

Activity level

The pace of economic activity continued expanding in the second quarter and early part of the third, thus confirming the outlook defined on the basis of prospective indicators in the previous Inflation Report. Though the growth that has occurred in recent months was certainly foreseen, the intensity of the process has surpassed expectations, as evinced by the fact that, at the end of the first quarter of the year, output indicators had already climbed to historically high levels.

The strength of the economic upturn is due to the dual factors of dynamic growth in the export sector and consolidation of expanding internal demand. Internally, it is important to stress expanding income as the factor that has fired consumer spending. This is evident in the increased output and sales of items that are less sensitive to credit conditions, such as foodstuffs and apparel. At the same time, sectors in which internal demand is more sensitive to credit conditions, such as capital goods and consumer durables, which have played a leading role in the economy's response to the more relaxed monetary policy in effect since last year, have registered consistently high growth under both output and sales in recent months.

Parallel to export growth, the recovery in internal demand has steadily raised the level of utilization of the nation's installed industrial capacity. This movement has been more significant in those sectors that have drawn the greatest benefit from external market operations, since they have been working at already high levels of utilization for quite some time. However, it is important to note that the increase in investment flows, stimulated by both the positive overall outlook and by the generalized reduction in idle capacity, particularly in the different export segments, has tended to accelerate the pace at which the industrial sector is expanding its output capacity.

In the crop/livestock sector, estimates of this year's grain harvest have been revised downward as a result of climatic

difficulties encountered particularly in the soybean and corn crops. Production of meats and derivatives, on the other hand, has managed to preserve the dynamics of past periods, driven above all else by continued growth in foreign sales.

1.1 Retail sales

The growth curve followed by the retail trade sector since mid-2003 has been maintained in 2004. Reflecting the increase in labor-based income, the current year has witnessed consolidation of a similar growth process under nondurable consumer goods, particularly supermarket products, apparel and footwear. At the same time, sales of consumer durables continued along a strong growth curve, despite lesser growth in credit operations in recent months.

According to the Monthly Trade Survey (PMC), which is released by the Brazilian Institute of Geography and Statistics (IBGE), the Index of Retail Sales Volume, which is based on deseasonalized data, registered a high of 2.6% in the quarter ended in July, when compared to the previous quarter. All of the different activities registered positive results in the period, with particularly strong performances under furniture and home appliances, 7.8%, and fabrics, apparel and footwear, 5%. The segment of automobiles, motorcycles, parts and spares, which is not included in the general index, registered an increase of 9.8%, using the same basis of comparison. In July, this indicator registered positive growth for the seventh consecutive month, according to the deseasonalized series.

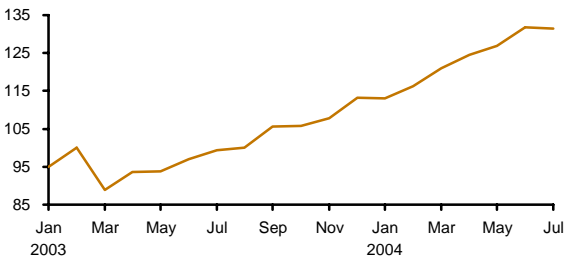
A state-by-state breakdown indicates that the volume of retail sales expanded in the quarter ended in July in all of the states analyzed, with the sole exception of Tocantins, which registered a deseasonalized decline of 3.3%. Also based on deseasonalized data, the sharpest increases were registered in Amazonas, 16.8%, Rondônia, 10.8%, and Mato Grosso do Sul, 7.4%.

In the first seven months of 2004, nominal sales revenues expanded by 11.8%, compared to the same period of 2003. This result was a consequence of combined increases of 9.7% in sales volume and 1.8% in retail prices. It should be stressed that, compared to the same period of 2003, median prices in the first seven months of 2004, increased by 6.2%, according to IBGE's Broad National Consumer Price Index (IPCA). In the period under consideration, all of the different sectors turned in growth in nominal revenues that was higher

Sales Volume Index in the Retail Sector

Furniture and home appliances

Seasonally adjusted data
2003=100

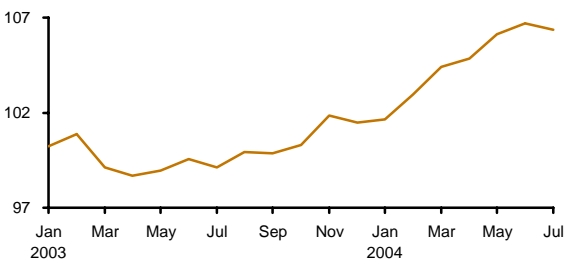


Source: IBGE

Sales Volume Index in the Retail Sector

Supermarkets

Seasonally adjusted data
2003=100



Source: IBGE

Sales Volume Index in the Retail Sector – Brazil

Itemization	Percentage change					
	2004					
	Feb	Mar	Apr	May	Jun	Jul
In the month^{1/}						
Retail sector	0.5	0.7	1.9	1.0	0.1	0.1
Fuel and lubricants	-0.1	3.0	-0.9	-1.0	1.0	0.2
Supermarkets	1.3	1.4	0.4	1.2	0.5	-0.3
Textiles, clothing and footwear	-2.7	2.8	-2.1	5.8	0.8	-2.4
Furniture and home appliances	2.9	4.0	2.8	2.0	3.8	-0.3
Vehicles and motorcycles	-0.4	0.3	-1.4	9.8	1.8	-0.9
Quarter/previous quarter^{1/}						
Retail sector	2.6	2.5	2.5	3.2	3.3	2.6
Fuel and lubricants	1.4	1.8	1.9	2.4	0.7	0.1
Supermarkets	1.3	1.8	2.4	3.0	2.8	2.2
Textiles, clothing and footwear	1.4	0.8	-0.4	1.7	2.9	5.0
Furniture and home appliances	7.3	7.2	8.3	8.7	9.4	7.8
Vehicles and motorcycles	1.7	0.4	-0.7	2.6	5.7	9.8

Source: IBGE

1/ Seasonally adjusted data.

Sales Index in the Retail Sector – Brazil

2004, July

Itemization	% accumulated growth in 2004		
	Nominal revenue	Volume	Price
Retail sector	11.8	9.7	1.8
Fuel and lubricants	-2.6	6.7	-8.7
Supermarkets	9.4	6.1	3.1
Textiles, clothing and footwear	17.3	7.4	9.2
Furniture and home appliances	32.3	29.8	1.9
Vehicles and motorcycles	26.6	17.5	7.7

Source: IBGE

Real sales of the retail sector^{1/}

Itemization	% accumulated growth in the year					
	2004					
	Jan	Feb	Mar	Apr	May	Jun
SP	4.8	5.2	4.3	4.9	5.1	6.3
RJ	-0.2	-2.0	-1.7	-2.5	-2.0	-1.6
MG	-2.6	-4.8	0.7	1.2	0.9	1.9

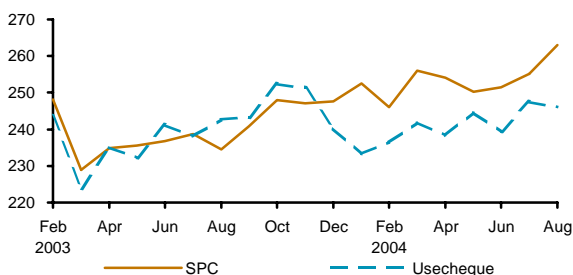
Source: Fecomercio SP, Fecomercio RJ and Fecomercio MG

1/ Data referring to the metropolitan areas of the state capitals.

Retail sales indicators

Seasonally adjusted data

1992=100



Source: ACSP

than price growth, with exception of fuels and lubricants. The most important segments were furniture and home appliances, 32.3%, automobiles and motorcycles, 26.6%, and fabrics, apparel and footwear, 17.3%.

Sectoral surveys of the various state trade federations confirmed continued sales growth in the first half of 2004. Thus, real revenues in the first six months of 2004, compared to the same period of 2003, expanded by 6.3% in São Paulo and 1.9% in Minas Gerais, considering the metropolitan regions of the state capitals. In Rio de Janeiro, there are positive signs that the downward trend that marked the start of the second quarter of 2004 is gradually being reversed, despite a reduction of 1.6% in revenues in the period.

Other indicators related to the sector of commerce indicate an upturn in retail activities in the first half of the year, showing that this movement continued into the early months of the second half. The number of consultations with the Credit Protection Service Center (SPC), which is an indicator of installment purchases and goods of larger aggregate value, released by the São Paulo Trade Association (ACSP), expanded by 7% in the first six months of the year, compared to the same period of 2003. In the quarter ended in August, the indicator based on seasonally adjusted data expanded by 1.2% compared to the quarter ended in May. Usecheque, which is an indicator of low value purchases with immediate payment, also released by the ACSP, registered growth of 1.2% using the same basis of comparison.

Another factor that contributed to continued growth in the sector of commerce was the downturn in the level of defaults at the end of the first half of 2004 and start of the second half, compared to the corresponding periods of the previous year. Thus, the ratio between checks returned due to insufficient backing and total checks cleared registered the lowest rate of the year, 5%, in the month of August. The median rate for the first eight months of the year came to 5.3%, compared to 5.4% in the same period of the previous year. Growth in the national Teledata indicator, which also reflects the ratio between checks returned and received, ratified the downward trend, which closed at 2.1% in July of the current year, compared to 2.6% in the same month of 2003.

ACSP statistics for the start of the second half of 2004 corroborate the downward curve in the rate of default registered by national indicators. In the first eight months of the year, the net rate in São Paulo came to 5.2% as against

Default rates

Itemization	Rate						
	2004						
	Mar	Apr	May	Jun	Jul	Aug	Year ^{1/}
SPC (SP) ^{2/}	6.5	6.4	5.1	4.3	3.3	3.9	5.2
Returned checks ^{3/}	5.7	5.4	5.2	5.1	5.1	5.0	5.3
Telecheque (RJ) ^{4/}	3.4	2.4	2.3	2.1	2.0	...	2.3
Telecheque (National) ^{4/ 5/}	3.6	2.6	2.3	2.1	2.1	...	2.6

Source: ACSP, Bacen and Teledata

1/ Annual average.

