Sul), industrial employment expanded 2.2% in 2006, compared to 5.2% in 2005 and 4% in 2004.

Table 1.16 – Formal employment – Job openings

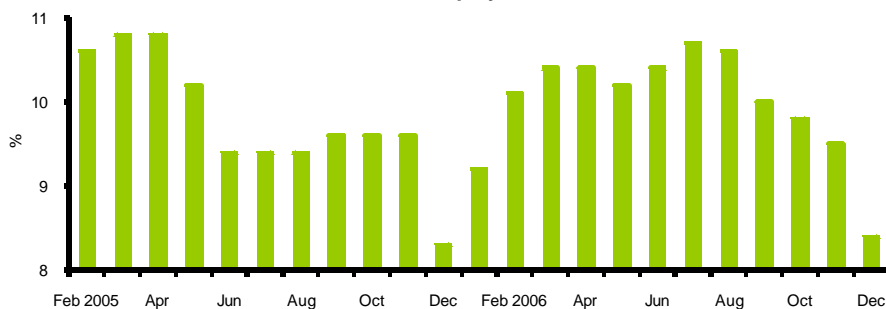
1,000 employees

Itemization	2004	2005	2006
Total	1 523.3	1 254.0	1 228.7
By sectors			
Manufacturing industry	504.9	177.5	250.2
Commerce	403.9	389.8	336.8
Services	470.1	569.7	588.6
Building	50.8	85.1	85.8
Crop and livestock	79.3	-12.9	6.6
Public utilities	4.6	13.5	7.4
Others ^{1/}	9.7	31.2	-46.6

Source: Ministry of Labor and Employment (MTE)

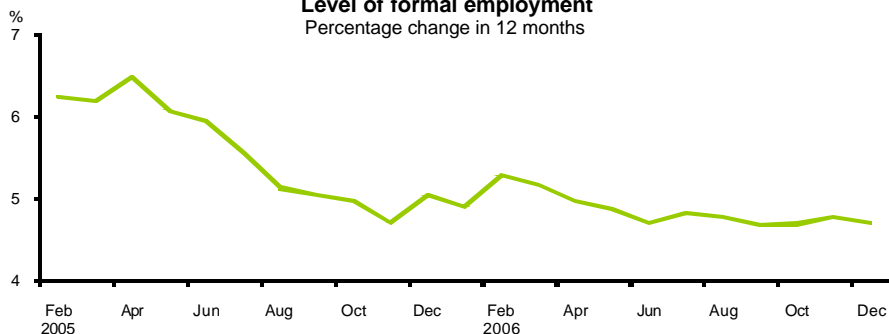
^{1/} It includes mineral extraction, public administration and others.

Graph 1.9
Median unemployment rate



Source: IBGE

Graph 1.10
Level of formal employment
Percentage change in 12 months



Wage and earnings indicators

The average real earnings habitually received by the working population in the six major metropolitan regions covered by IBGE's PME reached R\$1,045.75 in 2006, up 4.3% over the previous year. In the metropolitan regions of Recife and São Paulo, the increase was greater than 5%.

Gains in purchasing power were registered in all of the different job categories, with 5% for the self-employed, 4% for unregistered workers and 3.8% for registered workers. Overall wages of jobholders expanded 6.7% in the year, as a result of increases of 4.3% in earnings and 2.3% in employment.

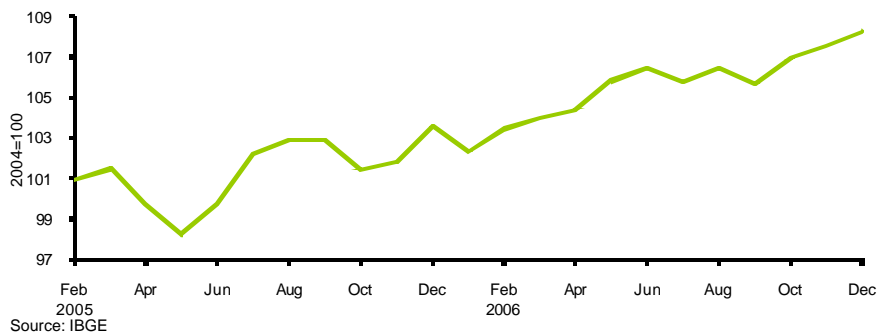
According to the PED, which is elaborated by Seade/Dieese, the average real earnings of persons employed in the São Paulo Metropolitan Region increased to 1.3% in 2006, following a 0.4% drop in 2005. Real overall earnings of jobholders increased 3.3%, a figure that also reflects 2% growth in the employment level.

