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The Brazilian economic growth was very significant last year. The Gross Domestic Product (GDP) increased 5.4% in 2007, exceeding its performance in the previous year. As pointed out in the last Bulletin of Industrial Conjuncture (March 2008), the industry contributed positively for this result, showing a growth rate of 4.9%, whereas the manufacturing industry reached 5.1% (System of National Accounts/Brazilian Institute of Geography and Statistics – SCN/IBGE).

Brazilian industry maintained this accelerated growth rate in the first quarter of 2008, which can be observed in data about physical production provided by the Monthly Industrial Survey-Physical Production (Pesquisa Industrial Mensal-Produção Física - PIM-PF/IBGE) (Table 1). Growth in the first quarter of 2008, as compared to that in the same quarter of the previous year, was of 6.3% for the general and manufacturing industry, below that observed in the last quarter of 2007, but still substantial. In its turn, the mining industry reached 6.5%, compared to 6.1% in the same periods. Considering the growth accumulated over the past four quarters, rates were of 6.6% for the general and manufacturing industry, and of 6.1% for the mining industry, above the rates accumulated last year (6.0% and 5.9%, respectively).

Table 1 – Industrial Production Growth Rate
(1Q/2006 to 1Q/2008) (In %)

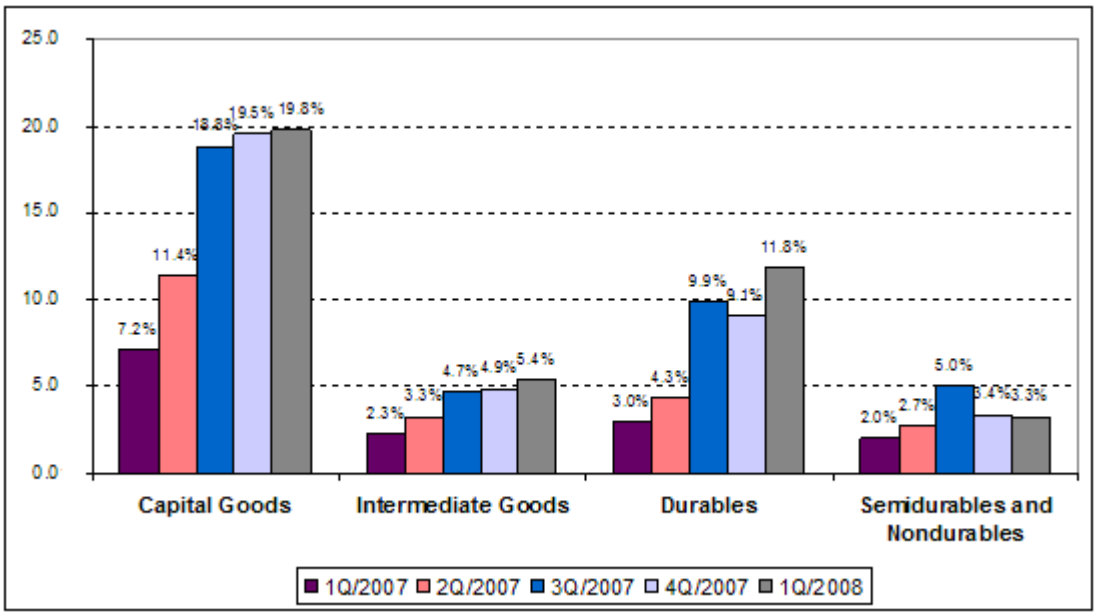
Activities	1Q 2006	2Q 2006	3Q 2006	4Q 2006	1Q 2007	2Q 2007	3Q 2007	4Q 2007	1Q 2008
Quarterly growth rate in relation to the same quarter of the previous year									
General Industry	**4.6**	**0.9**	**2.8**	**3.2**	**3.8**	**5.8**	**6.3**	**7.9**	**6.3**
Mining Industry	13.2	4.1	5.7	7.1	5.6	5.8	6.0	6.1	6.5
Manufacturing Industry	4.1	0.7	2.6	3.0	3.7	5.8	6.4	8.0	6.3
Growth rate accumulated over the past four quarters									
General Industry	**3.3**	**2.0**	**2.3**	**2.8**	**2.6**	**3.9**	**4.8**	**6.0**	**6.6**
Mining Industry	12.1	9.2	8.1	**7.4**	5.7	6.1	6.1	**5.9**	**6.1**
Manufacturing Industry	2.8	1.6	2.0	**2.6**	2.5	3.8	4.7	**6.0**	**6.6**

Source: NEIT/IE/UNICAMP based on data from PIM-PF/IBGE.