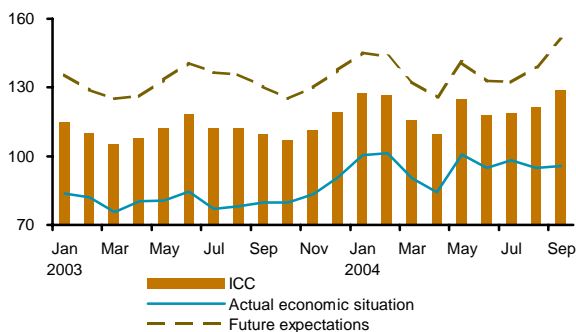
2/ New registrations (-) registrations cancelled out/effectuated consultations (t-3).

3/ Checks returned due to insufficient funds/cleared checks.

4/ Returned cheques/cleared checks.

5/ Average in the following cities: Belém, Fortaleza, Recife, Salvador, Belo Horizonte, São Paulo, Curitiba, Porto Alegre, Ribeirão Preto and Rio de Janeiro.

Consumer Confidence Index



Source: Fecomercio SP

5.8% in the same period of 2003. In August, the net rate came to 3.9%, after registering the lowest level of the year, 3.3%, in the previous month.

The results of the surveys on consumer expectations pointed to considerable optimism in the third quarter of 2004, thus confirming the perception that expansion in the sector of commerce would continue. The Consumer Confidence Indicator (ICC), which is released by the Trade Federation of the State of São Paulo (Fecomercio SP), registered growth of 4.8% in the July-September quarter, compared to the previous quarter. At the component level, the Consumer Expectations Index (IEC), which represents 60% of the general index, increased by 5.6%, while the Index of Current Economic Conditions (Icea), which represents the remainder of the general index, increased by 3.1%.

The IEC, which is published by the Trade Federation of the State of Rio de Janeiro (Fecomercio RJ), registered an upward trend in the level of optimism among Rio de Janeiro consumers, turning in a performance quite similar to that of São Paulo. The IEC turned in median growth of 2.4% in the quarter ended in August, compared to the quarter ended in May, and 15.9% in the first eight months of 2004, compared to the same period of the preceding year.

1.2 Output

Crop/livestock production

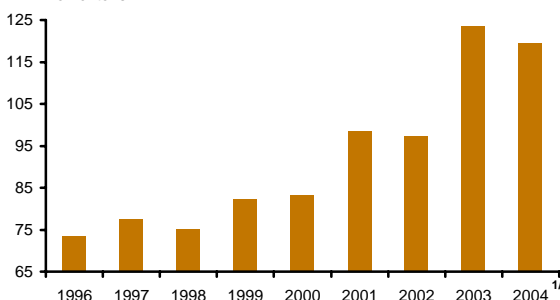
In the first six months of 2004, crop/livestock production expanded by 5.7%, when viewed against the same period of the previous year, according to IBGE's Quarterly National Accounts. Production in the second quarter of the current year expanded by 5% compared to the corresponding quarter of 2003, but fell by 0.3%, in deseasonalized terms, when viewed against the first quarter of 2004. The latter results can be attributed to the falloff in the soybean harvest.

According to the Systematic Survey of Farm Production (LSPA), which is carried out monthly by IBGE, expansion was registered in the harvest of such important grains as rice, wheat and cotton seeds, partially offset by reductions in the soybean, corn and bean harvests, which were impacted by climatic adversities. With regard to livestock, the sector continues registering positive results due, above all else, to growth in foreign sales.

Crop production

Grain production

In million of tons



Source: IBGE

1/ Forecast.

Agricultural production

Itemization	Production		Percentage change
	2003	2004 ^{1/}	
Grain production	123 632	119 479	-3.4
Cotton (seed)	1 451	2 326	60.3
Rice (in husk)	10 320	13 263	28.5
Beans	3 310	3 133	-5.3
Corn	47 988	41 891	-12.7
Soybean	51 482	49 181	-4.5
Wheat	6 029	6 246	3.6
Others	3 052	3 438	12.7
Other cultures			
Banana	6 775	6 576	-2.9
White potatoes	3 047	2 838	-6.9
Cocoa (beans)	170	178	5.1
Coffee (manufactured)	1 997	2 439	22.2
Sugar cane	389 849	422 318	8.3
Onions	1 194	1 160	-2.9
Tobacco (in leaves)	656	925	41.0
Orange	16 903	17 043	0.8
Manioc roots	22 147	24 066	8.7
Tomatoes	3 694	3 366	-8.9

Source: IBGE

1/ Estimated.

According to the July LSPA, national grain production in 2004 is expected to reach 119.5 million tons or 3.4% less than in 2003. The summer harvest, which accounts for about 86% of crop output, is now nearing conclusion. About the only thing lacking is to consolidate estimates for the second harvest and winter harvest, which are periods in which the corn and wheat crops normally turn in their best results, in that order.

The performance of the soybean, corn and, to a lesser extent, the bean crop, was the major factor underlying the 2004 harvest. Despite an increase of 15.7% in the area reserved to soybeans, output – initially forecast at 59 million tons – came to just 49.2 million tons, for a reduction of 4.5% when compared to 2003. The harvest failure was caused by adverse climatic factors, particularly in Mato Grosso and Paraná, as the harvest yield declined by 17.4%.

Output of corn – first harvest – totaled 31.2 million tons, with a reduction of 10% compared to the 2003 harvest. Median productivity fell by 7.7%, as a result of climatic factors, and the area planted diminished by 2.3%, partly as a result of the spread of soybean production. Estimates for corn production – second harvest – indicate 10.6 million tons, reflecting a drop of 20.1% compared to the 2003 results. This reduction was a consequence of cutbacks in the area planted and in yield, due to adverse climatic factors.

Bean production for the year's three harvests is expected to reach 3.1 million tons or 5.3% less than in 2003, closing with a reduction of 4.5% in yield. The good harvest registered in the previous year contributed to a falloff in the prices of this product and convinced many producers to migrate to such crops as soybeans and corn.

Production of wheat, which is the principal winter crop, is expected to close at 6.3 million tons or 3.6% more than in the 2003 harvest. The area planted expanded by 9.2%, while productivity dropped by 5.1%. Despite climatic adversities in the southern region, the State of Paraná, the nation's largest producer, registered a strong increase in its harvest, which could close as high as 3.2 million tons. The estimate of a larger national harvest and an increased world supply of the product has aided in reducing prices on both the internal and external markets.

Among other crops, particular mention should be made of coffee and sugar cane. National coffee production is

expected to close at about 2.4 million tons, with growth of 22.2% over the 2003 harvest. To some extent, this increase is explained by expected growth of 23% in productivity, which is a reflection of the low level productivity registered in 2003 as a result of climatic difficulties. One should also highlight improvement in the quality of the product, which has contributed importantly to increased foreign sales.

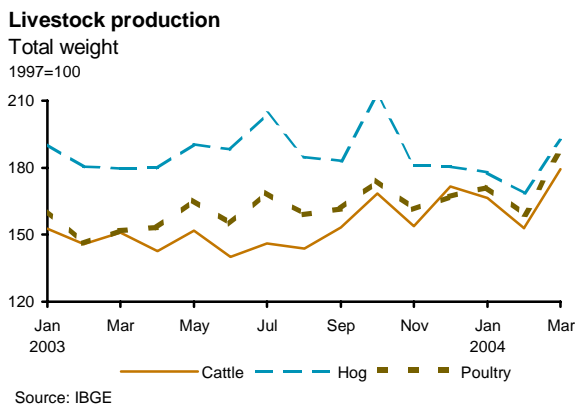
The sugar cane harvest is calculated at 422.3 million tons, representing growth of 8.3% compared to 2003. The area planted increased by 3.3%, while productivity is expected to expand by 5.8%. Despite the positive harvest performance, climatic factors resulted in some delay in the harvest in the southern region, which had a negative impact on the quality of the cane. This fact, together with the rechanneling of production into sugar output, contributed importantly to upward movement under alcohol prices. At the same time, the recent decision taken by the World Trade Organization (WTO) to veto sugar production subsidies in the European Union (EU), coupled with growth in alcohol demand in the United States and European and Asian countries, and increased internal demand for dual fuel vehicles, was a factor that clearly stimulated Brazilian production and exports of sugar cane derivatives.

Livestock production

According to the quarterly survey of animal slaughters released by the IBGE, total carcass weight of cattle slaughters came to 1.4 million tons in the first quarter of 2004, reflecting growth of 11% compared to the same period of 2003, and 4.1%, when based on deseasonalized data, compared to the result for the fourth quarter of last year. According to the Ministry of Development, Industry and Foreign Trade (MDIC), exports totaled 235.2 thousand tons in the May-July quarter, with growth of 69%, compared to the figures registered in the same quarter of 2003.

Poultry production came to 1.7 million tons in the first quarter of this year. This result reflects expansion of 12.9% compared to the same period of 2003 and 3.9% against the final quarter of 2003, when deseasonalized data are used. Exports totaled 650.7 thousand tons in the May-July quarter, with growth of 54.9% compared to the same period of 2003.

With respect to hog farming, total carcass weight came to 457.9 thousand tons in the first three months of the year, reflecting a drop of 2.1% in relation to the first quarter of the previous year. An analysis based on the deseasonalized



statistical series indicates volume that was 2.6% below that of the fourth quarter of 2003. With respect to exports, the registered volume in the quarter extending from May to July came to 126.9 thousand tons, or 2% more than in the same period of 2003.

Crop and Livestock Plan (PAP) 2004/2005

According to the PAP 2004/2005, released by the Ministry of Agriculture, Livestock and Supply (Mapa), the credit volume available for the next harvest should come to R\$39.5 billion or 45.5% more than in the previous harvest. Of this total, R\$28.8 billion will be targeted to current expenditures and marketing and R\$10.7 billion to investments, of which 80% will be channeled into the Mapa-BNDES System programs. Among the highlights, it is important to mention the resources targeted to the Program of Modernization of the Farm Tractor Fleet and Like Implements and Harvesters (Moderfrota), R\$3.5 billion; the Program of Agricultural Modernization and Conservation of Natural Resources (Moderagro), R\$600 million; the Program of Incentives to Irrigation and Storage (Moderinfra), R\$700 million; the Program of Cooperative Development for Aggregating Value to Crop/Livestock Production (Prodecoop), R\$550 million; and the Agribusiness Development Program (Prodeagro), R\$600 million.

