

For the most part, economic growth in the first quarter of 2007 reflected internal demand, driven by the dynamics of household consumption and, more recently, by expanding investments. At the same time, there is no denying the importance of the ongoing process of monetary policy easing to improvement in credit conditions, one of the primary factors underlying current sustained economic expansion.

Continued economic growth has already been discussed in recent Inflation Reports, highlighting accelerated growth in internal demand at rates above Gross Domestic Product (GDP) expansion, coupled with a negative external sector contribution, in an environment of exported volume growth and a continued strong surplus in trade in goods and services.

The labor market is clearly immersed in a virtuous cycle, with steady growth in formal job openings and overall real wages. Low rates of inflation have played a role of essential importance to positive gains in worker wages. Continued job market improvement and the impact of monetary policy easing are the main factors underlying consolidation of activity growth over the course of 2007.

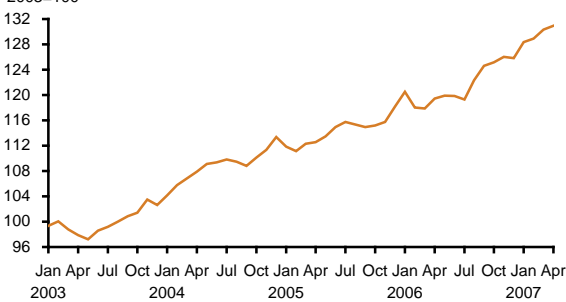
### 1.1 Retail sales

The major factors undergirding recent retail sector expansion have been labor market evolution, sharp improvement in consumer expectations, increased farm income, price stability and improved credit conditions. Expectations that this process will continue throughout the entire year point to steady growth in overall sales volume, as already mentioned in the previous Inflation Report.

According to data released in the Brazilian Institute of Geography and Statistics (IBGE) Monthly Retail Trade Survey (PMC), the volume of retail sales expanded 9.2% in the first four months of 2007, compared to the same period of 2006, following in the wake of 5.7% growth in

**Figure 1.1 – Retail sales**

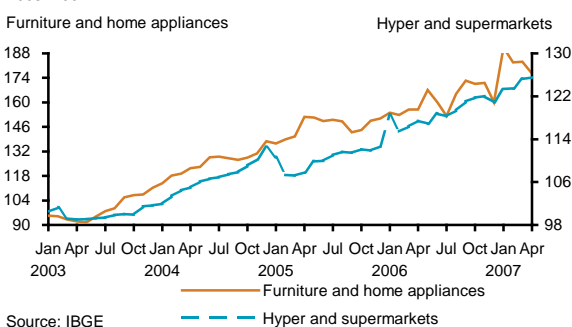
Seasonally adjusted data  
2003=100



Source: IBGE

**Figure 1.2 – Retail sales**

Seasonally adjusted data  
2003=100

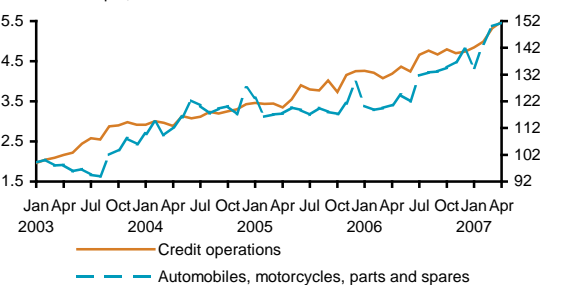


Source: IBGE

**Figure 1.3 – Retail sales**

Seasonally adjusted data

Credit  
R\$ billion of April, 2007  
Automobiles, motorcycles, parts and spares  
2003=100



Source: IBGE and Banco Central do Brasil

**Table 1.1 – Retail sales**

April 2007

	% accumulated growth in 2006		
	Nominal revenue	Volume	Price
Retail sector	9.4	9.2	0.2
Fuels and lubricants	1.5	5.3	-3.6
Hyper and supermarkets	9.1	6.4	2.5
Fabrics, apparel and footwear	10.6	7.3	3.1
Furniture and home appliances	13.5	18.5	-4.2
Broad retail sector	12.2	12.6	-0.4
Automobiles and motorcycles	18.5	21.3	-2.3
Building materials	10.8	7.2	3.4

Source: IBGE

the first half of 2006 and 6.6% in the second, compared to the corresponding periods of 2005. Using the broad retail trade sector concept, which incorporates the segments of building materials and automobiles, motorcycles, parts and spares, sales growth becomes even more evident, with 12.6% expansion in the first four months of 2007 and 4.1% and 8.4% in the first and second halves of 2006, respectively.

Based on seasonally adjusted data, an analysis at the margin suggests a continued positive performance. In this sense, sales expanded 2.6% in the three-month period ended in April, compared to the November-January period, with increases of 3.8% under furniture and home appliances, 2.4% under fuels and lubricants and 2.2% in the case of hypermarkets, supermarkets, food products, beverages and tobacco.

Using the same basis of comparison, sales of automobiles, motorcycles, parts and spares increased 7.9%. To some extent, increased sales in this segment, which has registered successive new sales records in recent months, as well as under furniture and home appliances, reflected the importance of improved credit conditions to the current upturn in retail sector sales.

Since the data series on sales of building materials has only been published since 2004, the resulting statistics have not been seasonally adjusted. Nonetheless, sales in this segment expanded 6% in the February-April 2007 period compared to the same three-month period of the previous year. Though sales have not picked up in recent months, operations tend to keep pace with ongoing improvements in credit conditions and increases in overall wages.

A breakdown at the state level shows across-the-board expansion in retail sales in the first four months of 2007, compared to the corresponding period of 2006. The most accentuated increases occurred in Alagoas, 32.8%; Acre, 20%; Maranhão, 17.6%; Ceará, 15.1%; and Mato Grosso do Sul, 14.1%. Sales in the southern states of the country, which had turned in only modest results in 2006, were positively impacted by recovery in the farm sector and machines and equipment segment, posting increases of 11.8% in Santa Catarina, 7.5% in Paraná and 5.1% in Rio Grande do Sul.

In cumulative terms for the year, regionally consolidated retail sales expanded 12.4% in the north of the country and 11.4% in the northeast, followed by the central-west region, with 8.8%; the southeast, with 9.5% and the south, with 7.6%. Despite accentuated growth in the north and northeast

**Table 1.2 – Retail sales**

	% change			
	2007			
	Jan	Feb	Mar	Apr
<b>In the month<sup>1/</sup></b>				
Retail sector	2.0	0.4	1.1	0.4
Fuels and lubricants	2.7	1.1	-0.2	-1.5
Hyper and supermarkets	2.0	0.1	1.4	0.2
Fabrics, apparel and footwear	3.0	-2.7	2.4	-1.7
Furniture and home appliances	19.5	-4.4	0.1	-3.6
Automobiles and motorcycles	-4.9	6.8	4.5	0.9
<b>3-month period/previous 3-month period<sup>1/</sup></b>				
Retail sector	2.2	1.9	2.8	2.6
Fuels and lubricants	2.6	3.8	4.4	2.4
Hyper and supermarkets	1.2	0.8	2.0	2.2
Fabrics, apparel and footwear	3.6	1.3	2.3	-0.5
Furniture and home appliances	2.9	3.9	11.1	3.8
Automobiles and motorcycles	3.0	3.7	3.7	7.9
<b>In the year</b>				
Retail sector	8.5	8.8	9.7	9.2
Fuels and lubricants	2.5	3.7	4.8	5.3
Hyper and supermarkets	4.9	5.9	7.2	6.4
Fabrics, apparel and footwear	6.5	5.1	6.8	6.1
Furniture and home appliances	24.1	21.8	20.3	18.5
Automobiles and motorcycles	14.3	16.8	17.4	21.3

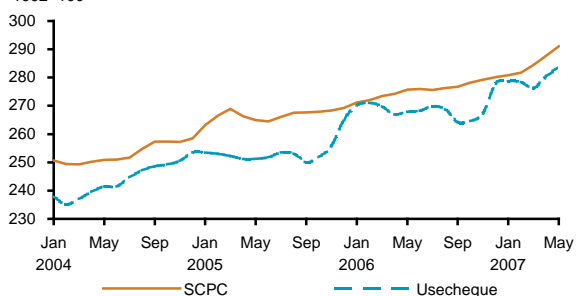
Source: IBGE

1/ Seasonally adjusted data.