Price indicators

Inflation declined in 2006 when compared to the preceding year, in a framework of deceleration under both regulated and market prices. The change in IBGE's IPCA came to 3.14%, well within the interval defined for inflation by the CMN.

The favorable behavior under farm product prices was a major factor underlying lesser growth in market prices during the year. Reductions in the prices of such items as chicken, table bread, beans and perishable foodstuffs, for example, had a significant impact in terms of slowing down the pace of price growth in the food sector during the year.

Graph 1.11
Real average earnings



Exchange rate appreciation also contributed to lesser price growth and had a positive impact in terms of more accentuated deceleration in the prices of internationally tradable goods, compared to the prices of nontradables, while also reducing the costs associated to imported inputs in the productive chain.

Table 1.17 – Average earnings of occupied people – 2006

Percentage change		
Itemization	Nominal	Real ^{1/}
Total	7.6	4.3
Job position		
Registered	7.0	3.8
Unregistered	7.2	4.0
Self-employed	8.3	5.0
By sector		
Private sector	7.8	4.5
Public sector	9.7	6.3

Source: IBGE

^{1/} Deflated by the INPC. Includes the metropolitan regions of Recife, Salvador, Belo Horizonte, Rio de Janeiro, São Paulo and Porto Alegre.

Deceleration in regulated prices basically reflected lesser growth in electricity rates, gasoline prices and downward movement in fixed telephone rates. The behavior of electricity and telephone rates reflected, among other factors, sharp drops in general price indices in 2005. Parallel to this, *Petróleo Brasileiro S/A* (Petrobras) did not increase gasoline prices during the course of 2006, in contrast to the previous year when prices rose 16.5%.

General Price Indices

Calculated by the FGV, the General Price Index (IGP-DI) and the corresponding weighted average of the Wholesale Price Index (IPA-DI), the Consumer Price Index – Brazil (IPC-Br) and the National Cost of Construction Index (INCC), which have respective weights of 60%, 30% and 10%, registered growth of 3.79% in 2006. This rate was the third smallest since the start of the series in 1944 and only closed above the rates registered in 2005 and 1998.

The IPA-DI expanded 4.29% in the year and reflected increases of 6.92% in the prices of farm products and 3.46% in those of industrial goods, compared to a reduction of 6.32% and an increase of 0.88% in the previous year, following the same order. The IPC-Br rose 2.05%, compared to a 4.93% high in 2005 and the INCC rose 5.04%, basically as a result of 6.02% growth in labor costs.

Consumer price indices

Used as a reference for the inflation target system, the IPCA rose 3.14% in 2006, against 5.69% in the previous year. Market prices rose 2.58%, compared to 4.32% in 2005, primarily as a result of pressures exerted by such items as sugar, 15.39%; cigarettes, 11.26%; domestic help, 10.75%; condominium fees, 7.02%; and courses, 6.79%. Regulated prices increased 4.28% in 2006, against 8.98% in the previous year.

In 2006, IBGE's National Consumer Price Index (INPC) reached 2.81%, against 5.05% in the previous year. This indicator differs from the IPCA in terms of the target population, which corresponds to families receiving monthly income between 1 and 8 times the monthly minimum wage, while the IPCA considers monthly income brackets between 1 and 40 times the minimum wage. Lesser growth in the INPC during the year, compared to the IPCA, resulted from the greater weight attributed to the prices of tradables in the weighting structure.

Inflation measured by the Consumer Price Index (IPC), which is calculated by the Institute of Economic Research Foundation (Fipe), encompassing families with earnings between 1 and 20 times the minimum monthly wage in the RMSP, closed 2006 at 2.54%, against 4.53% in the previous year.