Aside from these resources, the National Program for Strengthening Family Agriculture (Pronaf), which is managed by the Ministry of Agrarian Development (MDA), will have a budget of R\$7 billion, representing an increase of 30% compared to the last harvest.

In order to expand the supply of credit to the sector, the compulsory rate of investment in rural credit by Banco do Brasil rural savings accounts was raised by 10 p.p. to 50%, while cooperative banks – Banco Cooperativo do Brasil S.A. (Bancoob) and Banco Cooperativo Sicredi (Bansicredi) – were authorized to operate in this modality and are required to invest 65% of their deposits in rural credit operations. Aside from this, the government, in collaboration with the private sector, has refined new funding instruments targeted at internal and external savings, including the Agribusiness Certificate of Receivables (CRA), the Agriculture and Livestock Deposit Certificate (CDA) and the Agribusiness Warrant.

With respect to the traditional instruments used to support marketing operations and guaranteed income, the following

instruments were maintained: Federal Government Acquisitions (AGF), the Special Credit Line (LEC), Sales Option Contracts, repurchase or assigns of these contracts, Production Outflow Awards and Product Marketing Value (PEP and VEP, in that order), the Rural Product Bill (CPR), as well as operations with Promissory Notes and Rural Invoice (DR). Currently, the principal requirement for Federal Government Loans (EGF) is the placing of a lien on the merchandise financed in the operation, with no substitution of guaranties except in specifically defined cases.

Industrial output

Industrial output has expanded sharply in recent months and has been sustained by the consolidation of recovery in domestic demand and the excellent performance of the export sector. Having registered three consecutive months of record growth in May, June and July, these results clearly confirm the vigor of the ongoing process of expansion, indicating that the negative monthly rates registered in the first two months of the year were no more than a passing breather in the growing pace of manufacturing activity, following the strong expansion that marked the second half of 2003.

Industrial output expanded by 3.8% in the May-July quarter, compared to the quarter ended in April, according to deseasonalized data drawn from the Monthly Industrial Survey (PIM), released by the Brazilian Institute of Geography and Statistics (IBGE). Analyzing the comparison between production accumulated in the first seven months of 2004 and 2003, growth came to 7.8%. These results reflect expansion in the manufacturing sector, with 3.6% in the quarter and 8.2% accumulated in the year, plus the relative stability of the mineral extraction sector, which registered growth of 0.2% and 0.5% using the same basis of comparison. In the monthly deseasonalized series, industrial production in July 2004 was 8.3% higher than the median level in 2002 and 12.6% more than the low point registered in June 2003.

The positive results permeated all use categories, though expansion was clearly led by production of consumer durables and capital goods. Output of consumer durables registered a deseasonalized increase of 9.9% in the quarter extending from May to July, compared to the previous quarter, and an increase of 24.5% in the first seven months of the current year, viewed against the same period of 2003. In its turn, output of capital goods increased by 6.4% in the quarter and 24.9% in the first seven months of the year.

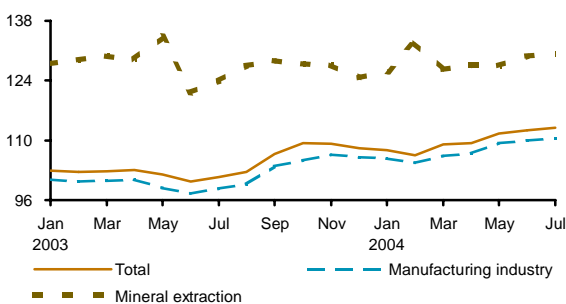
Industrial production

Itemization	Percentage change			
	2004			
	Apr	May	Jun	Jul
Industry (total)				
In the month ^{1/}	0.3	2.1	0.7	0.5
Quarter/previous quarter ^{1/}	-0.1	2.3	3.1	3.8
Same month of the previous year	6.7	7.8	13.0	9.6
Accumulated in the year	6.1	6.4	7.5	7.8
Accumulated in 12 months	2.0	2.8	3.9	5.0
Manufacturing industry				
In the month ^{1/}	0.5	2.3	0.5	0.4
Quarter/previous quarter ^{1/}	-0.2	1.9	2.9	3.6
Same month of the previous year	7.1	8.5	13.3	9.8
Accumulated in the year	6.5	6.9	8.0	8.2
Accumulated in 12 months	2.0	2.9	4.1	5.2
Mineral extraction				
In the month ^{1/}	0.8	-0.1	1.8	0.4
Quarter/previous quarter ^{1/}	2.3	-0.5	-0.2	0.2
Same month of the previous year	-1.3	-4.9	7.2	5.4
Accumulated in the year	-0.9	-1.7	-0.3	0.5
Accumulated in 12 months	1.4	0.4	1.3	1.9

Source: IBGE

1/ Seasonally adjusted data.

Industrial production Seasonally adjusted data 2000=100



Source: IBGE

Industrial production by category of use

Itemization	Percentage change			
	2004			
	Apr	May	Jun	Jul
In the month^{1/}				
Industrial production	0.3	2.1	0.7	0.5
Capital goods	2.0	3.8	0.7	- 1.1
Intermediate goods	0.3	2.0	0.0	2.3
Consumer goods	0.4	1.2	1.5	- 0.7
Durable	3.4	3.9	3.8	1.1
Semi and nondurable	0.4	1.3	0.5	- 1.0
Quarter/previous quarter^{1/}				
Industrial production	- 0.1	2.3	3.1	3.8
Capital goods	- 0.8	5.0	6.3	6.4
Intermediate goods	1.6	2.8	2.8	3.5
Consumer goods	- 1.0	- 0.1	1.5	2.4
Durable	0.9	4.2	7.3	9.9
Semi and nondurable	- 1.6	- 1.3	0.7	1.5
In the year				
Industrial production	6.1	6.4	7.5	7.8
Capital goods	22.3	23.5	25.1	24.9
Intermediate goods	4.8	5.3	6.2	6.7
Consumer goods	4.7	4.7	5.8	6.0
Durable	21.0	21.5	24.0	24.5
Semi and nondurable	1.1	0.9	1.8	2.0

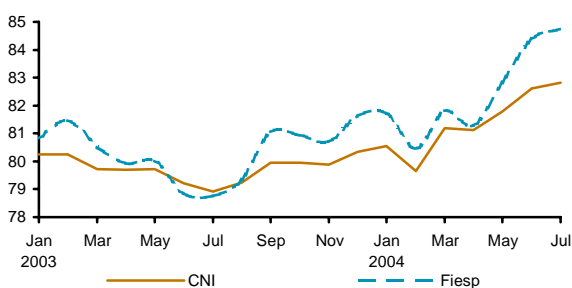
Source: IBGE

1/ Seasonally adjusted data.

Utilization of installed capacity

Seasonally adjusted data

Average percentage



Source: CNI and Fiesp

These results were generated by such segments as machines and equipment for the mining sector and construction, 40.4%; trucks and buses, 36.7%; construction and assembly of vessels, 18%; construction and assembly of aircraft, 17.3%; tractors, machines and equipment for the farm sector, 15.8%; and machines and equipment for industrial and commercial ends, 11.2%,

The evolution registered in the production of semidurable and nondurable consumer goods further strengthened perceptions that the recovery process had begun impacting sectors that are focused on the internal market and less sensitive to credit conditions. Production of this category turned in growth of 1.5% in the May to July quarter, compared to the previous quarter, according to deseasonalized data. In this case, the most important headings were production of soaps, detergents and cleaning products, 21.1%; fruit, vegetables, gravy and spice conserves, 9.7%; slaughters of swine and cattle and preparation of meats, 9.3%; perfumes and cosmetics goods, 8.1%; coffee, 7.4%; and footwear, 6.7%. In the first seven months of 2004, production of semidurable and nondurable consumer goods expanded by 2% when viewed against the same period of the previous year. Output of intermediate goods, which encompasses mining, turned in below average results: deseasonalized growth of 3.5% in the May-July quarter, compared to the previous quarter, and 6.7% in the first seven months, viewed against the corresponding period of 2003.

Acceleration in the pace of industrial activity was not concentrated in isolated sectors. Quite to the contrary, a segment-by-segment analysis demonstrates that positive performances were registered in twenty six segments of the manufacturing industry, while only four closed with negative growth when the May-July quarter is compared to the previous quarter in deseasonalized terms. A considerably more detailed breakdown, using the same basis of comparison, indicates that production growth of 82% was registered in the sixty six segments of the PIM. In this case, these series are sufficiently extensive to allow for deseasonalization.

Industrial exports continued exerting a powerful influence on the performance of the sector. The volumes of external sales of semimanufactured and manufactured products expanded by 14.7% and 13.8%, respectively, in the May-July quarter, compared to the previous quarter, after being seasonally adjusted. The highlights in the period were growth in exports of capital goods, 22.9%, and consumer durables, 24.5%. In the first seven months of 2004, exports of semimanufactured goods increased by 11.5% while those

Automotive vehicles – Production and sales

Itemization	Percentage change				
	2004				
	Apr	May	Jun	Jul	Aug
In the month^{1/}					
Production	-3.7	3.2	5.4	7.2	3.3
Total sales	-10.6	4.2	15.0	6.6	-1.3
Domestic sales	-5.6	3.1	9.9	3.2	-4.3
External sales	-17.6	-2.2	40.4	0.4	8.7
Quarter/previous quarter^{1/}					
Production	-1.1	2.2	3.1	9.2	12.6
Total sales	-3.4	-5.4	-3.8	9.2	18.2
Domestic sales	-3.4	-6.5	-3.5	4.8	10.7
External sales	0.1	0.9	-1.3	16.8	33.2
In the year					
Production	13.3	12.3	14.8	18.0	21.3
Total sales	15.0	14.4	15.6	18.8	20.6
Domestic sales	18.2	18.0	20.4	21.4	22.0
External sales	6.5	5.5	4.4	12.5	17.4

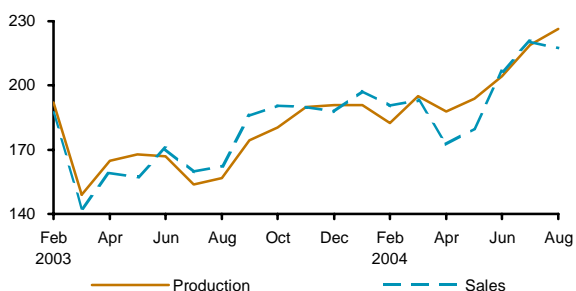
Source: Anfavea

1/ Seasonally adjusted data.