**Figure 1.4 – Retail sales indicators**

Seasonally adjusted data – Quarterly moving average

1992=100



Source: ACSP

**Table 1.3 – Default rates**

	%					
	2007					
	Jan	Feb	Mar	Apr	May	Year <sup>1/</sup>
<b>Returned checks<sup>2/</sup></b>						
Brazil	6.3	6.5	6.9	...	...	6.6
Northern region	9.6	9.6	10.4	...	...	9.9
Northeast region	8.6	9.3	10.0	...	...	9.3
Southeast region	5.8	5.9	6.3	...	...	6.0
Central-western region	7.3	7.3	7.7	...	...	7.4
Southern region	6.1	6.2	6.6	...	...	6.3
SCPC (SP) <sup>3/</sup>	5.6	6.3	7.1	8.1	8.0	7.0

Source: Banco Central do Brasil and ACSP

1/ Annual average.

2/ Returned checks/cleared checks.

3/ [New registrations (-) registrations cancelled]/[consultations (t-3)].

regions, it is important to stress that nationwide growth figures mainly reflected upturns in the south and central-west regions of the country, following only modest performances in the first four months of 2006. To some extent, this movement can be explained by rising farm income.

In the broad concept, regional sales followed the pattern registered in the restricted concept, with growth in all of the various states. The best performance, however, occurred in the north and northeast regions, while Mato Grosso and Rio Grande do Sul closed with the lowest rates of growth.

Based on seasonally adjusted data for the three-month periods ended in April and January, analysis at the margin shows more accentuated growth in Amapá, 5.3%; São Paulo, 4.8%; Rondônia, 4.5%; Maranhão, 54.3%; Espírito Santo, 4.2%; and Mato Grosso, 4.1%; with the downward movement only in Acre, 8.7%; Goiás, 2.7%; and Paraíba, 0.5%.

Compared to the same period of 2006, nominal retail trade revenues increased 9.4% in the first four months of 2007, for growth of 9.2% in sales volume and 0.2% in prices. With the sole exception of fuels and lubricants, nominal revenues posted by other segments of the retail sector surpassed the 2.99% rate of IPCA inflation registered in the period.

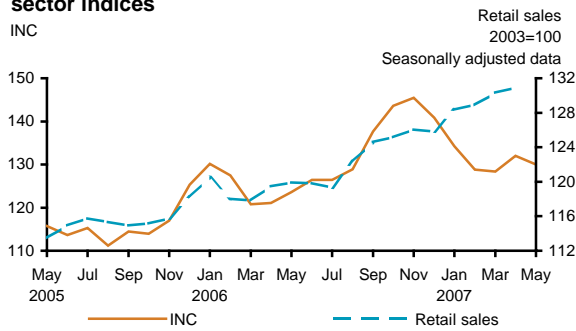
The number of contacts with the Credit Protection Service Center (SCPC), used as an indicator of installment purchases, expanded 1.2% between the three-month periods ended in May and February, while contacts with the Usecheque system, an indicator of check-based purchases, increased 0.5%.

The delinquency indicator used by the São Paulo Trade Association (ACSP) averaged 7% in the first five months of the year, compared to 6.7% in the same period of 2006. This growth was considered compatible with the rise in installment sales during the period under analysis and, at this point in time, does not represent any significant obstacle to further sales growth.

Nationwide consumer confidence surveys indicate that expectations in the early months of 2007 were higher than in the corresponding period of 2006. The National Confidence Index (INC), prepared by Ipsos Public Affairs (Ipsos) for the ACSP, reached 130 points in the month of May, against 128.8 points in March and 123.6 points in May 2006, registering growth in all of the various regions, with the sole exception of the Southeast, where the index remained stable.

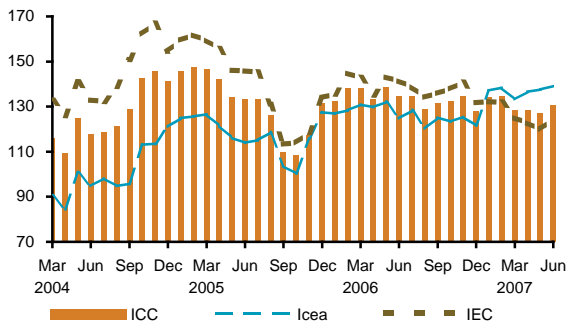
The Getulio Vargas Foundation (FGV) released its Consumer Confidence Index (ICC), showing month-on-month growth

**Figure 1.5 – National Consumer Confidence and retail sector indices**



Source: ACSP and IBGE

**Figure 1.6 – Consumer Confidence Index**



Source: Fecomercio SP

of 2.6% in May 2007, with highs of 1% in the component that assesses the current situation and 3.5% in that involving expectations for the coming months.

As released by the Trade Federation of the State of São Paulo (Fecomercio SP), the ICC, restricted to the metropolitan region of São Paulo, showed a quarter-on-quarter decline of 2.8% in the second quarter of the year. Despite this drop, the indicator closed at 128.6 points, well above the 100-point standard, considered the level of indifference. When the various components are analyzed, the Consumer Expectations Index (IEC), which accounts for 60% of the general index, dropped 5.6% and the Current Economic Conditions Index (Icea), which represents the remainder of the general index, increased 1.1%.

## 1.2 Output

### Crop/Livestock

According to IBGE’s Quarterly National Accounts, crop/livestock sector output expanded 2.1% in the first quarter of 2007, compared to the same quarter of the previous year. In the case of the 2007 harvest, the Systematic Farm Production Survey (LSPA) indicates positive results for such crops as corn, beans, soybeans, wheat and sugarcane, among others. The livestock segment is expected to continue the positive performance that has marked recent years, with important repercussions on exports, particularly involving poultry and pork.

### Crops

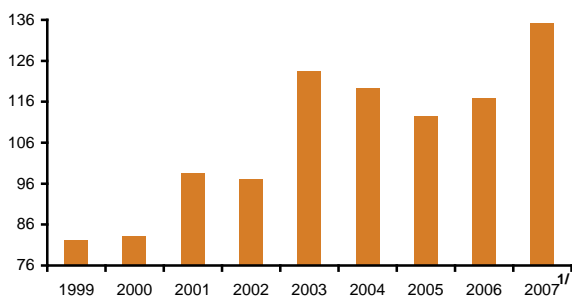
The LSPA estimate for the 2007 harvest indicates 135.1 million tons of grain, 15.5% more than in the previous year. Growth is forecast in all of the various regions, particularly in the south, 24.6%, and central-west region, 12.1%.