Domestic demand has been playing an active role in this recent growth, highlighted by the increase in family consumption, gross fixed capital formation, and imports. In the last Bulletin of Industrial Conjuncture (March 2008), we emphasized the acceleration of the investment rate throughout 2007, which reached 17.7% in the last quarter.

In view of the industry's physical production, this growth pattern headed by domestic demand, notably by investment, produced an accelerated growth in the capital goods sector. Its accumulated growth rate in the past four quarters has been increasing continuously since the second quarter of 2006. It happened throughout last year, which closed with the highest accumulated growth (19.5%) among other use categories, and remained the same in the first quarter of 2008, when it reached 19.9% (Chart 1), even considering a slightly descending rhythm in this first quarter in relation to the previous one. The production of consumer durables also continued to show a vigorous growth in the first quarter of 2008, exceeding the strong growth observed last year, mainly in its second half, closing the first quarter of 2008 with an accumulated rate of 11.8% in the past four quarters. The production of intermediate goods also showed constant growth, closing with 4.9% in the last quarter of 2007 and reaching 5.4% in the first quarter of 2008. The production of semidurables and nondurables shows a deceleration trend, reaching 3.3% in the total accumulated in the last four quarters.

Chart 1 – Industrial Production Evolution by Use Category
(rate accumulated in the past four quarters – 1Q/2007 to 1Q/2008) (In %)



Source: NEIT/IE/UNICAMP based on data from PIM-PF/IBGE.

Examining data on production by industrial activity, it is possible to observe the same slightly declining trend in growth rate in various sectors during this year's first quarter. However, regarding the total accumulated over the past four quarters, we can see that, out of the 27 industrial sectors included in PIM-PF/IBGE, 23 grew at the end of the first quarter of 2008.

From the point of view of sectors, those associated to capital goods and consumer durables take the lead once again. The five sectors that showed the highest accumulated growth rates until this year's first quarter were: motor vehicles (18.3%); other transportation equipment (17.7%); machinery and equipment (16.8%); electrical machinery, equipment and supplies (14.2%); and rubber and plastics (7.9%). The leading sectors in the beginning of the year virtually coincided with those that led growth in the last quarter of last year, except for the rubber and plastics sector, which showed a strong and continuous recovery over last year, culminating with a vigorous growth in the beginning of 2008.

Observing each sector's contribution to growth (or the composition of the growth rate) in the first quarter of 2008, the five main sectors were: motor vehicles (24.5%); machinery and equipment (10.9%); other chemicals (8.7%); other transportation equipment (6.4%); and basic metallurgy (6.3%).

The poor performance in some industrial sectors's production last year was overcome or eased off in the beginning of this year, as it was the case of electronic supplies, telecommunications equipment, and leather and footwear sectors. In the first case, after a decrease of 1.1% in 2007, the total accumulated until the first quarter of 2008 raised 3.8%, pulled by significant production increases in the last quarter of last year and in the first quarter of this year –10.9% and 10.2%, respectively – when compared to the same periods of the previous year. In the case of the leather and footwear sector, production almost stagnated until the first quarter of 2008 (-0.5%), a more favorable result when compared to last year's 2.2% reduction.