Vehicles – Production and sales

Seasonally adjusted data

1992=100

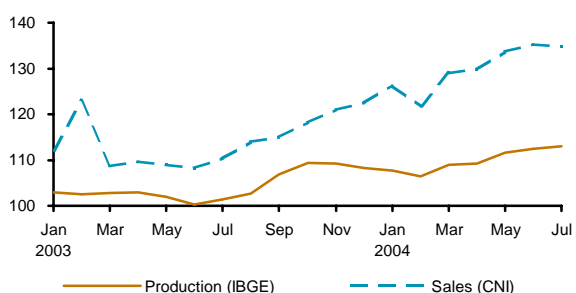


Source: Anfavea

Industrial production and sales

Seasonally adjusted data

2000=100



Source: IBGE and CNI

involving manufactured goods expanded by 25.9%, in relation to the same period of the previous year.

Recovery in manufacturing activity since mid-2003 has impacted the level of utilization of industrial output capacity (see box: Industry: Productive Capacity and Investments). The average level of utilization of installed capacity has been systematically growing, having reached 84.1%, according to deseasonalized data, in the second quarter of the year, as calculated by the Getulio Vargas Foundation (FGV). Among the different use categories, the most significant progress in the quarter compared to the previous quarter occurred in the consumer goods industry, 6.2 p.p., and capital goods, 3.8 p.p. Even so, the segments involved in the production of intermediate goods have continued registering high levels of utilization of idle capacity. However, the ongoing recovery in investment levels, which has been occurring since the third quarter of 2003, has tended to attenuate potential limitations on the performance of the productive chain.

Other indicators ratified the recent upturn in industrial output. The automobile industry has turned in an exceptional performance in recent months, in terms of production and internal and external sales. According to the National Association of Automotive Vehicle Manufacturers (Anfavea), the sector's output increased by 12.6%, while internal sales rose by 10.7% and foreign sales expanded by 33.2%, in the June-August quarter, as against the same period of 2003, expressed in deseasonalized terms. In the first eight months of the year, compared to the same period of 2003, production, internal sales and exports expanded by respective rates of 21.3%, 22% and 17.4%.

Based on deseasonalized data, real industrial sales in the quarter extending from May to July followed a consistent growth trajectory, registering 6.1%, compared to the previous quarter, according to figures released by the National Confederation of Industry (CNI). Despite differences of coverage and methodology among the available industrial production and sales indices, the quarterly comparison does demonstrate that the pace of sales growth has remained higher than output growth, suggesting that, in aggregate terms, the already observed tendency toward stock adjustments continued. The Situation Survey carried out by the FGV and released in July confirms this hypothesis. According to this survey, the situation of stocks was considered normal for 72% of industry, the highest percentage reached by this indicator since the series was started. CNI data corroborate the perception of normality in the stocks of final products.

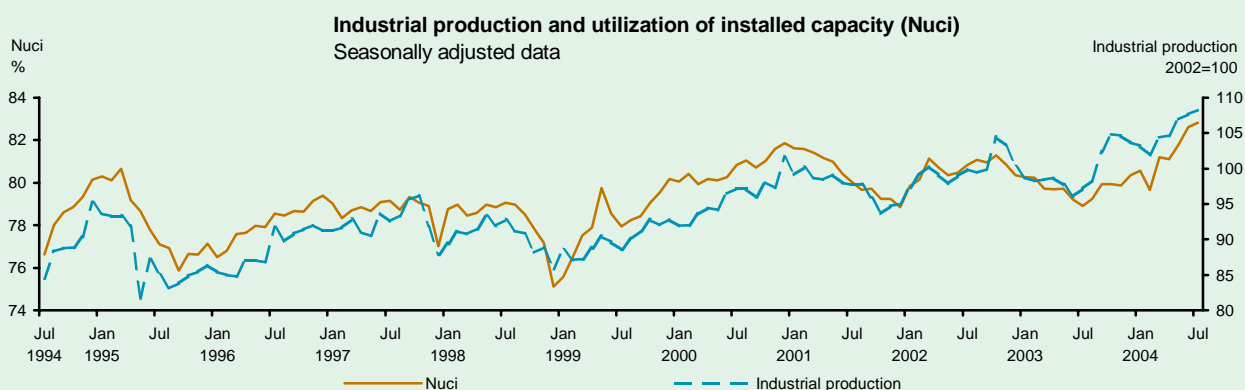
Industry: Productive Capacity and Investments

The vigorous pace of industrial activity, which is already expanding at historically record levels, has given rise to doubts regarding the sector's capacity to readily meet additional demand while ensuring the continuity of the growth process, while becoming an important source of monetary policy concern. As a matter of fact, assessments of the recent growth in indicators of the Level of Installed Industrial Capacity Utilization (Nuci) point to steady growth and clearly justify monitoring, particularly in certain intermediate goods sectors.

The median Nuci has been systematically expanding since mid-2003, reaching 84.1% in the second quarter of this year. Based on deseasonalized data released by the Getulio Vargas Foundation (FGV), this level had not been reached since the 2000-2001 growth cycle. The highest value previously registered occurred in the first quarter of 1995, in the wake of implementation of the Real Plan.

Another Nuci industrial measurement, calculated by the National Confederation of Industry (CNI) in twelve states, also indicates growth, moving to 82.8% in July 2004, the highest level ever recorded in this series. Thus, just as in the FGV data, previous Nuci peaks are noted in 1995, as a consequence of the Real Plan, and in 2000, following the exchange system shift and implementation of the inflation targeting system.

FGV data show that all categories registered Nuci indices higher than those of 2002 and 2003 in the second half of 2004, turning in the highest level under intermediate goods, 87.1%. Analysis of the



Source: CNI and IBGE

21 major sectors reveals that the highest levels were found mainly in the intermediate goods segment, particularly under paper and pulp, rubber and plastics, metallurgy, textiles and mechanics.

Utilization of installed capacity (Nuci)

	2004 II Q ^{1/} (current Nuci)	Record ^{1/}	Period	Average ^{1/} (M)	Standard deviation (DP)	Current Nuci - (M + DP)
Manufacturing industry	84.1	85.2	I-1995	80.2	3.4	0.5
Capital goods	82.4	84.7	IV-2000	73.7	6.0	2.8
Intermediate goods	87.1	89.6	III-1996	84.9	2.3	-0.1
Consumer goods	81.0	87.6	IV-1994	78.5	4.3	-1.8
Building material	81.0	86.0	IV-2000	78.6	5.8	-3.4
Perfumes, soaps and candles	90.6	91.6	III-1994	75.7	8.6	6.3
Mechanics	87.1	87.1	II-2004	74.9	7.3	4.9
Food products	85.2	85.6	III-2003	78.4	3.8	3.0
Textiles	91.0	91.2	IV-2002	84.2	4.7	2.1
Paper and cardboard	95.3	95.6	IV-1994	90.5	3.0	1.8
Furniture	84.0	85.3	I-1995	76.8	5.6	1.6
Metallurgy	92.1	93.0	III-1996	86.9	3.6	1.5
Plastics	85.4	87.6	IV-1994	78.0	6.7	0.7
Rubber	93.6	94.7	IV-1994	87.3	6.1	0.1
Electric and communications equipment	78.9	83.2	IV-1995	73.4	6.6	-1.2
Wood	86.4	94.9	IV-2000	82.7	5.1	-1.4
Clothing, footwear and cloth goods	84.0	88.0	II-2000	79.2	6.3	-1.5
Other	81.1	86.5	IV-1998	74.7	8.5	-2.2
Chemicals	83.8	90.1	I-1995	84.6	1.8	-2.5
Nonmetallic minerals	80.0	87.4	I-1995	79.1	5.5	-4.6
Leather and hides	79.5	86.4	IV-1999	78.8	5.6	-4.8
Editorial	77.4	90.4	II-1995	76.8	7.3	-6.8
Beverages	72.7	90.0	II-1991	72.5	8.5	-8.3
Transportation equipment	76.2	91.4	I-1995	79.3	6.3	-9.4
Pharmaceuticals	60.9	88.0	IV-1997	75.3	7.9	-22.3
Tobacco	58.9	97.5	II-1993	75.2	9.2	-25.5

Source: FGV

^{1/} Seasonally adjusted data.

In the metallurgical industry, the segments with the highest occupation levels are metallurgical products for household use and iron and steel goods (primary, semifinished). In the food industry, the highest occupation levels are found under preparation of milk and dairy products and slaughters and conserves of products of animal origin (meat and fish). In the chemical industry attention should be given to items manufactured on the basis of resins, fibers and artificial yarns while, in the segment of transportation equipment, producers of parts and spares for vehicles are nearing their capacity limit. It should be underscored that the conclusions of a technical note recently elaborated by CNI¹ converged in the same direction, indicating that, in specific sectors which are operating at historically high levels, investments are needed to ensure the continuity of the growth process.

Though data broken down by sector indicate that few segments are operating at levels near their record highs, a more careful analysis of these data, delving into their growth standards over the course of time, reveals that the high registered in the Nuci is not a phenomenon as concentrated as it might seem at first glance. The current level of Installed Capacity Utilization (UCI) is higher than the sum of the median² and the standard deviation of the series in nine of the twenty one principal segments, while five other segments are close to this situation.

Many industrial segments that have registered higher installed output capacity utilization are those that have registered substantial export growth in recent years, as demonstrated in the following chart, which draws a relation between export growth and the Nuci of corresponding sectors stated in Foreign Trade Study Center Foundation (Funcex) and FGV surveys. It should be mentioned that, driven by this growth, companies belonging to these segments have been investing with the aim of expanding their output capacity. Despite this, when one takes due account of the investment maturation period, it is possible that the installed capacity of certain segments may be insufficient to meet full export potential and domestic demand growth, at one and the same time.

1/ MOL, FONSECA, R. Increase of the installed capacity demands an up turn in investments Brasília: CNI, August 2004 (Technical Note 1).
2/ Deseasonalized data since 1991.