Soybean production is forecast at 58.5 million tons, for annual growth of 11.7%. The area under cultivation is expected to decline 6.7%, as some producers migrate into higher income crops, such as corn and sugarcane. Productivity is expected to increase 19.8%, reflecting utilization of more productive land and favorable climatic conditions during the planting period.

The corn harvest was estimated at 52.9 million tons. Annual growth of 24.1% is sustained by 10.2% expansion in the

**Figure 1.7 – Grain production**

In million tons



Source: IBGE

1/ Estimate.

**Table 1.4 – Farm production**

	In 1,000 tons		
	Production		% change 2007/2006
	2006	2007 <sup>1/</sup>	
Grain production	116 993	135 118	15.5
Cotton (seed)	1 816	2 373	30.7
Rice	11 505	11 044	-4.0
Beans	3 437	3 715	8.1
Corn	42 632	52 916	24.1
Soybean	52 356	58 490	11.7
Wheat	2 482	4 028	62.3
Others	2 765	2 552	-7.7

Source: IBGE

1/ Estimate.

area under cultivation and 12.7% in productivity. The major determining factors underlying this performance were favorable climatic conditions and price evolution, reflecting the rise in international demand generated partially by expectations of growth in corn-based ethanol production in the United States.

The bean and herbaceous and arboreous cottonseed harvests are expected to reach 3.7 million and 2.4 million tons, respectively, in 2007, corresponding to increases of 8.1% and 30.7%. Rice production is estimated at 11 million tons, 4% less than in 2006, reflecting both unfavorable price trends and reductions in average yield.

Sugarcane production for 2007 is estimated at 513.3 million tons, 12.7% more than in the previous harvest. The area under cultivation is evaluated at 6.7 million ha, for 8.9% annual growth, while average productivity is expected to expand 3.5%. The development projected for this crop reflects excellent climatic conditions and greater external demand for sugar and alcohol. According to the Foreign Trade Secretariat (Secex), subordinated to the Ministry of Development, Industry and Commerce (MDIC), sugar exports (both raw and refined) and ethyl alcohol came to 6.7 million tons and 1.3 billion liters, respectively, in the first five months of 2007, corresponding to growth of 31.1% and 80.5% compared to the same period of 2006.

The coffee bean harvest is projected at 2.2 million tons. In annual terms, this represents a reduction of 13.4% caused basically by a 13.3% drop in average yield in the two-year low production cycle.

Wheat production is forecast to close at 4 million tons, with annual growth of 62.3%. To some extent, this performance reflects the results of the previous harvest, which was impacted by climatic adversities and clearly uncompetitive prices for the national crop. The area under cultivation is expected to grow 14.1%, while average productivity should increase 42.2%.

**Table 1.5 – Livestock production**

Total slaughters

Itemization	% accumulated growth in the year						
	2006						
	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Cattle	5.5	5.2	5.5	6.3	8.3	8.5	8.1
Swine	5.4	6.2	6.4	5.8	6.3	6.4	6.6
Poultry	5.8	5.6	5.4	4.8	4.6	4.1	3.4

Source: IBGE

## Livestock

According to the Quarterly Animal Slaughter Survey released by IBGE in April 2007, beef production totaled 6.9 million tons in 2006, up 8.1% compared to 2005. When the same basis of comparison is used, poultry and pork production reached 8.1 million and 2.3 million tons, for growth of 3.4% and 6.6%, respectively.

Exports of beef totaled 1.2 million tons in 2006 and continued expanding in the early months of 2007. Data available through April indicate 41.5% growth in the year, compared to the same period of 2006. Exports of poultry and pork, which had declined 6.4% and 16.4% in 2006, recovered in 2007, posting respective growth rates of 16.3% and 39.1% in the year through April.

## Industrial output

The industrial growth cycle begun in 2006 gained added momentum in the early months of the current year, driven by expanding investments which, in turn, reflected interest rate cutbacks and expectations of a period of sustained economic growth. High levels of confidence among industry executives indicate that industrial output will continue expanding in the coming six months. The outlook for medium-term expansion in the nation's productive capacity is backed by strong growth in capital goods output, most of which is absorbed by the domestic market.

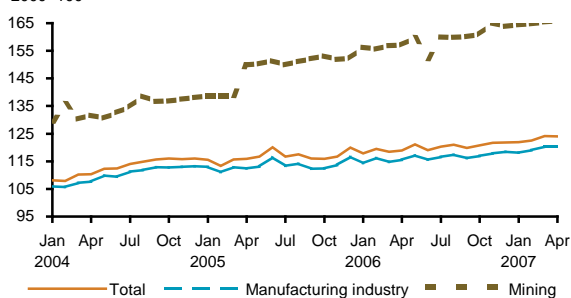
According to IBGE's Monthly Industrial Survey – Physical Production (PIM-PF), industrial output accelerated in early 2007. Utilizing seasonally adjusted data, industrial production increased 1.5% in the three-month period ended in April, compared to the November-January period, when growth closed at 1% using the same basis of comparison. In 2006, industrial output registered average three-month growth of 0.8%.

Growth in industrial output in 2006 was sustained by mining sector performance, which expanded at an average quarterly rate of 1.7% compared to 0.7% in the case of manufacturing. In the early part of this year, the ratio reversed course, as manufacturing sector output expanded 1.5% in the three-month period ended in April, compared to the November-January period, and mining sector production rose 0.6%.

The incentive generated by the 2006 reduction in medium and long-term credit costs became even more evident in early 2007. Viewed in terms of seasonally adjusted data, capital goods production, which had registered average quarterly growth of 1.9% in 2006, jumped to 2.9% in the February-April period, compared to the three-month period ended in January. In the same context, production of consumer durables, intermediate goods and semidurable and nondurable consumer goods, which had expanded at an average quarterly rate of 1.2%, 0.6% and 0.8%, respectively, in 2006, posted rates of 4.3%, 1.6% and 0.7% in the three-month period ended in April, in the same order.

**Figure 1.8 – Industrial production**

Seasonally adjusted data  
2000=100



Source: IBGE

**Table 1.6 – Industrial production**

	% change			
	2007			
	Jan	Feb	Mar	Apr
<b>Industry (total)</b>				
In the month <sup>1/</sup>	0.0	0.5	1.3	-0.1
3-month period/previous 3-month period <sup>1/</sup>	1.0	1.1	1.2	1.5
Same month of the previous year	4.5	3.0	3.9	6.0
Accumulated in the year	4.5	3.7	3.8	4.3
Accumulated in 12 months	2.9	2.8	2.7	3.3
<b>Manufacturing industry</b>				
In the month <sup>1/</sup>	-0.3	0.8	1.1	0.0
3-month period/previous 3-month period <sup>1/</sup>	1.1	1.3	1.2	1.5
Same month of the previous year	4.4	2.8	3.8	6.0
Accumulated in the year	4.4	3.6	3.7	4.3
Accumulated in 12 months	2.7	2.6	2.5	3.1
<b>Mining</b>				
In the month <sup>1/</sup>	0.4	0.2	0.4	0.3
3-month period/previous 3-month period <sup>1/</sup>	2.6	1.4	1.0	0.6
Same month of the previous year	5.1	6.3	5.6	5.6
Accumulated in the year	5.1	5.7	5.6	5.6
Accumulated in 12 months	6.7	6.2	5.7	5.7

Source: IBGE

1/ Seasonally adjusted data.