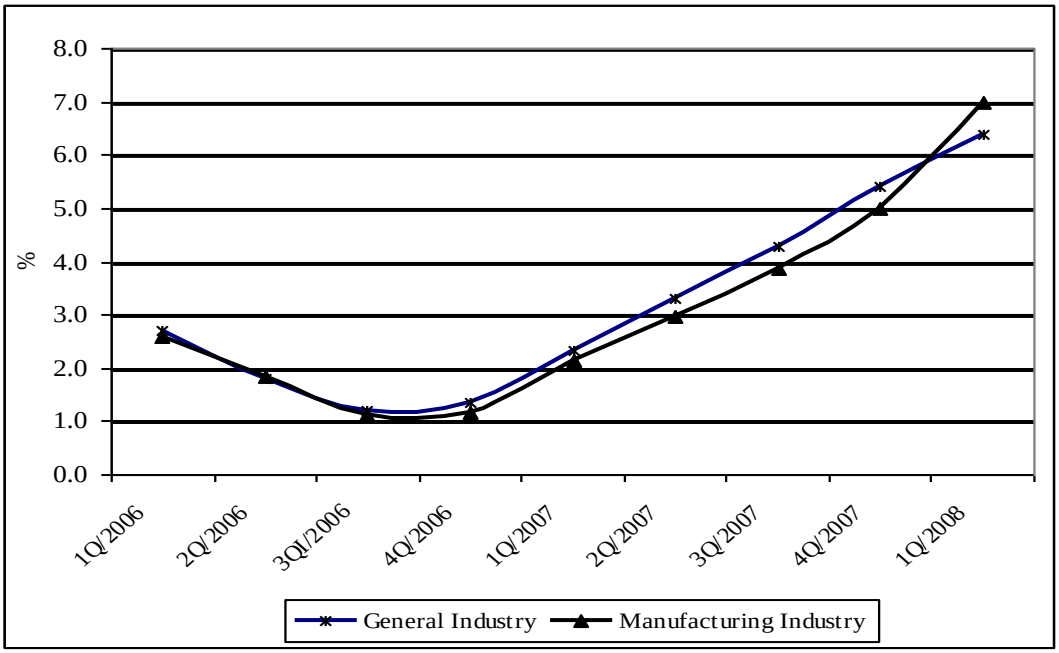
On the other hand, production lost dynamism in some activities in the beginning of this year when compared to the same period last year, even considering its positive performance in the total accumulated over the 12-month period that ended in the first quarter of 2008. This is the case of the sectors of toilet goods, soap, detergent and cleaners (-1.9%); pharmaceuticals (-4.9%); and computer and office equipment (-12.0%). The latter was influenced by a very positive result in the biennial 2006-2007, but reverted sharply in the first quarter of this year.

Finally, examining both the accumulated growth in the past four quarters and its behavior in this year's first quarter compared to the same period last year, some activities stand out for an obvious reduction in physical production, such as tobacco and wood. In the first case, the negative behavior observed in the previous year became stronger, closing with a decrease of 10.4% in the total accumulated in the last four quarters.

The favorable result of industrial production has been translating into accelerated employment rates in the industry. According to data from the Monthly Survey of Industrial Employment and Wages (Pesquisa Industrial Mensal de Emprego e Salário - PIMES/IBGE), salaried employees increased 3.0% in the general industry and 3.1% in the manufacturing industry in the first quarter of 2008, exceeding the 2.2% growth accumulated last year.

Data from PIMES also allow for confirming an increase of 6.4% in the real value of the general industry payroll and of 7.0% in the manufacturing industry in the total accumulated in the first quarter of 2008, strengthening the growth observed in the total accumulated last year (5.4% and 5.0%, respectively). Growth in the manufacturing industry even surpassed that observed in the general industry in the beginning of this year (Chart 2). Therefore, data on the first quarter of this year corroborate the favorable performance of the real value of industry payroll, which had already showed persistent throughout 2007. It is worth remembering that last year's growth meant a reversion in the real income mass reduction trend seen in the previous year.

Chart 2 – Growth Rate of Real Value of Industry Payroll
(rate accumulated over the past four quarters – 1Q/2006 to 1Q/2008) (In %)



Source: NEIT/IE/UNICAMP based on data from PIMES/IBGE.

According to the General Registry of Employed and Unemployed Individuals (Cadastro Geral de Empregados e Desempregados - CAGED/MTE-Ministry of Labor and Employment) [1], the general industry generated created about 386,600 job vacancies in 2007 (372,500 in the manufacturing industry and 14,100 in the mining industry) (Table 2). Formal employment creation remained strong in the first quarter of 2008, reaching 153,100 vacancies in the general industry (149,700 in the manufacturing industry and 3,400 in the mining industry). This number meant a volume equivalent to almost 40% of the total job vacancies created throughout 2007. With regard to growth rate in the same period of the previous year, it represented an increase of 40.5% in the general industry, 43.0% in the manufacturing industry, and a decrease of 20.7% in the mining industry.