Exports (*quantum*) and Nuci – Selected segments

%

Selected segments	Exports			Associated segment ^{2/}	Nuci	
	2002	2003	2004 ^{1/}		2004 II Q	Recorded
Manufactured	5.2	20.9	24.9			
Semi-manufactured	14.0	9.7	9.9			
Capital goods	-5.9	16.1	52.3	Capital goods	82.4	84.7
Intermediate goods	10.4	15.6	13.5	Intermediate goods	87.1	89.6
Tractors and related machinery	4.0	54.8	65.5	Mechanics	87.1	87.1
Textile	-4.6	39.2	9.5	Textiles	91.0	91.2
Paper, cardboard and related machinery	4.7	27.1	11.0	Paper and cardboard	95.3	95.6
Nonmetallic metallurgy	19.5	4.7	11.5	Metallurgy	92.1	93.0
Metallurgy – Others	17.1	4.7	10.2	Metallurgy	92.1	93.0
Siderurgy	19.3	15.9	4.5	Metallurgy	92.1	93.0
Rubber	8.0	23.8	5.5	Rubber	93.6	94.7
Wood and furniture	18.2	21.5	31.5	Furniture	84.0	85.3
Parts and other vehicles	-3.5	1.9	28.8	Transportation equipment	76.2	91.4
Autovehicles	4.2	37.6	42.6	Transportation equipment	76.2	91.4

Source: Funcex and FGV

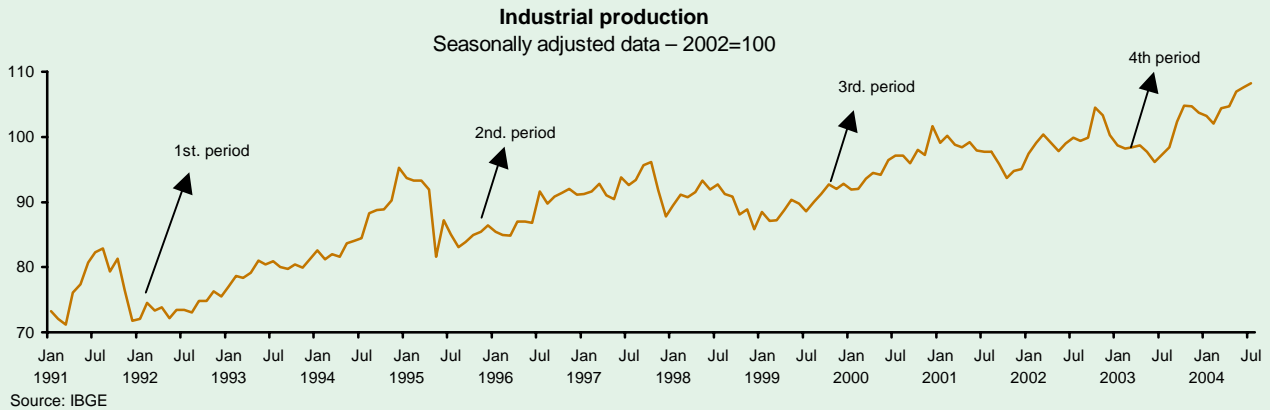
1/ Up to June.

2/ Approximation; there is no exact correspondence between the IBGE, FGV and Funcex classification.

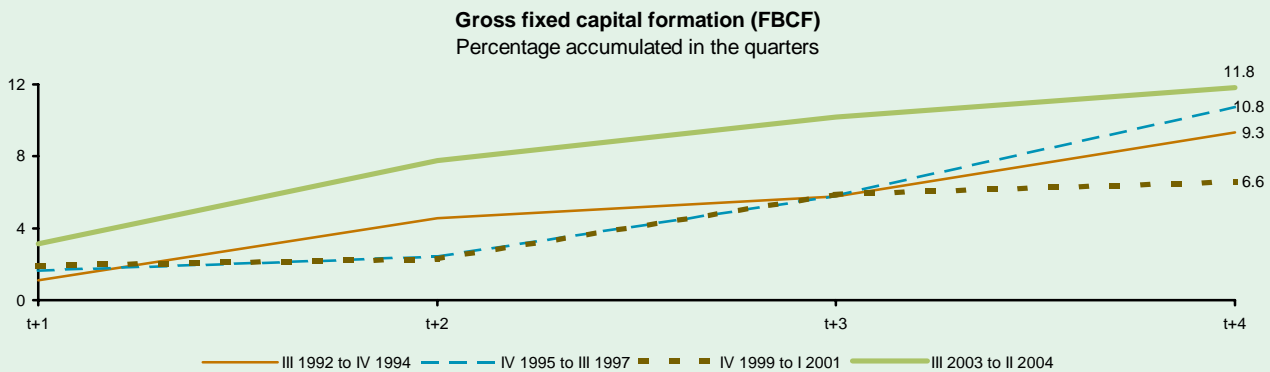
In aggregate terms, investment indicators demonstrate that productive capacity is expanding, thus attenuating concerns regarding bottlenecks in the growth process over the medium-term. Since the third quarter of 2003, Gross Fixed Capital Formation has registered positive growth when compared to the immediately previous quarter in the deseasonalized series, having expanded by 6.8% in the first half of 2004 compared to the same period of the previous year, according to Quarterly National Accounts. Another indicator that evinces expanded investment flows is that of capital goods absorption. Analyzing the first seven months of 2004, against the same period of the preceding year, capital goods output increased by 24.9% and imports expanded by 7.9%. These growth figures insured absorption expansion of 12.8% even though foreign sales increased by 54.5% in the period.

It should be stressed that the period in which this investment cycle began – third quarter of 2003 – came as a surprise to analysts who, at the time, pointed to excess idle output capacity and the still incipient growth process as barriers to investment recovery. Apparently, the outlook for gains in light of expectations of recovery in internal demand and the strengthening of economic fundamentals, particularly in the external accounts framework, together with fiscal management and inflation control, prevailed over investment decisions.

The intensity at which investments expanded in this period shows the influence of these aspects. Analyzing data from 1991 onward, four periods of upward movement in industrial activity, including the current moment, can be distinguished. The three previous periods began in the third quarter of 1992 and in the fourth quarter of 1995 and 1999.

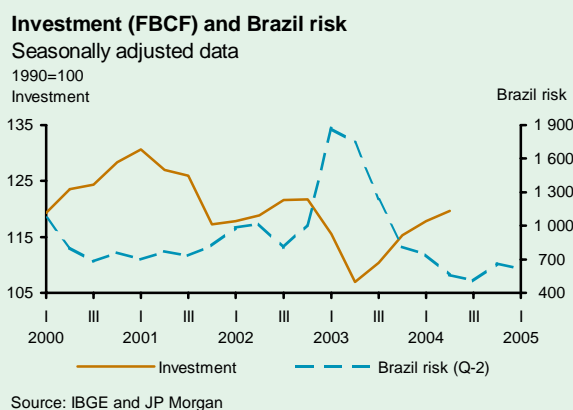
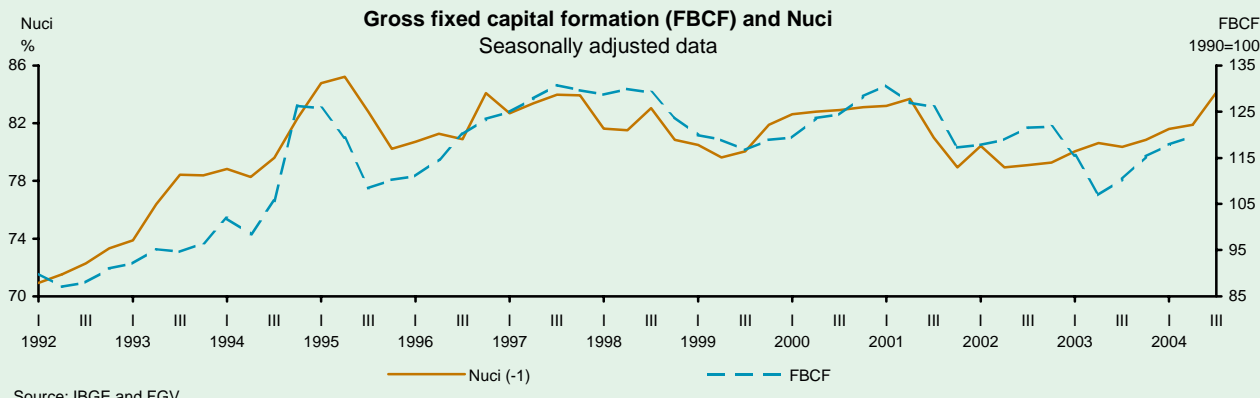


In all these periods, investments kept pace with output growth. However in the current movement, recovery of these flows has been more intense, as shown by quarterly national accounts data.



Parallel to this, leading investment indicators suggest that the current movement should continue. The level of installed capacity utilization is closely correlated to the evolution of gross capital formation. This is a consequence of the natural reaction of companies to expand capacity when bottlenecks in the productive flow come on the horizon. Thus, the sharp growth in occupation of output capacity heralds continued investments.

Another leading variable of the investment level – perception of country risk – points in the same



direction. The lower Brazil risk level, as measured by Emerging Market Bond Index Plus (Embi+), and its downward trajectory in recent months have positively impacted the expectations of businesspersons and consumers, just as the credit costs borne by companies that borrowed abroad have acted as an additional incentive to continued investment growth.

In summary, the steady increase in the level of utilization of installed industrial output capacity as demonstrated by FGV and CNI data, has given rise to concern at the magnitude and the sectoral scope of that increase, since reductions in idle capacity tend to influence the dynamics of price structures. It should be underlined that, even when production is well below the physical limits of existent facilities, the unit cost of the additional goods to be produced already begins rising or, in other words given the available fixed factors, marginal costs normally move upward with the level of production. This phenomenon – it should be added – stands as economic justification so that in conventional supply and demand diagrams, supply curves follow an upward format, drawing a relationship between higher price levels and larger quantities transacted. Emergency measures, such as multiple productions shifts or increased imports which would not be competitive under normal market conditions, may be capable of avoiding supply shortfalls, but they do not mitigate the pressures of costs inherent to a progressively higher occupation level. However, one should note increased investment flows as well as the positive outlook for the coming months, since these reflect the efforts made to expand industrial production capacity, a process that will certainly result in a return to mere comfortable installed industrial output levels.