**Table 1.7 – Industrial production by use category**

	% change			
	2007			
	Jan	Feb	Mar	Apr
<b>In the month<sup>1/</sup></b>				
Industrial production	0.0	0.5	1.3	-0.1
Capital goods	1.5	0.3	-0.4	-1.2
Intermediate goods	-0.2	0.6	1.9	-0.6
Consumer goods	-0.6	1.2	0.5	0.3
Durables	2.3	1.9	2.0	-1.4
Semi and nondurables	-0.7	0.8	-0.4	0.8
<b>3-month period/previous 3-month period<sup>1/</sup></b>				
Industrial production	1.0	1.1	1.2	1.5
Capital goods	6.4	9.4	6.9	2.9
Intermediate goods	1.2	1.5	1.6	1.6
Consumer goods	0.7	0.9	0.7	1.4
Durables	0.9	2.8	4.1	4.3
Semi and nondurables	0.4	0.8	0.3	0.7
<b>In the year</b>				
Industrial production	4.5	3.7	3.8	4.3
Capital goods	17.7	16.1	14.8	15.4
Intermediate goods	3.2	3.3	3.8	4.2
Consumer goods	2.9	1.5	1.5	2.3
Durables	4.4	0.8	2.3	3.1
Semi and nondurables	2.5	1.7	1.3	2.0

Source: IBGE

1/ Seasonally adjusted data.

Among the various activities surveyed in the PIM-PF, distribution of physical industrial output is clearly compatible with the incentives generated by both demand and relative prices. In this framework, compared to the corresponding period of 2006, growth in the 12-month moving average for the period ended in April indicates that production in the segment of office machines and computer equipment increased 40.5%, followed by furniture, 11.2%; machines and equipment, 9.1%; medical, hospital, optical and other instrumentation equipment, 7.8%; beverages, 7.5%; machines, apparatuses and electric equipment, 6.7%; basic metallurgy, 6.2%; and food products, 3.5%. In the opposite situation, mention should be made of reductions in the output of electronic equipment, communications equipment and apparatuses, 8%, mainly due to declining exports of cell telephone devices; footwear and leather goods, 2.8%; and apparel and accessories, 3.8%.

Recovery in farm income led to growth in the production of goods for that sector. When one considers the average indices for the three-month periods ended in April 2007 and April of the previous year, output of fertilizers and soil correction products increased 17%, while production of herbicides and pesticides increased 16.8% and output of tractors, farm machines and equipment rose 22.2%.

Regional production indicators (PIM-PF Regional) demonstrate that the process of accelerated industrial output growth noted between the end of 2006 and early months of the current year was more accentuated in the southern region. Compared to the same period of the previous year, growth in average production in the three-month period ended in April reached 7.9% in Paraná, 6.4% in Rio Grande do Sul and 2.5% in Santa Catarina. This performance was impacted by the dynamics of the segments of automotive vehicles, other chemical products and publishing and printing in the state of Paraná; automotive vehicles, oil refining and alcohol production and machines and equipment in Rio Grande do Sul; and food products in Santa Catarina. Physical production of the states located in the Amazon region dropped 2.5% in the period under consideration, reflecting the falloff in output of cell telephone devices and television sets.

Even in a framework of growing capital goods absorption, the increased dynamics of industrial output raised the level of utilization of installed production capacity. According to the Manufacturing Industry Survey (SCIT) carried out by the FGV, the utilization level of installed industrial capacity moved to 84.5% in May, 1.8 p.p. above the level for the same month of the previous year.

## Alterations in South X Northeast Industrial Behavior

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Industrial output in the southern and northeast regions of Brazil showed highly distinct dynamics in the 2005/2006 period, with implications for evolution of the job market and retail sector sales. While the southern states showed declines or only very slight growth in industrial output, the northeastern states were considerably more dynamic, particularly in 2006. The underlying determinants of this behavior were increased concentration of southern industries on foreign trade; the greater weight of commodities in northeastern industrial output; higher income growth in the northeast; and reductions in agricultural income with important impacts on industrial production in the south of the country.

According to IBGE's Regional Industrial Survey (PIR), while industrial product declined 0.9% in the southern region<sup>1</sup> in 2005 and 1.3% in 2006, the northeast posted positive growth of 2.5% and 3.3%, respectively.

Analysis of data broken down by activity reveals that the heading "food and beverages", which accounts for 24.1% of northeastern industrial output and 23.9% in the south, is the major factor underlying this performance. In 2006, this industrial segment posted a high of 3.7% in the northeast and only 1% in the south, primarily as a result of larger income gains in the northeast generated as much by higher overall wages as by federal government assistance programs. In this framework, data from IBGE's Monthly Employment Survey (PME) indicate a high of 8.5% in overall wages in the northeast of the country (metropolitan regions of Recife and

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1/ Industrial output indices in the southern region, calculated by Depec, consider the production indices of each one of the southern states, weighted by relative participation of their manufacturing sectors in each of the regions, according to IBGE's Annual Industrial Survey (PIA) – Company 2005.

Salvador) and 4.9% in the south (metropolitan region of Porto Alegre).

**Table 1 – Industrial production by activity**

Itemization	% change							
	2006				2007 (up to April)			
	Growth		Contribution		Growth		Contribution	
Northeast	South	Northeast	South	Northeast	South	Northeast	South	
Food and beverages	3.7	1.0	0.9	0.3	9.2	8.7	2.2	2.1
Basic metallurgy	10.9	...	0.9	...	2.5	...	0.2	...
Celulose, paper and paper products	16.6	2.6	0.6	0.1	-3.3	0.0	-0.1	0.0
Textiles	5.5	-0.5	0.4	0.0	-5.5	0.5	-0.4	0.0
Non-metallurgical mineral products	7.3	-4.2	0.4	-0.1	7.6	12.7	0.4	0.4
Coke, oil refining and alcohol production	2.3	0.6	0.3	0.1	-3.5	2.9	-0.4	0.3
Leather, travel accessories and footwear	5.2	-8.8	0.2	-0.4	-0.8	-10.3	0.0	-0.5
Other chemical products	1.0	-0.2	0.2	0.0	2.3	13.5	0.5	1.2
Machines, apparatuses and electric equipment	1.2	6.1	0.0	0.1	-5.7	6.5	-0.1	0.2
Mining industries	-4.4	...	-0.4	...	-3.7	...	-0.3	...
Apparel and accessories	-14.5	-10.0	-0.4	-0.2	-4.9	-15.4	-0.1	-0.4
Publishing, printing and copy of recordings	...	4.4	...	0.1	...	19.7	...	0.3
Rubber and plastic products	...	8.8	...	0.4	...	4.2	...	0.2
Furniture	...	3.7	...	0.1	...	10.6	...	0.3
Machinery and equipment	...	-3.8	...	-0.4	...	16.0	...	1.6
Wood products	...	-14.4	...	-0.6	...	-10.0	...	-0.4
Metal products – Excluding machinery and equipment	...	-6.7	...	-0.2	...	-1.5	...	-0.1
Tobacco products	...	-7.3	...	-0.2	...	10.0	...	0.3
Automotive vehicles, tractors and bodyworks	...	-3.2	...	-0.3	...	18.9	...	1.8
Total	3.2	-1.2	...	...	1.7	7.3	...	...

Source: IBGE

In the same sense, the segment of textile products posted highly differentiated behaviors in the two regions, with a 5.5% high in the northeast (weight of 7.7%) and a decline of 0.5% in the south (weight of 2.1%).

Other activities driving northeastern industrial growth were cellulose, paper and paper products, basic metallurgy and nonmetallic mineral products. In the northeast, the Ceará industrial sector expanded 8.2% in 2006, the best performance among all of the states of the region. These results were driven by the sectors of machines, apparatuses and electric equipment; chemical products; and textiles.