Table 2 – Evolution of Formal Employment Creation in Industry
(1Q/2007 and 1Q/2008)

	Hired (thousands)			Dismissed (thousands)			Job Vacancies Created (thousands)		
	Total 2007	**1Q 2007**	**1Q 2008**	**Total 2007**	**1Q 2007**	**1Q 2008**	**Total 2007**	**1Q 2007**	**1Q 2008**
General Industry	**3,027,8**	758,1	894,4	**2,641,2**	649,1	741,4	**386,6**	109,0	153,1
Mining Industry	**55,2**	14,3	14,0	**41,1**	10,0	10,7	**14,1**	4,3	3,4
Manufacturing Industry	**2,972,6**	743,8	880,4	**2,600,1**	639,1	730,7	**372,5**	104,7	149,7

Source: NEIT/IE/UNICAMP based on data from CAGED/MTE.

The sectors with the largest shares in the creation of new job vacancies in industry in the first quarter were: machinery and equipment (13.3%); metal products (10.5%);

[1] CAGED/MTE shows results from all companies that hired/dismissed formally employed individuals in the period under study, therefore providing census coverage. Data for 2007 and 2008 were organized based on the new CNAE 2.0, and can be different from data analyzed in the last Bulletin of Industrial Conjuncture (March 2008), which used the old CNAE 1.0. In its turn, PIMES/IBGE provides sample coverage, including companies with five employees or more. Therefore, divergent trends can be found in these two sources of data, mainly in sectors where small and medium companies prevail.

tobacco (10%); leather and footwear (9.9%); oil refining and alcohol production (9.4%); and motor vehicles (7.4%). Machinery and equipment and motor vehicles have also led the growth in industrial production in the same period, representing a large share in its composition. This certainly contributed to a positive result in formal employment creation in the beginning of this year.

Observing data on wages paid to hired and dismissed workers, we can see an increase of 18% in the wage bill of hired workers, whereas the wage bill of dismissed workers increased 4%. As a result, the net wage bill increase, which had been of R$ 17 millions in the first quarter of 2007, reached R$ 96 millions in the first quarter of 2008.

Concerning the average hiring wage, growth was weak in the same period, which confirms the positive effect of the current cycle of industrial growth on the level of employment and wages. It is also interesting to observe that the average wages of hired and dismissed workers are closer, as shown in the ratio between these two variables: in the first quarter of 2007, the average wage of hired workers corresponded to 89% of the amount paid to the dismissed, whereas it reached 98% in the first quarter of 2008 (Table 3). This is interesting information, because in moments of stagnation and slow growth in production, the average hiring wage tends to be much lower than the dismissal wage, since the average time of employment of dismissed or retired workers tends to raise their average wages. It is also worth observing that several leading sectors in the industrial production growth have already been showing a higher real income mass for hired workers than for dismissed workers since last year.

Table 3 – Wage Bill and Average Wage Evolution in Industry – hiring and dismissal (1Q/2007 and 1Q/2008)

Indicator	Hiring		Dismissal		Hiring/Dismissal	
	1Q 07	1Q 08	1Q 07	1Q 08	1Q 07	1Q 08
Wage bill (R$ millions)						
General Industry	530,5	630,7	513,1	534,1	1,03	1,18
Mining Industry	17,5	15,5	12,0	12,8	1,46	1,21
Manufacturing Industry	513,0	615,2	501,1	521,3	1,02	1,18
Average wage (R$)						
General Industry	699,8	705,2	790,5	720,5	0,89	0,98
Mining Industry	1.225,3	1.106,6	1.197,6	1.201,5	1,02	0,92
Manufacturing Industry	689,7	698,7	784,1	713,5	0,88	0,98

Note: Values deflated by IPCA – at December 2007 prices.
Source: NEIT/IE/UNICAMP based on data from CAGED/MTE.