Manufacturing industry stocks^{1/}

Itemization	2003			2004	
	II	III	IV	I	II
Manufacturing industry					
Final products	56.3	54.6	52.1	50.6	50.3
Raw materials/intermediate goods	48.5	49.6	48.2	47.6	48.7
Large companies					
Final products	58.9	57.1	53.5	52.2	52.1
Raw materials/intermediate goods	52.6	52.9	50.6	49.7	51.5
Small and medium companies					
Final products	54.9	53.2	51.3	49.8	49.4
Raw materials/intermediate goods	46.2	47.8	46.8	46.5	47.3

Source: CNI

1/ Values over 50 indicate stocks above the planned level.

According to the CNI, the dynamics of the industrial sector was reflected in deseasonalized increases of 1.9% in employment and 1.4% in the overall wages of the sector, in the May to July quarter, when compared to the previous quarter.

Business expectations point to short-term optimism. The Industrial Businesspersons Confidence Indicator (Icni), which is calculated by the CNI, closed July at the highest level for this time of the year since 2000. The FGV Situation Survey also confirmed this finding by demonstrating that 57% of the companies surveyed foresaw increased demand between July and September while only 9% forecast declines. In the same sense, 53% of companies intended to increase their production in the period cited, while 8% expected reductions. Projections for the labor market are positive, as the proportion of the companies that intend to contract additional labor was 27 p.p. higher than those that planned layoffs. This was the best result for this time of year since 1986.

Therefore, industrial indicators clearly support expectations that industry will continue expanding, generating positive repercussions on the job market. In its turn, recovery in the labor market is expected to play a role of increasing importance in stimulating internal demand, adding to the aggregate momentum and aiding in progressively establishing a new balance in terms of the relative performance of the various sectors of the economy.

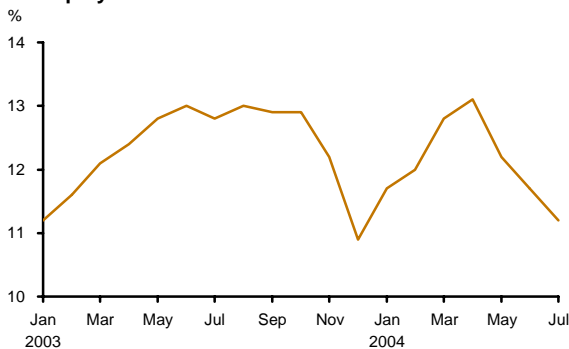
1.3 Labor market

Employment

In recent months, the job market has reflected the expanded pace of economic activity. Creation of new job positions intensified as of the second quarter, as indicated by IBGE's Monthly Employment Survey (PME), which incorporates six metropolitan regions, as well as by the nationwide data released by the Ministry of Labor and Employment (MTE).

The rate of open unemployment calculated by the PME registered successive monthly declines from April onward, when the rate peaked at 13.1%, before dropping to 11.2% in July. As a result of this evolution, the median rate of unemployment in the first seven months of the year closed 0.2 p.p. below the rate in the same period of 2003. It should be stressed that the reduction in the jobless rate that has occurred since April was mainly a consequence of generation

Unemployment rate



Source: IBGE

Occupied people by categories of employment

Itemization	Percentage change			
	2004			
	Apr	May	Jun	Jul
Total of occupied people	0.7	0.8	0.4	0.9
By categories of employment				
Registered	-0.1	1.5	0.3	0.2
Nonregistered	3.7	1.8	-0.1	0.4
Non-earning workers, military and civil servants	1.2	1.1	1.2	4.7
Self-employed	-1.6	-2.6	0.2	2.7
Employers	0.5	3.9	3.2	-1.4

Source: IBGE

Formal employment

Itemization	New job openings (1,000 employees)				
	2004				In the year
	Apr	May	Jun	Jul	
Total	187.5	291.8	207.9	202.0	1 236.7
Manufacturing industry	64.4	89.5	47.5	56.0	382.4
Commerce	27.2	39.9	28.3	33.6	164.4
Services	49.0	56.1	39.6	42.7	309.5
Building	12.7	14.7	10.0	10.7	71.3
Crop and livestock	28.8	86.9	78.5	55.2	271.6
Public utilities	0.5	0.8	0.5	0.9	5.0
Others ^{1/}	5.0	4.0	3.5	3.0	32.5

Source: MTE

1/ Includes mineral extraction, public administration and others.

of new job openings, as the economically active population remained stable in the period. According to the PME, 347.6 thousand positions were created in the quarter extending from May to July, in contrast to the elimination of 43.5 thousand jobs in the corresponding period of 2003.

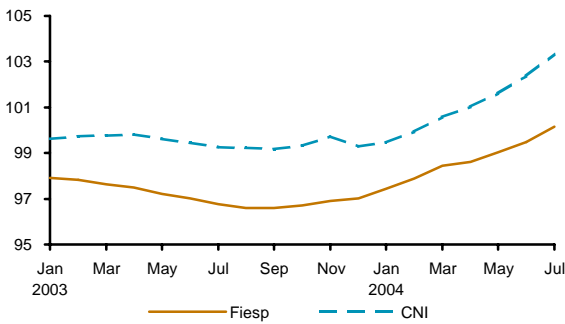
An analysis of the different categories indicates that most of the new jobs were concentrated in the formal sector of the economy, with 162.7 thousand openings in the May-July quarter, demonstrating the increased confidence of the business community in the recovery of the economy. At the same, 90 thousand openings were created among nonregistered workers, with an additional 94.9 thousand in other categories.

With respect to formal employment, MTE data for the entire country indicate that the growth that marked the May-July period has continued. The period was marked by 702 thousand hirings, compared to 303 thousand in the same quarter of 2003. The balance for the first seven months of the year totaled 1,237 thousand new vacancies, as against 598 thousand in 2003 and 742 thousand in 2002. The more accelerated pace at which jobs have been created has been an across-the-board phenomenon in the various sectors of the economy. Job growth has been most intense in the manufacturing sector, responsible for generating 382 thousand vacancies up to July, compared to 118 thousand in 2003, reflecting strong recovery in manufacturing activity. The service sector contributed with 309 thousand positions, while crop/livestock farming contributed with 272 thousand and commerce accounted for 164 thousand, numbers that are significantly higher than those registered in the same period of 2003 (169 thousand, 232 thousand and 69 thousand, respectively). One should also stress the growth registered in the construction industry, which generated 71 thousand positions in the period, compared to 17 thousand from January to July 2003.

The process of job creation registered by the MTE has been more intense than that perceived by the PME and suggests that the labor market in the interior of the country has become significantly more dynamic, when compared to metropolitan regions, as indicated in the last Inflation Report. To some extent, one can attribute this difference to the dynamics and formalization of employment in the crop/livestock sector and the process of geographic deconcentration of industry.

With regard to employment in the industrial sector, statistics calculated by sectoral entities confirmed the highly positive movement that has marked the period. According to a twelve

Industrial employment
Seasonally adjusted data
2000=100

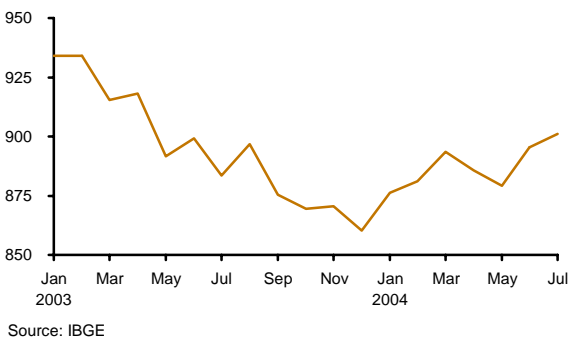


state CNI survey, the level of employment registered a deseasonalized increase of 1.6% in the second quarter when compared to the first. In June and July, the job level reached a point that had only been achieved in September 1998, which is fully consistent with the record levels of industrial output indicated by the IBGE for the period. Among the states covered by the survey, Goiás and Amazonas turned in the sharpest growth in jobs when compared to the previous year, with respective increases of 11.5% and 8.2%, in the first six months of the year.

According to the Federation of Industries of the State of São Paulo (Fiesp), industrial employment in São Paulo increased by 1% in the first half of the year, compared to the same period of 2003. In June, employment measured by Fiesp expanded in deseasonalized terms by 0.5% compared to the previous month. Aside from this, statistics released by the state's employer associations indicated the opening of 42 thousand vacancies from January to July.

Income

Real average habitual earnings
In R\$ at July 2004 prices, deflated by INPC



After registering declines in the months of April and May, the median habitual income of workers moved into a positive curve in the two following months, thus regaining the trend that began at the start of the year. According to the PME, real income, using the IBGE's National Consumer Price Index (INPC) as deflator, increased by 2% in July, compared to the level registered in the same month of 2003, registering the first positive growth figure for the series in this type of comparison. In accumulated terms for the year up to July, however, average purchasing power declined by 2.6%, compared to the same period of 2003. This result reflected reductions of 3.6% in the real earnings of public sector employees and 0.5% in the earnings received by private sector employees.

A survey carried out by the Inter Trade Union Department of Statistics and Socio-Economic Studies (Dieese), based on reports provided by union entities involved in collective bargaining processes, indicated improvement in wage negotiations in the first half of 2004, compared to the same period of previous years. In this sense, 79.4% of the negotiations resulted in increases equal to or greater than inflation measured by the INPC and accumulated in the twelve month period prior to negotiations, making this figure the highest percentage since 1996. Another indicator that demonstrates the strengthening of the positions assumed by workers in wage negotiations is the sharp cutback in the

Wage negotiations – 1st half 2004

Readjustments in comparasion to INPC ^{1/}	% ^{2/}			
	Industry	Commerce	Services	Total
Superior	57.9	37.5	34.7	47.3
Equal	25.7	37.5	39.8	32.1
Inferior	16.4	25.0	25.5	20.6
Share ^{3/}	53.4	9.2	37.4	100.0

Source: Dieese

1/ INPC acumulated in the last twelve months up to negotiation.

2/ 262 negotiations.

3/ Sectoral share of companies included in the Survey.