In the case of the southern region, Rio Grande do Sul was the only state surveyed by IBGE data to register consecutive negative industrial output figures in 2005 and 2006, with 3.6% and 2%,

respectively. This performance reflected reductions in the sectors of machines and equipment, principally those focused on the farm sector, metal goods and footwear and leather articles. The behavior of the automotive vehicle industry contributed to the weak performance of industry in the State of Paraná, while the segments of wood, apparel and accessories and food products were decisive elements in the stagnation of industry in the State of Santa Catarina.

There is a direct relationship between the behavior of regional industrial production and the exported volume of significant products in the industrial profile of these regions. According to the Foreign Trade Studies Center Foundation (Funcex), exported volumes of automotive vehicles, wood and furniture, and machines and tractors, sectors that, when taken together, accounted for 23.1% of southern region output and were not included in the surveys carried out in northeastern industry, declined 8.5%, 7.8% and 5.1%, respectively, in 2006, contributing with -1.2 percentage points (p.p.) to the annual industrial performance result in the South.

An additional determining factor underlying the recent behavior of production in the southern region were the effects of farm sector income losses in the 2005/2006 period. In this sense, output of agricultural capital goods turned in negative growth under machines, 16.5%, and parts, 38.9%, for the second consecutive year. Parallel to this, mention should also be made of the impact of avian flu on world consumption of chicken meat, a segment of enormous importance to the southern region.

Output in northeastern industry benefited from the behavior of commodities, similarly to what occurred in the segments of steel and metallurgy, which were positively impacted by increased domestic demand, particularly in the second half of 2006; as well as cellulose, as evident in annual growth of 7% in the exported volume of cellulose, paper and printing.

Results for industrial output in the first four months of 2007 included in the National Accounts elaborated by IBGE suggest recovery in the southern region, impacted by income gains in the farm sector, reaching as much as 19.4% in the first quarter of the year when compared to the same period of 2006. In this

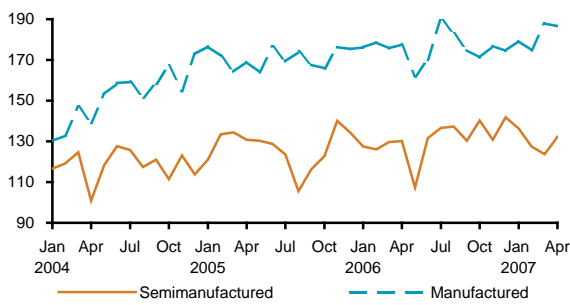
sense, southern production showed growth of 7.3% in the first four months of 2007, compared to the same period of the previous year, in contrast to 1.7% expansion in the northeast of the country.

The enhanced dynamics in that region were generated by the performance of the sectors of automotive vehicles, machines and equipment and food products, with respective growth rates of 18.9%, 16% and 8.7% in the four-month period under consideration. Viewed as a whole, these segments accounted for 5.4 p.p. of industrial expansion in the south of the country during the period under analysis. The more moderate performance registered by industrial production in the northeast of Brazil reflected declines under textiles and oil refining and alcohol production.

In this context, though the pace of growth in such segments as wood, apparel and leather, remains relatively low, recovery in farm income and its impact on the production of agricultural machines and food production have guaranteed a more robust recovery in the southern industrial structure. In the northeast, income gains remain as a determining factor for continued growth in the industrial sector. This behavior suggests that industrial performance in these important regions should be less heterogeneous in 2007 than in recent years.

**Figure 1.9 – Industrial exports – Volume**

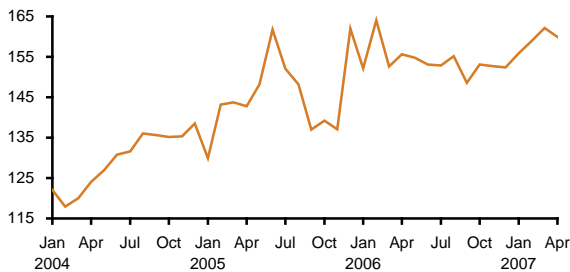
Seasonally adjusted data  
2002=100



Source: Funcex

**Figure 1.10 – Industrial production**

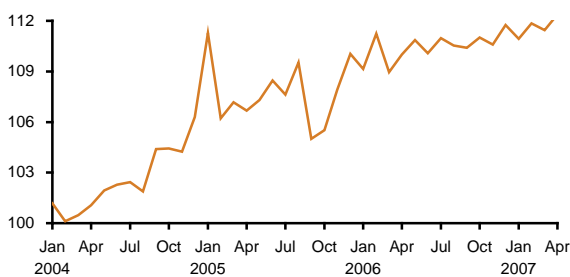
Durable consumer goods  
Seasonally adjusted data  
2000=100



Source: IBGE

**Figure 1.11 – Industrial production**

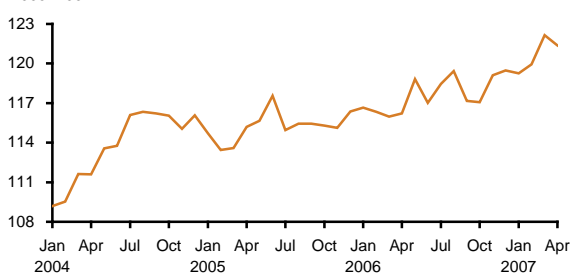
Semi and nondurable goods  
Seasonally adjusted data  
2000=100



Source: IBGE

**Figure 1.12 – Industrial production**

Intermediate goods  
Seasonally adjusted data  
2000=100



Source: IBGE

According to seasonally adjusted quarterly data, the level of industrial capacity utilization climbed to 85.3% in April, up 2.1 p.p. compared to the January level and quite close to the April 1995 record of 85.4%. Using the same type of analysis, industrial capacity utilization in the consumer goods segment reached a record level of 83.4%, while the sectors of metallurgy and food products also set records, with respective levels of 94.4% and 87.9%.

According to the National Confederation of Industry (CNI), the average level of capacity utilization in the manufacturing sector closed April at 81.7%. In the February-April period, the level averaged 81.4%, 2.1 p.p. above the same period of the previous year. Here, the strongest increases occurred in preparation of leather and production of leather goods and footwear, 5.4 p.p.; coke, fuel refining and alcohol production, 4.8 p.p. In the opposite sense, the sharpest reductions occurred under automotive vehicles, 3.2 p.p., and electronic and communications equipment, 2.5 p.p.

In general, production has increased more rapidly than industrial employment, reflecting productivity gains typical of a period of economic expansion that is taking full advantage of capital goods absorption. According to CNI data, industrial productivity rose 3% between the three-month periods ended in April 2007 and in April 2006, closing at 4.3% in the mining industry and 2.9% in manufacturing.

In sectoral terms, stress should be given to productivity gains in the segments of machines and equipment, 12.5%, reflecting increases of 14.4% in physical production and 1.6% in the number of hours paid; and tobacco, 9%, resulting from 1.2% growth in production; and a 9.1% decline in the number of hours paid. Productivity declined in the segments of coke, oil refining, nuclear fuels and alcohol, 13.5%, reflecting a 1.2% drop in production and growth of 14% in the quantity of hours paid; and food and beverages, 2.9%, with increases of 6.4% in hours paid and 5.3% in output.

