*Economic activity continues lukewarm as inflation bubbles up*

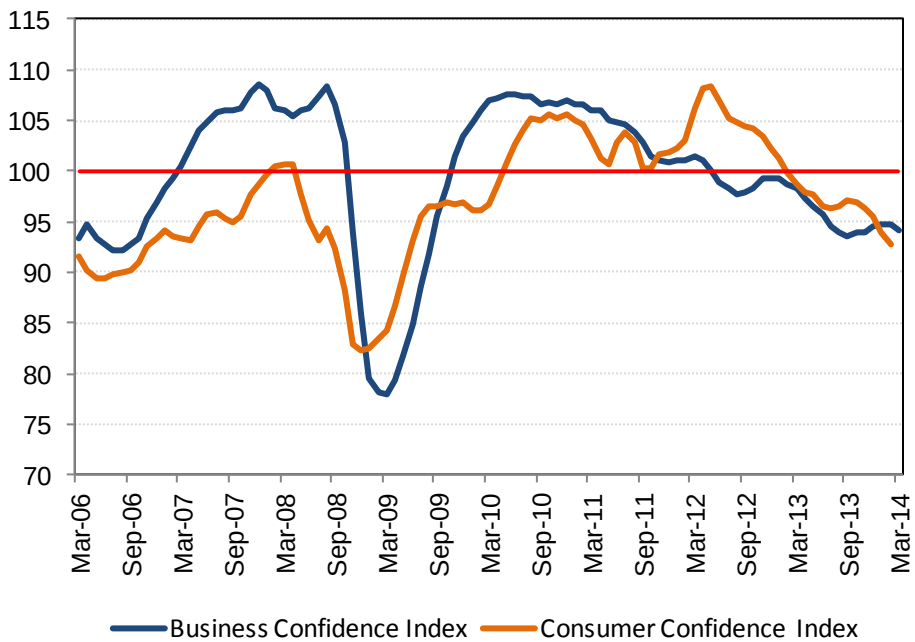
THE EARLY OUTLOOK for the Brazilian economy this year is troubling. Since the previous column in March, a few new positive economic facts have been registered: Brazil's economy added jobs in February and unemployment remains low. In contrast, more negative facts have come up: Standard & Poor's has lowered the country's sovereign credit rating, and electricity supply conditions have been worsening, raising costs and uncertainties for consumers, energy distribution companies, and government. The bad news reinforces the perception that Brazil's economic situation is deteriorating and delays in adjusting economic policy to reality simply heighten the risk to the outlook.

With respect to economic activity, after rising by 3.8% in January industrial production slowed to 0.4% in February, vehicle production fell 3.6%, and retail sales declined by 3.3%. Both business and consumer confidence have been steadily heading downward.

For the first quarter we estimate that GDP growth was only 0.4% quarter-on-quarter, seasonally adjusted. On the demand side, gross fixed investment seems to have slowed. On the supply side, we are counting on good performance in agriculture, mining, construction and electricity production. For the year as a whole, we hold to our growth forecast of 1.8%.

Consumer price inflation was 0.9% in March because of shortages in the supply of food and agricultural items as well as a continuing upward trend in inflation in services prices, which closed the 12 months to March at 9%. It is becoming ever more likely that later this year 12-month inflation will breach the 6.5% inflation target ceiling, despite government controls on the prices of electricity, fuel, and city bus fares. In 2015, controlled prices clearly will have to be adjusted, causing a large "corrective inflation." The government is understandably reluctant to make the necessary adjustments now because of October's presidential election.

**Business and consumer confidence is still declining. ***




Source: IBRE/FGV.

* Seasonally adjusted.