Real wages in the manufacturing industry

Itemization	% accumulated growth in the year			
	2004			
	Apr	May	Jun	Jul
CNI				
Overall real wages	7.2	7.5	7.8	7.9
Fiesp				
Overall real wages	8.2	8.4	8.4	8.5
Average real wages	7.8	7.6	7.4	7.1

Source: CNI and Fiesp

Gross Domestic Product – On the demand side

Itemization	Percentage change in the year					
	2003				2004	
	I Q	II Q	III Q	IV Q	I Q	II Q
GDP at market prices	1.9	0.4	-0.3	-0.2	2.7	4.2
Family consumption	-3.0	-4.5	-4.2	-3.3	1.2	3.1
Government consumption	-0.1	0.5	0.6	0.6	1.5	1.4
Gross fixed capital formation	-1.7	-6.2	-7.2	-6.6	2.2	6.8
Exports	18.4	24.3	15.8	14.2	19.3	17.8
Imports	-5.8	-5.9	-5.8	-1.9	11.7	13.0

Source: IBGE

number of phased-in increases from 2003 to 2004, from 30% to 10%.

In sectoral terms, industry stands as the segment that has offered the largest increases in the course of the first half-year period. In that period, 25.7% of industrial companies granted wage hikes based on the change in the INPC, while 57.9% agreed to higher increases. Workers in the areas of services and commerce obtained similar results, with 75% of the negotiations resulting in wage increases equal to or greater than the INPC. In contrast, the figure for the service sector was only 24%, while commerce closed with 67%. In regional terms, the increases were higher in the southern region, where 91% of the agreements reached in the first half of the year incorporated rates equal to or greater than the change in the INPC. In the southeast and northeast regions, this percentage came to 73% and 69.7%, respectively.

According to the CNI, the earnings of workers in the manufacturing sector increased at positive rates in the first seven months of 2004, with median monthly gains of 7.8%, compared to the same months of 2003, as this sector continued to lead all others in terms of wage increases. This analysis is valid for all the states surveyed, with the largest gains being registered in Bahia, 16.6%, Goiás, 15.1%, Santa Catarina, 13.5%, and Rio Grande do Sul, 10.3%.

Overall wages have reflected growth in employment and median wages in the industrial sector. In the first seven months of 2004, compared to the same period of the previous year, overall wages paid in the sector increased by 8.5% in the State of São Paulo, according to Fiesp, and 7.9%, in the thirteen states surveyed by the CNI. Comparing the deseasonalized data for the quarters ended in July and April, growth rates came to 1.5% and 1.4%, respectively.

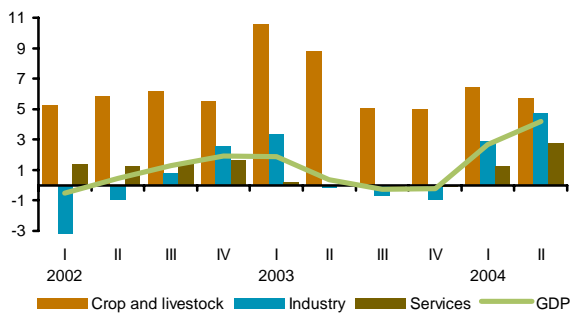
1.4 Gross Domestic Product

GDP expanded by 4.2% in the first half of 2004, compared to the same period of 2003. Using this basis of comparison, this was the best result since 2000. It is important to note that this growth was a generalized phenomenon among the components of this aggregate, independently of whether the figure is broken down by product or by demand.

Among the components of demand, the dynamics of the foreign trade sector was maintained, as exports increased by 17.8% and imports grew by 13% in the half-year period.

Gross Domestic Product

% growth accumulated in the year



Source: IBGE

Gross Domestic Product

Itemization	Percentage change					
	2003				2004	
	I	II	III	IV	I	II
Accumulated in the year	1.9	0.4	-0.3	-0.2	2.7	4.2
Accumulated in 4 quarters	2.5	1.9	0.7	-0.2	0.0	1.7
Quarter/same quarter of the previous year	1.9	-1.1	-1.5	-0.1	2.7	5.7
Quarter/previous quarter seasonally adjusted	-1.1	-1.2	0.4	1.7	1.7	1.5

Source: IBGE

Gross Domestic Product

Itemization	Quarter/previous quarter, seasonally adjusted					
	2003				2004	
	I	II	III	IV	I	II
GDP at market prices	-1.1	-1.2	0.4	1.7	1.7	1.5
Crop and livestock	2.5	0.1	-3.0	5.0	3.3	-0.3
Industry	-2.8	-3.5	3.0	1.7	1.5	0.2
Services	-0.5	-0.5	0.1	1.1	0.5	2.5

Source: IBGE

The 3.1% increase in household consumption in the same period is seen to be particularly relevant to the process of sustained economic growth, particularly when one considers that it accounts for 56.9% of the composition of the GDP and turned in negative results in the last three years. Positive growth under this component in the first half of the year reflected upward movement in income, particularly under the heading of overall wages, mirroring the steady recovery in employment levels. Fixed gross capital formation was the internal demand component that expanded most sharply in the first six months of the year, compared to the same period of 2003, with expansion of 6.8%. This behavior resulted from increased investments in both construction and capital goods. Here, the investment absorption level increased by 21% in the same period, a pace that was fully consistent with the outlook for expansion in the activity level and with the positive performance of the country's economic fundamentals. Finally, growth of 1.4% in government consumption in the half-year period remained at a level quite similar to that registered in the first quarter of the year.

In sectoral terms, the crop/livestock sector expanded by 5.7% in the first half of the year, compared to the same period of the previous year, while industry and the service sector turned in growth of 4.7% and 2.8%, respectively. Growth in the crop/livestock sector has continued reflecting the dynamics of primary product exports with a volume increase of 14.4%, using the same basis of comparison, according to data calculated by the Center of Foreign Trade Studies Foundation (Funcex), at the same time in which the productivity of the sector also increased. Both of these movements were driven by maintenance in 2004 of the highly favorable farm product prices in effect during all of 2003.

Expansion in the industrial sector reflected growth of 7.3% in manufacturing and 2% in public utility industrial services and in the construction industry. Mineral production declined by 2.9% in the half-year period and was impacted mainly by the 1.8% reduction in petroleum output, according to statistics released by the National Petroleum Agency (ANP).

Expansion of the service sector included practically all of the various subsectors, with the strongest performances being registered under commerce, 7.6%; transportation, 6.9%; financial institutions, 3.6%; public administration services, 1.5%; rentals, 1.3%; as well as "other services", with 2.6%. The communications sector turned in a reduction of 1%, using the same basis of comparison.

GDP Growth Estimates

The pace of economic expansion in the second quarter of this year surpassed expectations at the start of the period, particularly with regard to industrial activity. In light of this performance and the outlook for the final two quarters of 2004, estimates of real GDP growth for the year were revised upward from 3.5%, stated in the preceding Inflation Report, to 4.4%.

After hitting historical highs at the end of the first quarter, manufacturing output continued on an intense growth curve in the second quarter of the year¹, reflecting the continuity of the recovery in internal demand coupled with rising exports. In the same period, in the secondary sector, the construction industry registered the highest growth rates since 2000.

The dynamics of the industrial sector has impacted the service sector, generating particularly strong repercussions on the performance of the sub sectors of commerce and transportation, as well as financial institutions and other services, which registered strong growth in the second quarter.

The crop/livestock sector has continued registering a positive performance, thus confirming growth expectations for the year. The negative second quarter result, calculated on the basis of seasonally adjusted data, compared to the previous quarter, was expected due to the failure in the soybean harvest which had its greatest impact in this period.

1/ Emphasis should be given to the fact that, in seasonally adjusted terms, the general industry result for the second quarter did not register this growth, due perhaps to methodological problems rooted in the PIM. Based exclusively on data drawn from the new PIM, general industry (manufacturing and mining) registered seasonally adjusted growth of 3.1% in the second quarter compared to the first quarter.

Gross Domestic Product

Itemization	Percentage change in the year		
	2003		2004
	Pesos	%	Estimated
Crop and livestock	10.2	5.0	4.3
Industry	38.7	-1.0	6.0
Mineral extraction	4.0	2.8	2.1
Manufacturing	23.7	0.7	7.6
Construction	7.1	-8.6	4.6
Public utilities	3.8	1.9	3.0
Services	56.7	-0.1	2.9
Commerce	7.7	-2.6	7.5
Transportation	2.0	-0.8	6.0
Communications	2.6	0.1	1.1
Financial institutions	7.3	0.1	3.8
Other services	10.3	-0.5	3.2
Rents	10.5	0.9	1.2
Public administration	16.3	0.5	1.2
Value added at basic prices		0.0	4.2
Taxes on products	11.8	-1.7	6.5
GDP at market prices	111.8	-0.2	4.4

Source: IBGE and Banco Central do Brasil

Perceptions of a continued growth trajectory in these sectors over the course of the year have been reinforced by the recent evolution of the factors that condition demand. Steady growth in overall wages in recent months – due to recovery in both income and employment – and the continuity of expansion in credit operations are elements that tend to support increased consumer outlays. Parallel to this, investment indicators have evolved positively and should register growth in the final two quarters of the year, thus confirming the expectations delineated by leading indicators. In the external scenario, export operations will tend to continue at the high level registered in the first eight months of the year. An additional factor that should produce a positive impact is the relatively favorable outlook for recovery in the activity level of the world economy in the second half of 2004, notwithstanding the recent oil price spiral.