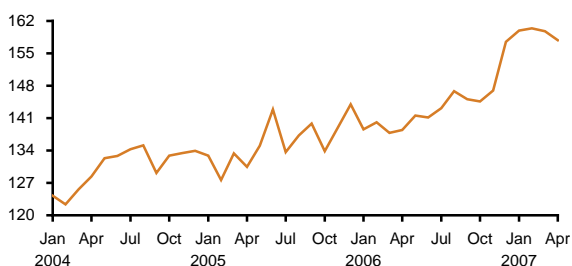
The confidence level among industry executives remains high with regard to the current situation and expectations for the near future of the economy. The Industry Businessmen Confidence Index (IcEI), calculated by CNI, reached 59.4 points in April. Here, one should clarify that 50 points correspond to stability in industrial activity. FGV's Industrial Confidence Index (ICI), which has a stability level of 100 points, dropped to 118.2 in May, down 2.5 points compared to April, when the index had reached its highest level since it was first calculated in April 1995.

**Figure 1.13 – Industrial production**

Capital goods

Seasonally adjusted data

2000=100

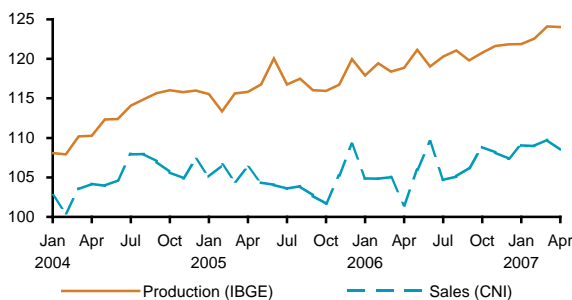


Source: IBGE

**Figure 1.14 – Industrial production and sales**

Seasonally adjusted data

2003=100

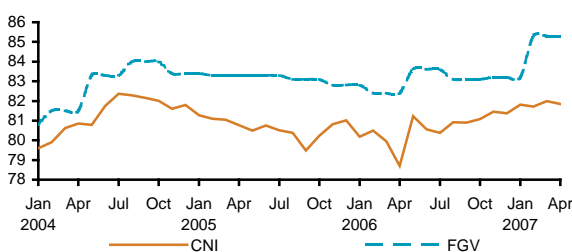


Source: IBGE and CNI

**Figure 1.15 – Utilization of installed capacity in the manufacturing industry**

Seasonally adjusted data

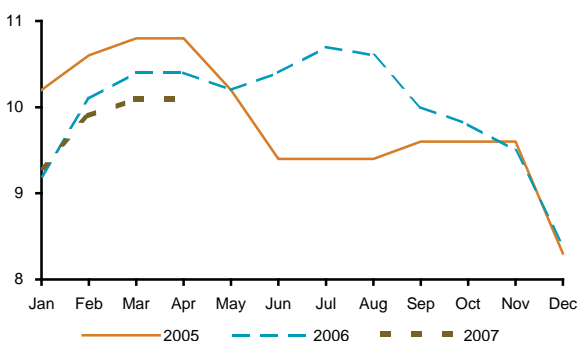
%



Source: CNI and FGV

**Figure 1.16 – Unemployment rate**

%



The optimism of industrial executives is reflected in both current investment intentions and those for the near future. According to FGV's Manufacturing Industry Survey – Special Queries (SCIT-QE), carried out in April, 34% of the companies contacted stated that they were investing more in the first half of this year than in the previous half-year period, while 21% were doing precisely the opposite. With regard to the second half of 2007, 34% of the companies contacted manifested the intention of increasing investments, while 14% intended to reduce them.

## 1.3 Labor market

### Employment

Labor market indicators in the first four months of 2007 were clearly positive, particularly in terms of formal employment, with positive impacts on real earnings and real overall wages. It should be stressed that this scenario tends to stimulate people to look for jobs, reducing the number of those who have simply given up hope of finding work. The natural consequence of this change is growth in official unemployment figures. This is a phenomenon already noted in other cycles of economic expansion in recent years.

According to IBGE's PME, which encompasses six metropolitan regions, the rate of open unemployment remained on a predictable upward curve and closed the first four months of 2007 at 10.1%, against 8.4% in December 2006. Basically, this increase reflected unfavorable seasonal factors, resulting in elimination of 258,000 job positions.

Compared to the same period of 2006, the average rate of unemployment dropped 0.17 p.p., reflecting 2.9% growth in the number of employed persons and 0.9% in the number of those unemployed. Using data for April 2007 and the same month of the previous year, 640,000 job openings were created, at the same time as the quality of these jobs improved. This is evident in the fact that the number of formal job opportunities increased 361,000, while the informal market contracted 90,000 employees.

According to the General File of Employed and Unemployed Persons (Caged), calculated by the Ministry of Labor and Employment (MTE), 701,619 job positions were created in the year through April. This was a new record for the four-month period since this series was first calculated in January 1985. The volume of new jobs represented a 4.8% increase in total registered employees, reflecting growth of 6.4% in

**Table 1.8 – Formal employment**

	Job openings – Accumulated in the period (1,000 employees)				
	2007				Year
	Jan	Feb	Mar	Apr	
Total	105.5	148.0	146.1	302.0	701.6
Manufacturing industry	39.1	30.8	40.5	103.8	214.2
Commerce	- 9.9	11.8	12.9	36.9	51.6
Services	47.3	62.8	56.5	82.8	249.4
Construction	11.7	5.5	17.3	30.9	65.4
Crop/livestock	17.2	22.0	11.3	41.2	91.8
Public utilities	0.8	1.0	0.7	1.3	3.8
Others <sup>1/</sup>	- 0.8	14.2	6.9	5.1	25.3

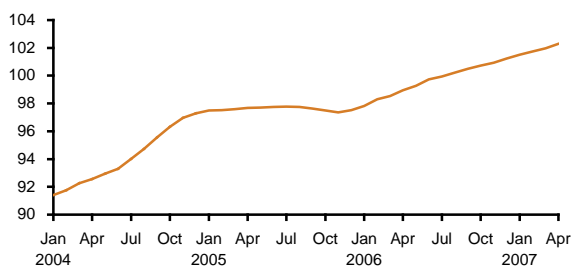
Source: MTE

1/ Includes mining, public administration and others.

**Figure 1.17 – Employment in the manufacturing industry – Quarterly moving average**

Seasonally adjusted data

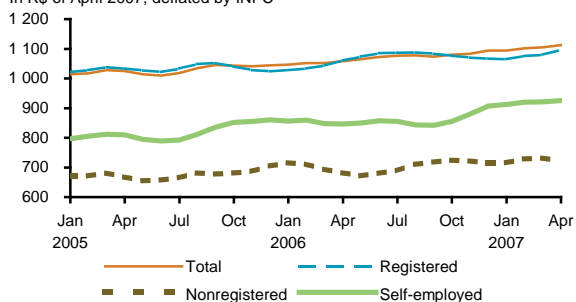
2003=100



Source: CNI

**Figure 1.18 – Average real regular earnings<sup>1/</sup>**

In R\$ of April 2007, deflated by INPC



Source: IBGE

1/ Quarterly moving average.

the construction industry; 5.9% in the commerce; 4.8% in the service sector; and 4.6% in manufacturing.

According to data gathered by CNI among twelve state federations, employment in the manufacturing sector expanded 3.4% in the first four months of 2007, compared to the same period of 2006. In much the same way, analysis at the margin utilizing seasonally adjusted data shows an increase in jobs in this segment of the economy, reaching 0.8% in the three-month period ended in April, compared to the November-January period.