Regulated prices

In 2006, regulated prices² expanded 4.28%, compared to 8.98% in 2005, reflecting 1.38 p.p. growth in the IPCA. The items that generated the strongest pressures were medicines, health plans, gasoline, bottled gas and urban bus fares, intercity buses and water and sewage rates, accounting for approximately 95% of annual growth in these prices.

The reduction in the annual growth of regulated prices was a consequence of alterations in fixed telephone rates and residential electricity rates, as well as gasoline prices.

Alterations in fixed telephone rates are authorized annually by the National Telecommunications Agency (Anatel), based on changes in a basket of price

^{2/} Monitored prices are those directly or indirectly defined by the federal, state or local governments. In some cases, price readjustments are set through contracts between producers/suppliers and the corresponding regulating agencies, as for instance in the cases of electric energy and fixed telephone system.

Table 1.18 – IPCA items share in 2006

Groups	IPCA				
	Weight ^{1/}	Accumulated change in 2005	Accumulated change in 2006	Accumulated share in 2006	Index share ^{2/}
IPCA	100.0	5.7	3.1	3.1	100.0
Foodstuffs and beverages	20.9	2.0	1.2	0.3	8.2
Housing	15.1	6.4	3.1	0.5	14.8
Housing products	5.0	2.7	-2.7	-0.1	-4.4
Apparel	6.0	7.1	5.1	0.3	9.6
Transportation	21.7	8.1	3.0	0.7	20.9
Health and personal care	10.7	6.2	6.0	0.6	20.4
Personal outlays	9.3	7.0	7.3	0.7	21.5
Education	6.0	7.2	6.2	0.4	12.0
Communication	5.2	6.4	-0.2	-0.0	-0.4

Source: IBGE

^{1/} Average weight in 2006.

^{2/} It is obtained by dividing the accumulated share in the year by the accumulated change in the year.

indices and a factor reflecting the productivity gains of the companies involved. In 2006, the drop in rates came to an average of 0.83%.

In 2006, average alterations in electricity rates reached 0.27%, with variations from -7.5% in Brasília to 6.45% in Goiânia, with reductions in the rates charged in five of the 11 regions surveyed. The alterations introduced follow a schedule defined by the Brazilian Electricity Regulatory Agency (Aneel), which sets the period for annual alterations for each one of the concession companies. These changes are based on managerial costs, which determine a productivity gain factor for each companies, together with the General Price Index – Market (IGP-M), calculated by the FGV, accumulated over the 12-month period prior to the date of the increase, as well as nonmanagerial costs, such as energy purchased and transmission costs.

Cores

In 2006, the three measurements of the IPCA inflation core calculated by the Central Bank registered the lowest growth rates since 1998, keeping pace with deceleration of the headline index.

The core by exclusion varied 3.56%, against 5.55% in the previous year. The core measured by the trimmed-means method without smoothing registered more accentuated deceleration than the IPCA in 2006 and dropped from 5.3% in 2005

Table 1.19 – Major items included in the IPCA during 2006

Itemization	IPCA			
	Weight ^{1/}	Accumulated change in 2005	Accumulated change in 2006	Accumulated share in 2006
Index (A)	100.0	5.69	3.14	3.14
Non-monitored prices	67.7	4.32	2.58	1.74
Monitored prices	32.3	8.98	4.28	1.38
Selected monitored items				
Health care	3.0	12.03	12.29	0.37
Urban transportation	4.4	10.44	8.12	0.36
Water and sewage fees	1.8	13.42	4.99	0.09
Medicine	3.5	6.02	4.62	0.16
Gasoline	4.6	7.76	2.94	0.14
Domestic gas	1.4	0.24	7.49	0.10
Electric energy	4.3	8.07	0.27	0.01
Telephone	3.6	6.68	-0.83	-0.03
Air ticket	0.5	28.10	-9.62	-0.05