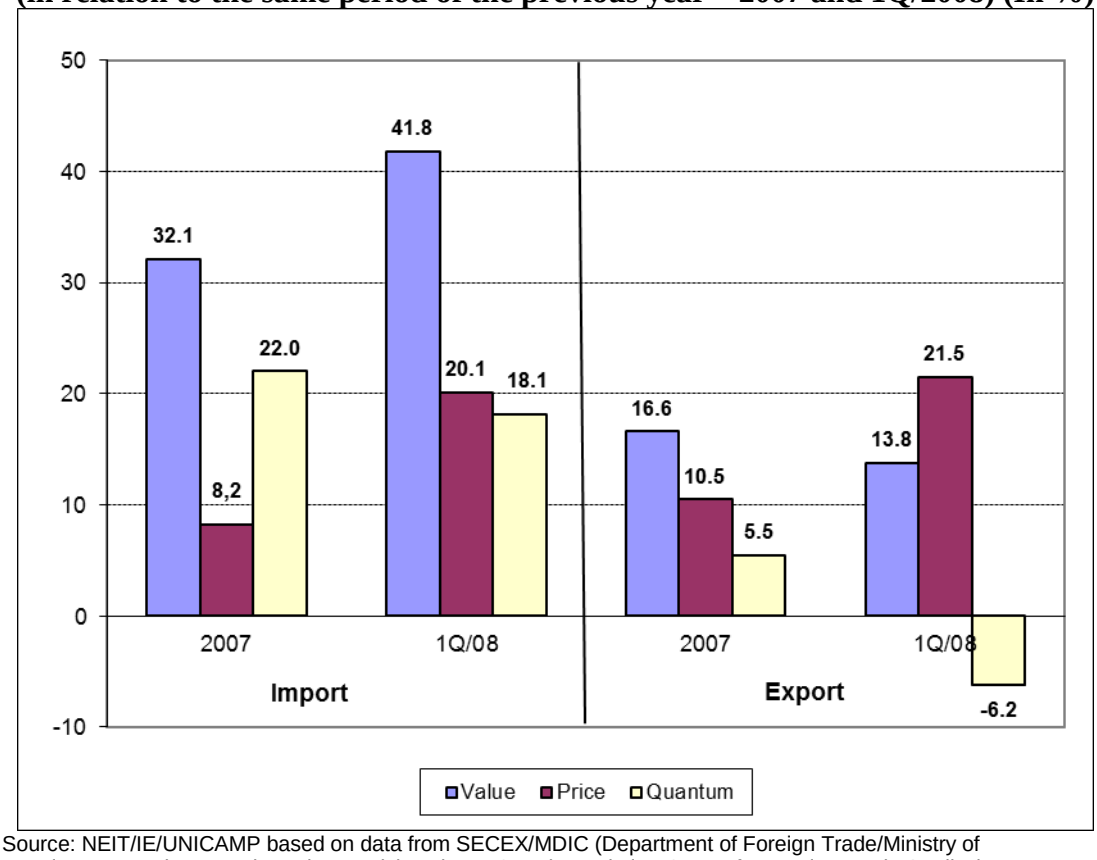
Regarding foreign trade, a set of important trends observed last year remained in the first quarter of 2008 – in some cases, more intensively – such as the deceleration of trade surplus, headed by an increase in imports and a decrease in quantum exported.

The trade surplus in the first quarter of 2008 (US$ 2,835 billions) was 78.9% lower than that of last year's first quarter, pointing to a deepening deterioration of the positive trade balance in a scenario of economic growth and appreciated currency.

Imports marked the time of this movement. They reached, in value, approximately R$ 35,8 billions in the total accumulated in the first three months of this year, growing 41.8% in relation to last year's first quarter. Part of this growth was a result of imports price, with an accumulated growth of 20.1% in the first quarter of 2008, when compared to prices in the same period of the previous year. Quantum indexes showed

a similar growth: 18.1%. It is worth observing that, when compared to results observed in the total accumulated last year, this increase in imports prices was much higher, whereas the quantum index was slightly lower (Chart 3).

Chart 3 – Growth Rate of Exports and Imports: value, price and quantum (in relation to the same period of the previous year – 2007 and 1Q/2008) (In %)



Source: NEIT/IE/UNICAMP based on data from SECEX/MDIC (Department of Foreign Trade/Ministry of Development, Industry and Foreign Trade) and FUNCEX (Foundation Center for Foreign Trade Studies).