## Earnings

Average real earnings regularly received by workers in the six major metropolitan regions covered by the PME posted average growth of 5% in the first four months of the year, compared to the same period of 2006. Average earnings closed April at R\$1,114.00, a nominal increase of 10% compared to the same month of 2006, while overall real wages, the product of the real average wages regularly received by workers times the number of persons occupied, increased 8.4%.

## 1.4 Gross Domestic Product

According to seasonally adjusted data drawn from IBGE's Quarterly National Accounts, GDP expanded 0.8% in the first quarter of the year, compared to the final quarter of 2006. At the margin, GDP growth ratified perceptions of recovery in the pace of economic expansion, driven mainly by steady growth in real income and employment, the excellent performance of the farm sector and the impact of the ongoing process of monetary policy easing.

Using the same basis of comparison, the industrial and service sectors posted increases of 0.3% and 1.7%, respectively, coupled with a 2.4% drop in crop/livestock output. With regard to the various demand components, it is important to stress continued growth in Gross Fixed Capital Formation (GFCF), reaching 2.1%. Household consumption increased 0.9% and government consumption rose 3.5%, while exports expanded 1.2% and imports increased to 4.1%, a level fully compatible with the uptick in the activity level.

Compared to the first quarter of 2006, GDP expanded 4.3%. Basically, this result reflects the dynamics of the economic upturn that began in the second half of 2006, marked by

across-the-board growth at the component level in both output and demand.

Crop/livestock production increased 2.1% in the first quarter of 2007, compared to the same period of the previous year. This result reflected a positive performance by crops of considerable weight in the first quarter of the year, including, for example, cotton, corn and soybeans, with estimated output growth of 30.7%, 24.1% and 11.7%, respectively, in 2007. To some extent, the overall result was impacted by the decline in the rice harvest, a component of particular importance in the first quarter of the year. The positive outlook for the grain harvest points to significant expansion in 2007 production. Another factor of significance was the positive performance of beef cattle, the most important component of the livestock sector.

**Table 1.9 – Gross Domestic Product at market prices**

	% growth				
	2006				2007
	I Q	II Q	III Q	IV Q	I Q
Accumulated in the year	4.1	2.7	3.3	3.7	4.3
Accumulated in 4 quarters	3.3	2.9	3.3	3.7	3.8
Quarter/same quarter of the previous year					
Quarter/previous quarter <sup>1/</sup>	4.1	1.5	4.5	4.8	4.3
Crop/livestock	1.3	-0.4	2.7	1.1	0.8
Industry	1.8	0.0	5.9	0.5	-2.4
Services	1.2	-2.0	3.5	0.9	0.3
	1.2	0.3	1.3	1.1	1.7

Source: IBGE

1/ Seasonally adjusted data.

**Table 1.10 – Gross Domestic Product**

Accumulated in the year

	% growth				
	2006				2007
	I Q	II Q	III Q	IV Q	I Q
Crop/livestock	-2.7	-2.5	2.4	4.1	2.1
Industry	5.0	1.9	2.5	2.8	3.0
Mining	14.0	6.8	6.1	6.0	4.1
Manufacturing	3.4	0.2	1.1	1.6	2.8
Construction	7.3	4.8	5.2	4.6	2.4
Public utilities	3.0	2.6	3.3	3.6	3.9
Services	4.4	3.7	3.7	3.7	4.6
Commerce	6.2	4.0	4.1	4.8	6.0
Transportation	5.0	3.1	3.0	3.2	3.5
Communications	1.2	0.2	1.9	2.3	7.3
Financial institutions	9.2	9.8	7.9	6.1	9.2
Other services	2.9	2.5	2.4	2.6	3.7
Rentals	4.2	4.3	4.5	4.3	4.2
Public administration	3.2	2.8	2.9	3.1	2.1
Value added at basic prices	3.9	2.5	3.1	3.5	3.9
Taxes on products	5.3	4.4	4.6	5.2	6.9
GDP at market prices	4.1	2.7	3.3	3.7	4.3

Source: IBGE

In the first quarter, the industrial sector expanded 3% compared to the corresponding period of 2006, with emphasis on growth in the production and distribution of electricity, gas and water, 3.9%; manufacturing industry output, 2.8%; construction, 2.4%, driven by an increased flow of funding into the housing sector through real estate financing operations. Mining activity increased 4.1%, reflecting growth in the production of iron ore, 7.9%, and oil and gas, 2.6%.

In the face of rising domestic demand, the service sector expanded 4.6% in the first quarter of 2007, compared to the same period of the previous year. This process was led by financial intermediation services, insurance, private pension funds and related services, 9.2%; computer services, 7.3%; commerce, 6%; and real estate activities, 4.2%. The sectors of transportation, storage and postal services, together with administration, health and public education also turned in 3.5% and 2.1% positive growth rates, respectively, in the period.

Just as occurred under supply, all of the various demand components turned in positive performances in the first quarter of 2007, compared to the corresponding period of the previous year. Household consumption increased 6%, the 14th consecutive positive result when the corresponding quarters of subsequent years are compared. In this case, growth was caused mainly by rising real overall wages, employment and the volume of financial system credit channeled to individuals. Government consumption increased 4% and, in line with the performance of the construction industry and production and imports of machines and equipment, GFCF expanded 7.2%. Exports rose 5.9% and imports increased 19.9%. External demand contributed a -1.5 p.p. to 4.3% GDP

## Revision of 2007 GDP

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The GDP growth estimate for 2007 was revised upward from 4.1% in the last “Inflation Report” to 4.7%. The reasons underlying this shift were the recently announced first-quarter results, recent evolution of the economy and methodological alterations instituted by the IBGE<sup>1</sup>.

Reflecting annual growth of 7% compared to the previous estimate of 4.8%, the current forecast incorporates a more optimistic scenario for the farm sector. This alteration mirrors expansion of 15.5% (against 11% in March) projected by IBGE’s LSPA for the farm harvest, mainly involving the soybean, corn and bean crops, coupled with a continued positive outlook for the sugarcane harvest and crop output as a whole.

Growth estimates in the industrial sector dropped 0.3 p.p. to 4.4%, incorporating the first quarter 2007 result. In the coming months, the mining sector is expected to increase its output, particularly in the segments of iron ore and production and distribution of electricity, gas and water. In this framework, projected growth for the farm sector, stronger domestic demand and a continued effort on the part of exporters are projected to result in added momentum during the course of the year.

The estimate for service sector growth was altered from 2.3% to 4.3%, the component primarily responsible for the expected increase in 2007 GDP. This alteration was based mainly on methodological changes in important subsectors and strong growth in domestic demand which, in the case of services, will be met basically by domestic output.

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1/ In this regard, see box “System of National Accounts – Reference 2000”, released in the March 2007 Inflation Report”.