Source: IBGE

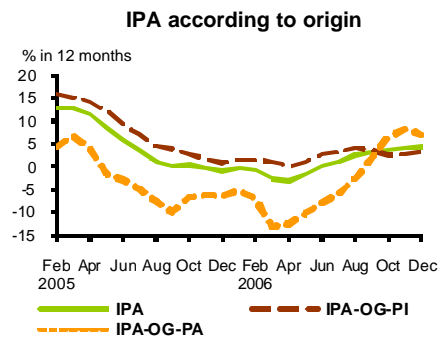
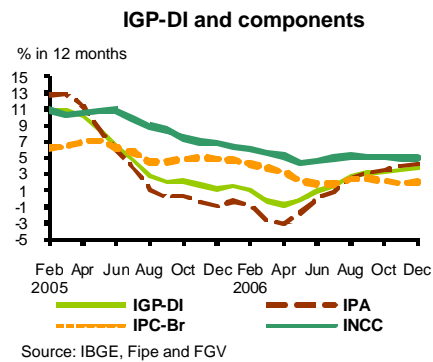
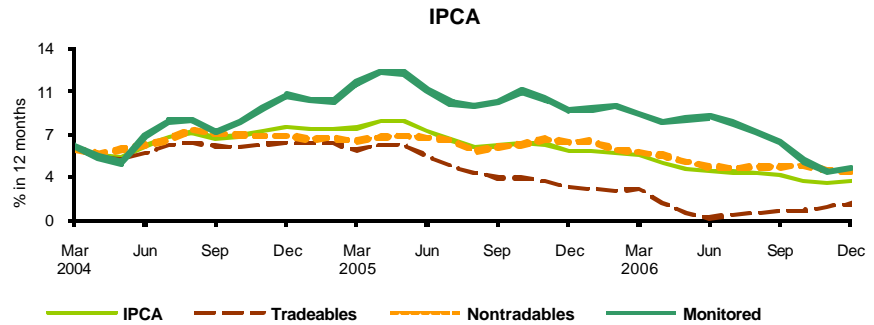
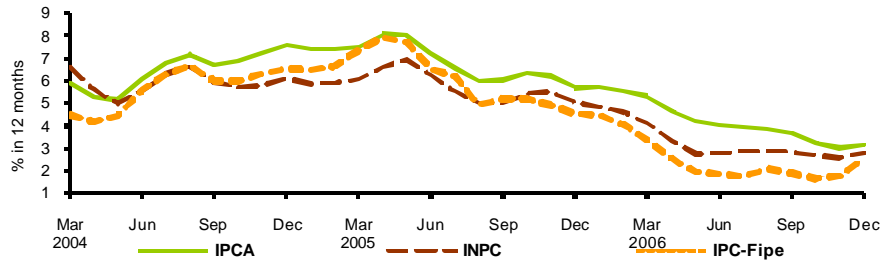
^{1/} Average weight in 2006.

to 2.76%. The core based on the smoothed trimmed-means method³ accumulated a high of 4.63% in the year and remained at a higher level than the other inflation indices. This performance resulted from the concept underlying this indicator, which includes delayed growth in the prices of some items. Among the smoothed items that contributed significantly to deceleration of the IPCA in the year, mention should be made of public transportation, residential electricity, fuels and communications.

The IPC-Br core, calculated by applying the smoothed trimmed-means method to specific items, varied 2.82% in 2006 against 5.07% in 2005, according to FGV data.

^{3/} Alterations carried out in IPCA's Family Budget Survey (POF) in July 2006 included the breakdown of the item Courses into Courses and Sundry Courses. As a result, the calculations of the new item "Sundry Courses" utilized the variations of the former Sundry Courses sub-item, and the item Courses was recalculated in order to avoid double counting of Sundry Courses.

Graph 1.12
Consumer price indices



Source: IBGE, Fipe and FGV

Table 1.20 – Consumer prices and core inflation in 2006

Itemization	2005	2006		
		1st half	2nd half	In the year
IPCA	5.69	1.54	1.58	3.14
Exclusion	5.55	2.15	1.38	3.56
Trimmed means				
Smoothed	6.76	2.75	1.83	4.63
Non smoothed	5.30	1.84	0.91	2.76
IPC-Br	4.93	0.62	1.43	2.05
Core IPC-Br	5.07	1.57	1.23	2.82

Source: IBGE and FGV