

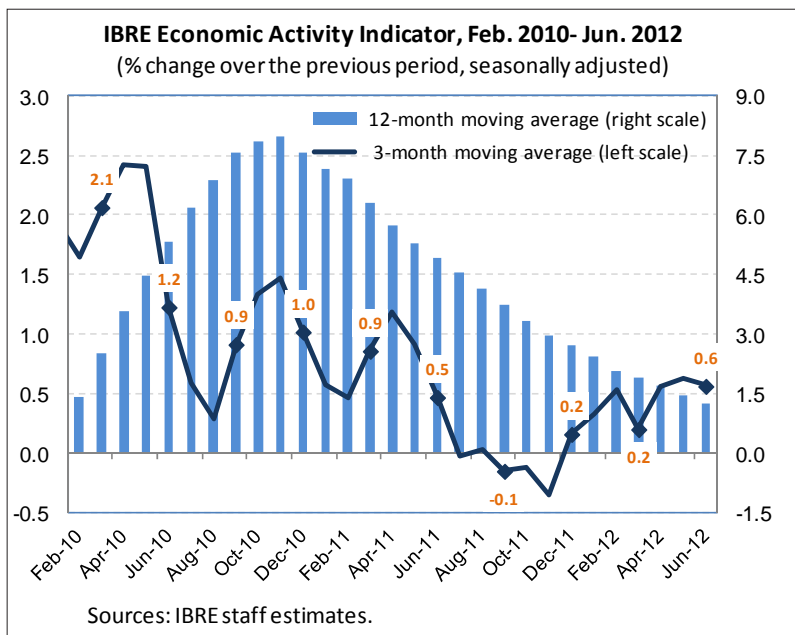
The possibility of Brazil's growth softening rises as the outlook for the global economy worsens. The latest Composite Leading Indicators from the Organization for Economic Cooperation and Development suggest economic activity in most developed economies is already cooling.

THE IBRE INDICATOR of Economic Activity predicts growth of 0.6% of GDP in the quarter ended June, three times as much as in the first quarter (0.2%). However, there is considerable uncertainty about the strength of Brazil's recovery for the rest of the year.

On the supply side, it is clear that this year the contribution of agriculture will be negative, and of industry almost as bad. Therefore, hopes turn again to the services sector. Can it add enough momentum to economic activity later this year even as demand is faltering?

On the demand side, rising household defaults and high indebtedness do not encourage consumption, even though government has cut taxes on some durable goods. Household consumption could contribute 1.5 to 1.6 percentage points to GDP growth this year, and government

0.4 to 0.5 percentage points; investment demand is expected to remain flat. So, GDP growth will depend fundamentally on the contribution of net exports—which is expected to be negative with the global economy still slowing. A growth rate of 2% of GDP in 2012 now seems ambitious.



Manufacturing is ailing

The results for Brazil's manufacturing industry through May and IBRE business surveys of projected industrial production through September are depressing. For the second quarter, IBRE estimates a 1.3% decline quarter-on-quarter in manufacturing production, and business surveys point to a decline in future production. Despite various government stimulus packages and a depreciating exchange rate, the underlying causes of manufacturing's lack of competitiveness and productivity remain. Brazil still ranks as one of the worst business venues in the world because of the size and complexity of taxes, poor infrastructure, complex bureaucracy, and legal risk. Labor productivity is also low due to deficiencies in the education system.