Gross Domestic Product

Itemization	Percentage change in the year					
	2003				2004	
	I Q	II Q	III Q	IV Q	I Q	II Q
Crop and livestock	10.6	8.8	5.1	5.0	6.4	5.7
Industry	3.3	-0.2	-0.7	-1.0	2.9	4.7
Mineral extraction	4.2	1.8	2.1	2.8	-3.9	-2.9
Manufacturing	3.9	1.0	0.7	0.7	6.0	7.3
Construction	-0.9	-6.0	-7.7	-8.6	-2.3	2.0
Public utilities	8.1	3.1	2.5	1.9	1.3	2.0
Services	0.2	0.0	-0.3	-0.1	1.2	2.8
Commerce	-0.2	-2.0	-3.4	-2.6	5.1	7.6
Transportation	-4.0	-2.3	-1.6	-0.8	7.4	6.9
Communications	2.4	2.7	1.4	0.1	-1.9	-1.0
Financial institutions	2.2	1.0	0.1	0.1	1.9	3.6
Other services	-0.1	-1.0	-0.6	-0.5	-2.1	2.6
Rents	0.4	0.6	0.6	0.9	1.1	1.3
Public administration	0.2	0.6	0.5	0.5	1.1	1.5
Financial dummy	4.4	1.7	0.6	0.3	0.3	3.3
Value added at basic prices	2.0	0.6	0.0	0.0	2.5	3.9
Taxes on products	0.5	-1.8	-2.4	-1.7	4.0	6.6
GDP at market prices	1.9	0.4	-0.3	-0.2	2.7	4.2

Source: IBGE

Investment indicators

Itemization	Percentage change			
	2004			
	Apr	May	Jun	Jul
Quarter/previous quarter ^{1/}				
Capital goods				
Absorption ^{2/}	0.2	3.5	3.7	1.8
Production	-0.8	5.0	6.3	6.4
Imports	4.3	5.1	2.9	0.3
Exports	8.1	16.1	13.3	18.4
Inputs for the building industry	-0.3	2.8	2.7	3.8
In the year				
Capital goods				
Absorption ^{2/}	9.9	12.2	13.8	12.8
Production	22.3	23.5	25.1	24.9
Imports	3.9	5.9	8.9	7.9
Exports	50.5	47.4	52.3	54.5
Inputs for the building industry	1.7	2.2	3.8	4.6
BNDES financing	74.3	59.0	47.7	36.4

Source: IBGE, Funcex and BNDES

^{1/} Seasonally adjusted data.

^{2/} Production + imports - exports.

The quarterly series of seasonally adjusted national accounts must still be viewed with some degree of caution, since methodological difficulties are encountered in linking the data generated by the new PIM to the national accounts series. These series are to be revised by IBGE when the third quarter GDP figures are released. Despite this, the deseasonalized series indicated GDP growth for the fourth consecutive quarter, with an increase of 1.5% in the second quarter of the year. In this comparison, the output of the crop/livestock sector declined by 0.3%, basically as a result of the downturn in the volume of the soybean harvest, since the harvest of this product has its greatest weight in the second quarter. Output of the industrial sector remained stable, notwithstanding sectoral indicators that pointed to strong growth in the period, using the same basis of comparison. The distortions rooted in the linking of the PIM can explain this disparity. The service sector expanded by 2.5% in the period, using the same reference base.

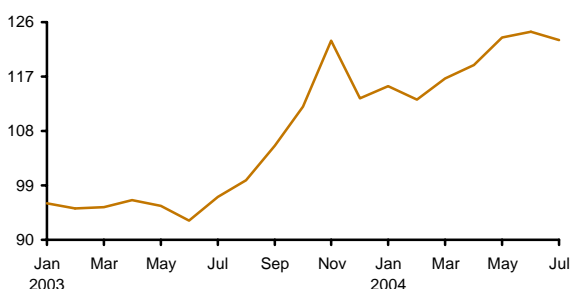
1.5 Investments

Outlays on investments followed an upward curve over the course of the first half of 2004, following a trend that had begun at the start of the previous half-year period. Among the factors that have contributed to this positive performance, it is important to underscore the continued growth of export sectors, consolidation of the process of renewed expansion in other productive segments and the strengthening of the nation's economic fundamentals.

According to the Quarterly National Accounts published by the IBGE, investments – excluding stock variations – increased by 6.8% in the first six months of 2004, when compared to the same period of 2003. This performance had already been anticipated by monthly indicators of gross fixed capital formation, which had registered positive growth in the first six months of the year, with 3.8% for construction activity and 25.1% for the production of capital goods. Absorption of capital goods in the half-year period continued expanding, albeit at a lesser pace than capital goods output, since exports of machines and equipment expanded by 52.3% and imports grew by 8.9% in the period. Already available indicators for the month of July continue pointing to growth in gross fixed capital formation, as output of construction industry inputs and capital goods expanded by 4.6% and 24.9%, respectively, when compared with the first seven months of 2004 and the same period of 2003. Exports and imports of capital goods increased by 54.5% and 7.9%, using the same basis of comparison.

Capital goods production

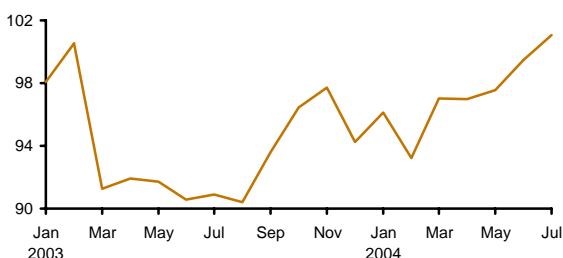
Seasonally adjusted data
2002=100



Source: IBGE

Inputs production for the building industry

Seasonally adjusted data
2002=100



Source: IBGE

Production of capital goods

Percentage change in the year

Itemization	2004			
	Apr	May	Jun	Jul
In the year				
Capital goods	22.3	23.5	25.1	24.9
Industrial	10.9	12.7	14.8	15.0
Serial	16.4	18.0	19.9	20.2
Nonserial	-15.9	-13.8	-11.6	-11.5
Agricultural	25.1	22.1	20.5	16.5
Farm parts	22.9	9.6	7.3	3.3
Building	28.9	25.6	28.1	32.3
Electric energy	12.3	14.9	11.8	12.9
Transportation	19.2	21.7	24.3	25.2
Mixed	25.3	25.5	27.6	26.6

Source: IBGE

Reflecting the positive evolution of the indicators of gross fixed capital formation, the participation of investments in GDP has been recovering. Looking at the first quarter of 2004, this participation corresponded to 22.2%, according to the Quarterly National Accounts released by the IBGE, compared to 20.1% in 2003. Monthly indicators point to continued expansion of this participation, which is fundamental to sustaining the process of renewed economic activity. However, it should be noted that the participation of investments in GDP is still well below the level registered in the second quarter of 1994, when participation set a record of 25.1%.

Analysis of capital goods production broken down by destination of the product reveals the scope of the increase in investments in the first half of the year and the start of the second. Thus, up to July, production of goods targeted to the construction industry expanded by 32.3%; while the output of capital goods for the transportation sector registered 25.2%; machines and tractors for the farm sector closed with 16.5%; production of parts for the farm sector came to 3.3%; and industrial goods produced in series closed with 20.2%.

Data released by the Brazilian Association of the Machines and Equipment Industry (Abimaq), for the January-July period, reflect recovery in investments, turning in positive growth in all of the indicators for the industry of mechanical capital goods. Median utilization of installed capacity moved from 76.5% in the first seven months of 2003 to 80.6% in the corresponding period of 2004. Using the same basis of comparison, real revenues of the sector increased by 7.9%, using the heading of Industrial Products, industrial machines and equipment of the FGV's Wholesale Price Index – Overall Supply (IPA-OG) as deflator; exports of machines and equipment expanded by 33% and imports in this category grew by 13.2%; the average number of weeks to fill orders in portfolio increased by 2.2% and the number of employees in the sector rose by 9.7%.

More recent data released by Anfavea also reflects the upturn in investments. Output of machines and equipment expanded by 17.7% in the first eight months of 2004, compared to the same period of 2003, with growth of 26.9% in the output of harvesters and 14.9% under wheeled tractors. Using the same basis of comparison, production of trucks expanded by 34.3% and that of buses by 9.3%.

Disbursements by the BNDES System – National Bank of Economic and Social Development (BNDES), the Special

Production of automotive vehicles

Itemization	Percentage change				
	2004				
	Apr	May	Jun	Jul	Aug
In the month^{1/}					
Farm machines	-6.7	-2.4	2.5	0.2	3.0
Busses	-5.7	5.5	13.3	9.5	-13.9
Trucks	2.2	1.8	6.4	1.6	3.6
Quarter/previous quarter^{1/}					
Farm machines	13.9	9.6	-2.4	-3.7	-0.4
Busses	-14.8	6.2	13.1	19.5	16.6
Trucks	7.1	11.3	11.9	10.4	11.0
In the year					
Farm machines	29.4	24.4	21.2	19.7	17.7
Busses	-0.1	2.0	5.9	9.0	9.3
Trucks	20.3	25.0	29.4	32.2	34.3

Source: Anfavea

1/ Seasonally adjusted data.

BNDES disbursement^{1/}

Itemization	Accumulated in the year (in R\$ million)			
	2003	2004		
		I Q	I H	Jul
Total	33 534	8 508	18 033	20 982
Manufacturing industry	15 937	4 306	7 393	8 289
Commerce and services	12 844	2 595	7 298	8 630
Crop and livestock	4 595	1 569	3 185	3 900
Extraction industry	157	37	157	163

Source: BNDES

1/ Includes BNDES, Finame and BNDESpar.

Industrial Financing Agency (Finame) and BNDES Participações S.A. (BNDESpar) – added up to R\$20.9 billion in the first seven months of 2004, a figure that is 36.4% higher than that registered in the same period of 2003. By sector of activity, financing granted to mining and manufacturing increased by 120% and 29.8%, respectively; those channeled to commerce and services, by 29.6%; and those targeted to the crop/livestock sector, 72.1%.

The Long-Term Interest Rate (TJLP), which is the basic cost of financing contracted with the BNDES System, remained at 9.75% per year in the second and third quarters of 2004, compared to 10% per year in the first quarter.

1.6 Conclusion

At the end of the second quarter of the year, economic activity indicators revealed a historically high production level. These levels resulted from the process of recovery under way since 2003. This process was initially sustained by the export sector and expanding credit and, later, by expanding income and employment.

With consolidation of this situation, themes related to the sustainability of the growth process have gained importance in the economic debate. With regard to current indicators and the outlook for the future, the macroeconomic fundamentals are better positioned now than in any other recent strong upturns in activity. Consequently, the current cycle will certainly be more durable than past episodes. The simultaneous occurrence of a consolidated framework of fiscal responsibility and sustainability of the public debt, an initially comfortable position for the balance of payments current account result, a real rate of exchange in line with market forces and inflation that is clearly under control have all contributed to make the macroeconomic fundamentals of the current cycle considerably more robust.

Increased confidence in the solidity of macroeconomic fundamentals, reinforced by measures of a microeconomic nature that make it possible to consolidate a favorable business climate, will aid in bringing about the investments needed for a more stable and accelerated growth process. Recent evolution of capital formation indicators and investment conditions is consistent with the start of this process.