**Table 1 – Gross Domestic Product – Demand side**

Period	%						
	GDP at market prices	Household consumption	Government consumption	Total consumption	GFCF	Exports	Imports
<b>2001</b>	1.3	0.7	2.7	1.2	0.4	10.0	1.5
<b>2002</b>	2.7	1.9	4.7	2.6	-5.2	7.4	-11.9
<b>2003</b>	1.1	-0.8	1.2	-0.3	-4.6	10.4	-1.6
<b>2004</b>	5.7	3.8	4.1	3.9	9.1	15.3	14.4
<b>2005</b>	2.9	4.7	1.9	4.1	3.6	10.1	9.3
Contribution (p.p.)		2.8	0.4	3.2	0.6	1.7	-1.2
<b>2006</b>	3.7	4.3	3.6	4.2	8.7	4.6	18.1
Contribution (p.p.)		2.6	0.7	3.4	1.4	0.7	-2.1
<b>2007 (estimated)</b>	4.7	6.1	2.9	5.3	8.5	5.7	18.8
Contribution (p.p.)		3.7	0.6	4.3	1.4	0.8	-2.2

Source: IBGE and Banco Central

**Table 2 – Gross Domestic Product**

	Cumulative growth in the year						
	2006	2006				2007	2007 <sup>1/</sup>
	Weights	I Q	II Q	III Q	IV Q	I Q	
Crop/livestock	4.4	-2.7	-2.5	2.4	4.1	7.0	
Industry	26.6	5.0	1.9	2.5	2.8	4.4	
Mining	2.5	14.0	6.8	6.1	6.0	6.2	
Manufacturing	15.8	3.4	0.2	1.1	1.6	4.2	
Construction	4.7	7.3	4.8	5.2	4.6	4.1	
Public utilities	3.5	3.0	2.6	3.3	3.6	4.8	
Services	55.1	4.4	3.7	3.7	3.7	4.3	
Commerce	8.9	6.2	4.0	4.1	4.8	6.7	
Transportation	4.4	5.0	3.1	3.0	3.2	5.1	
Communications	3.6	1.2	0.2	1.9	2.3	3.4	
Financial institutions	6.1	9.2	9.8	7.9	6.1	6.7	
Other services	11.8	2.9	2.5	2.4	2.6	3.2	
Rentals	7.6	4.2	4.3	4.5	4.3	4.1	
Public administration	12.7	3.2	2.8	2.9	3.1	2.5	
Value added at basic prices		3.9	2.5	3.1	3.5	4.5	
Taxes on products	13.9	5.3	4.4	4.6	5.2	6.0	
GDP at market prices	100.0	4.1	2.7	3.3	3.7	4.7	

Source: IBGE and Banco Central

1/ Estimated.

Consequently, the good performance of the service sector reflects methodological improvements aimed at measuring the performance of this sector, as well as recouping in other segments of the economy that, among other areas, have a direct impact on the subsectors of commerce, transportation, storage and postal services.

Viewed under the prism of demand, growth estimates for GFCF shifted from 7.1% to 8.5%. For the most part, this increase reflects first quarter expansion under investments and is considered clearly consistent with the increased optimism found within the business community and ongoing reductions in investment costs.

Alterations in the weighting of the various GFCF components became an additional determinant underlying the increase in the annual projection. In this sense, in the current GDP calculation methodology, the participation of the capital goods segment has become more relevant than the construction industry, since the former has demonstrated considerably greater dynamics.

Projections for imported volume closed at 18.8%. Growth of 4.8 p.p. compared to the previous estimate not only incorporated recent results but also considered continuation of the current trajectory of domestic demand.

Estimates for household consumption, government consumption and exports were revised upward to 6.1%, 2.9% and 5.7%, respectively, with relatively small changes compared to previous projections.

In this scenario, the contribution of domestic demand to GDP growth is estimated at 6.1 p.p., including changes in stock volumes, while the contribution of the external sector is expected to be a negative 1.4 p.p., marking the second consecutive year in which economic expansion has depended exclusively on burgeoning domestic demand.

growth in the quarter, while the overall impact of domestic demand reached 5.8 p.p., using inventory changes as the measuring rod.

## 1.5 Investments

As released by IBGE, the Quarterly National Accounts indicate that investments – excluding inventory changes – expanded 7.2% in the first quarter of 2007, compared to the same period of 2006. This was the 13th consecutive quarter of positive growth using this type of comparison. In much the same way, an analysis at the margin based on seasonally adjusted data reveals the dynamics of this segment, with 2.1% growth compared to the quarter ended in December 2006.

The positive performance of investments in the first quarter of the year was anticipated by the trajectory of monthly GFCF indicators. Absorption of capital goods, the major component of GFCF continued expanding in the quarter, a period during which domestic output rose 14.8%; exports increased 11.2%; and imports grew 30.9%.

Viewed against the same period of 2006, quarterly growth in capital goods output reflected across-the-board sectoral expansion, led by mixed use capital goods, 18.3%; typically industrialized products, 15.9%; and products channeled to the farm sector, 13%. Powered by recovery in farm income, the latter sector is expected to post accentuated growth over the course of the year, as suggested by more recent National Association of Automotive Vehicle Manufacturers (Anfavea) data, pointing to 17% cumulative growth in the year through May in farm machine output, compared to the same period of 2006.

Parallel to this, it is important to stress more recent evolution in the production of building industry inputs and capital goods, with respective annual growth rates of the 3.5% and 15.4% through April, together with 8.4% and 32% expansion in exports and imports of capital goods, respectively, in the same period, thus further reinforcing the already positive outlook for 2007 investments. This benign scenario is further strengthened by the evolution of such leading indicators as Brazil risk, measured by the Emerging Markets Bond Index Plus (Embi+), released by J.P. Morgan, by the already historically low level of interest and by continued growth in farm income.

**Table 1.11 – Gross Domestic Product<sup>1/</sup>**  
Accumulated in the year

	% growth				
	2006				2007
	I Q	II Q	III Q	IV Q	I Q
GDP at market prices	4.1	2.7	3.3	3.7	4.3
Household consumption	4.0	4.1	4.1	4.3	6.0
Government consumption	5.0	4.3	4.1	3.6	4.0
GFCF	11.8	8.5	8.4	8.7	7.2
Exports	8.2	3.0	4.5	4.6	5.9
Imports	15.6	14.4	16.5	18.1	19.9

Source: IBGE

1/ Seasonally adjusted.

**Table 1.12 – Gross Domestic Product**  
Quarter/previous quarter  
Seasonally adjusted

	% growth				
	2006				2007
	I Q	II Q	III Q	IV Q	I Q
GDP at market prices	1.3	-0.4	2.7	1.1	0.8
Crop/livestock	1.8	0.0	5.9	0.5	-2.4
Industry	1.2	-2.0	3.5	0.9	0.3
Services	1.2	0.3	1.3	1.1	1.7
Household consumption	-0.2	2.1	1.2	1.7	0.9
Government consumption	2.7	-0.2	0.4	-0.2	3.5
GFCF	4.8	-1.6	4.6	1.8	2.1
Exports	0.7	-4.0	10.0	-1.2	1.2
Imports	7.1	1.9	8.3	3.8	4.1

Source: IBGE

## 1.6 Conclusion

Since the second half of 2006, economic growth has been driven by the dynamics of domestic demand. The growth cycle registered under household consumption has been sustained both by increased income and employment and by improved credit conditions.

Strong growth in investment flows in the early months of 2007 reveals recovery in farm income, high levels of business confidence, an already low Brazil risk rating, the volume of capital goods imports, together with the ongoing process of monetary policy easing. In this context, the recent upturn in utilization of installed industrial output capacity, a factor fully compatible with the increased dynamics of production, is not expected to raise any obstacles whatsoever to continued strong and sustained economic activity over the short-term. Over the medium-term, conditions remain benign, particularly when one considers the already positive posture adopted by the business community, most notably in segments with lesser degrees of idleness, when viewed against growth in productive capacity.

On the external front, imports have expanded more rapidly than exports, due to the dynamics of the internal market and the opportunities that have arisen to expand productive capacity. Here, one should note that growth in capital goods imports surpassed total average volume expansion of imports, thus reinforcing expectations that installed output capacity will progressively adjust to the scenario of continued expansion in domestic demand.