The Brazilian economy has stagnated since the third quarter of 2011 because of both low domestic investment and the fallout from the European financial crisis. Because GDP grew by only an estimate 0.7% in the second quarter of 2012, the estimate for growth in 2012 has been revised downward to 1.8%.

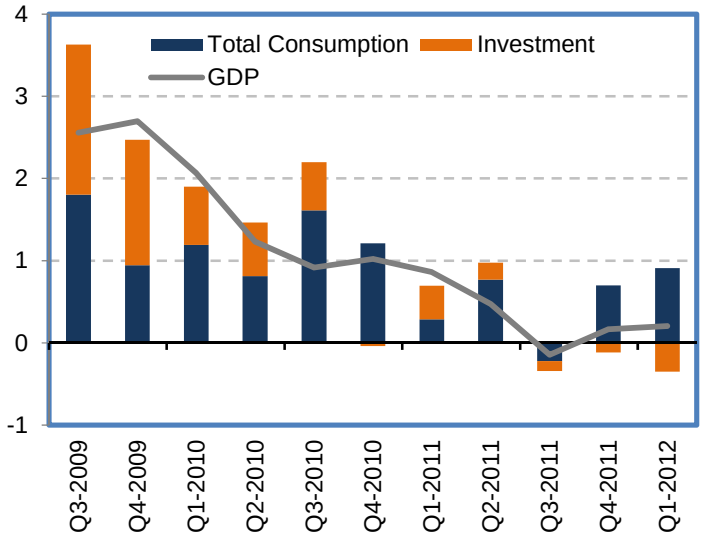
THE ECONOMY IS still slowing, though the IBRE Indicator of Economic Activity suggests there was an acceleration in activity in the second quarter. Our preliminary projection for second-quarter GDP growth is 0.7%, following growth of 0.2% in the first quarter. This considerably reduces the GDP forecast for this year, down from 3.0% to 1.8%. 2013 should see more robust growth of 3.8%.

It is worth pointing out that the contribution of physical investment to GDP growth has been declining compared to the contribution of government and household consumption since early 2010. Investment should increase by only 0.4% in 2012; household consumption (3.2%) and government (2.8%) will support economic growth for the rest of the year.

With the significant decline in economic activity, inflation has also subsided. However, the fall of inflation has been more intense in industrial goods than in services. Inflation in 2012 is projected to decline to 4.9%, but as the economy resumes growing, inflationary pressures will return, bringing inflation up to 5.3% in 2013.

The central bank will continue its monetary easing, and the policy interest rate will drop from the current 8.5% to 7.5% in August, but we see a gradual increase to 9.0% over the next year in response to inflationary pressures.

Investment contribution to growth has declined.
(% change)



Risks

As yet there is no definitive solution in sight for the European financial crisis. The risks associated with the deleveraging of the high debt burdens in developed countries remain high, and are one reason that investment flows into emerging countries like Brazil have moderated. The confidence of both international investors and Brazilian businesspeople has worsened significantly.

Also, Brazil's economy has serious structural imbalances. The acute slowdown in investment associated with both the adverse international picture and the domestic business climate has negative implications for the future growth of production capacity. If growth resumes based on domestic consumer demand without any increase in supply capacity the structural imbalances will deepen and lower potential growth.

Brazil: Revised economic outlook, 2012-2013

	2011	2012 Proj.	2012 Rev. proj.	2013 Proj.
Real GDP growth (% change)	2.7	**3.0**	**1.8**	**3.8**
Inflation (% change)	6.5	**5.1**	**4.9**	**5.3**
Central Bank benchmark rate (end-period, %)	11.00	**9.50**	**7.50**	**9.00**
Exchange rate (average, Reais per U.S. dollar)	1.7	**1.8**	**1.9**	**1.9**
Budget primary surplus (% of GDP)	3.2	**2.5**	**2.6**	**3.2**
External current account balance (% of GDP)	-2.1	**-2.8**	**-2.6**	**-2.8**
Trade balance (US$ billions)	29.8	**14.1**	**20.1**	**18.7**
Export growth (% change)	26.8	**2.9**	**1.5**	**8.3**

Source: IBRE staff estimates and projections.