Economic and financial indicators

Consumer confidence gap

The risk of a slowdown in the global economic recovery has risen considerably, but governments should continue planning to tighten fiscal policy, says the IMF World Economic Outlook released on July 8. "In the near term, the main risk is an escalation of financial stress and contagion, prompted by rising concern over sovereign risk," it says. Europe's weakened economy is now the central threat to global recovery as its countries struggle with heavy public debt, undercapitalized banks, and slowing growth. The faltering global economic recovery is reflected in the growing consumer confidence gap, with confidence higher in emerging markets (China and Brazil) and lower in developed economies (Europe and the US).

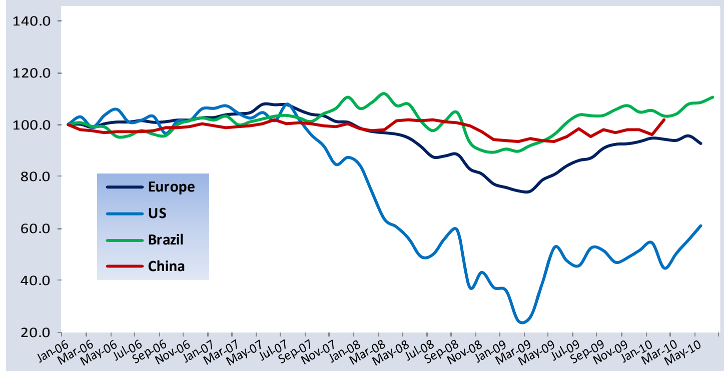
Uncertain inflation outlook

Official consumer prices (IPCA) were flat in June (4.84% year-on-year), although the markets had expected a 0.11% increase (4.96% year-on-year). The annualized rate is the lowest since February. The main driver of the downward surprise was a steep drop in food prices. Core inflation also slowed in June, according to analysts. FGV's general price index (IGP-DI) also increased less than expected at 0.34% month-on-month. Market analysts viewed the decline as temporary and still expect inflation to accelerate as the year progresses.

Competitiveness and rising wages

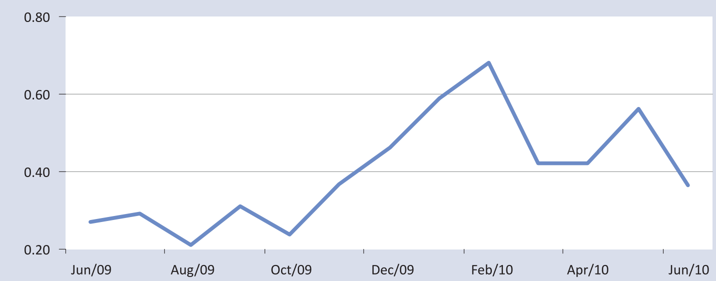
Rising real wages are partly responsible for the loss of competitiveness of manufacturing exports even though the industry has become significantly more productive over the past 10 years. Following the international crisis, Brazil's economy began to grow much faster than the world average. At the outbreak of the crisis at the end of 2008, devaluation of the currency brought about a short-lived improvement, but by mid-2009, as the domestic market began to recover wages rebounded and the exchange rate appreciated, causing a loss of competitiveness.

Consumer confidence gap between emerging market and developed countries



Sources: IBRE-FGV (Brazil), Conference Board (US), Europe Comission (EU), and Hyperlink Research (China).

Core inflation declined in June, but uncertainty regarding inflation remains.

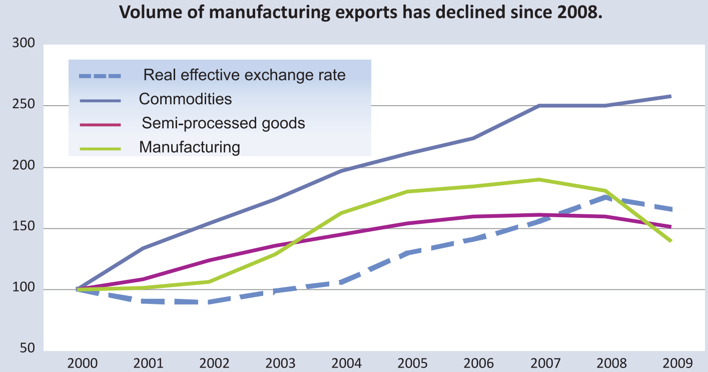


Source: Central Bank of Brazil.

Higher wages are making Brazilian exports of manufactures costlier.

Sources: IBRE-FGV, FIESP, and Central Bank of Brazil.

Volume of manufacturing exports has declined since 2008.



Source: International Trade Foundation (FUNCEX) and *International Financial Statistics* (IMF).

Is Brazil becoming less competitive?

The volumes of commodities exported have been growing strongly in the last 10 years partly to meet China's needs. However, manufacturing exports began to stagnate in 2005 and have actually declined since 2008, partly as a result of exchange rate appreciation but more recently because of competition from China. Brazilian manufacturing exports have lost market share worldwide and become increasingly dependent on the South American market.

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