With regard to use categories, substantial increases in the imported quantum of capital goods (34%) and consumer durables (64%) stood out. These segments also showed significant increase in physical production. However, it must be remembered that, in the case of the goods mentioned, the national production growth was surpassed by the imported quantum growth in the period examined, showing that the domestic demand stimulus to capital goods and consumer durables production have also spilled over to the foreign sector.

Exports, which showed a result of approximately US$ 38,7 billions in this year's first quarter, grew 13.8% in relation to the first quarter of 2007 (Chart 3). The disaggregation of price fluctuation and quantum exported effects make results more worrying: a large part of exports increase in relation to the first quarter of the previous year was linked to a raise in prices (21.5%), with an emphasis on basic products (34.5%) and fuels (62.3%). This raise in prices counterbalanced a decrease in the quantum exported (-6.2%) in the beginning of this year. It is interesting to mention that, concerning product classes, the quantum decrease was general, although higher in basic products (-13.2%). From the point of view of use categories, capital goods were the only with increased exports quantum index (6.8%). All other, mainly fuels (-

30.5%) performed negatively, which reveals a worrying trend of sustaining exports value based exclusively on price evolution in the international market.

An analysis of foreign trade disaggregated by sector shows more clearly the main contributions to this movement of imports increase and exports quantum decrease.

The sectors that stood out in domestic production growth also showed a significant increase in imported values in the first quarter of this year: motor vehicles (65.7%), electronic and telecommunication supplies (45%), machinery and equipment (45.7%), and basic metallurgy (49.3%). They also stood out because of their share in imports (slightly higher than 30% in the average for the last three months) and, therefore, their substantial contribution to imports volume growth.

The role of the mentioned sectors in the recent increase in imports becomes more important when we analyze the evolution of quantum and price indexes. All of them remained below the average raise in total imports prices. In its turn, the quantum imported was always above average, with an emphasis on imports of "vehicles, trailers and bodies", which shows an increase of 52.8%, the highest among all sectors analyzed. Regarding price evolution, the agricultural sector (55.3%), the sectors of oil extraction (53.6%), oil by-products (47.6%), and nonmetallic minerals (49.7%) are the most notable in the first quarter of 2008. Still considering imports, out of the 29 sectors highlighted by FUNCEX, only nonmetallic minerals (-25.8%) and tobacco products (-58.9%) showed a reduction in the imported value accumulated in the first quarter of this year, and are exceptions to the general movement.

Concerning exports, the performance of the different sectors was very heterogeneous with regard to value accumulated in the first quarter of this year. Among the sectors that stood out positively (growth above average) are: coke, oil refining and other fuels (43.3%); food and beverage (20%), and agriculture and cattle raising (27.1%). These sectors showed an above average raise in exports prices in the period (21.5%).

The sectors primarily responsible for the national production growth were also those highlighted in exports growth, such as other transportation equipment (36.1%), motor vehicles (14.7%); electrical machinery, equipment and supplies (27.4%), and rubber and plastics (22.9%). However, as the quantum exported grew less than physical production, one can argue that these sectors took from domestic market most part of their motivation to increase production during the last quarter. The notable exception was other transportation equipment, a sector that increased significantly its quantum exported (24.9%). In general, sectors with reduced exports value do not carry an important weight in exports. Exceptions are oil extraction (-8.3%); nonmetallic minerals (-7.4%), and electronic and telecommunications supplies (-6%).

Although prices have evolved favorably in all 24 sectors considered, in 16 of them there was a reduction in exports quantum, which contributed to the already stressed decrease in the total volume exported. Some sectors that have been facing problems with exchange rates showed clearly the symptoms mentioned: apparel and accessories (-29%), leather and footwear (-14.5%), and wooden products (-10.4%). Other sectors, such as electronic and telecommunications supplies (-12.7%), basic metallurgy (-10.9%), and nonmetallic mineral products (-19.3%) also showed decreased quanta. In these sectors, a heated domestic market and difficulties to increase penetration in foreign markets seem to be making companies turn part of previously exported products to the domestic market.

The set of information analyzed before allows for confirming that the current growth cycle, fuelled by domestic demand, especially investment, still shows great dynamism, even considering its recent deceleration. The evolution of investments deserves to be analyzed in depth, since in a scenario of heated demand the growth of gross capital formation above that of other demand components is fundamental to sustain growth and prevent reversion.

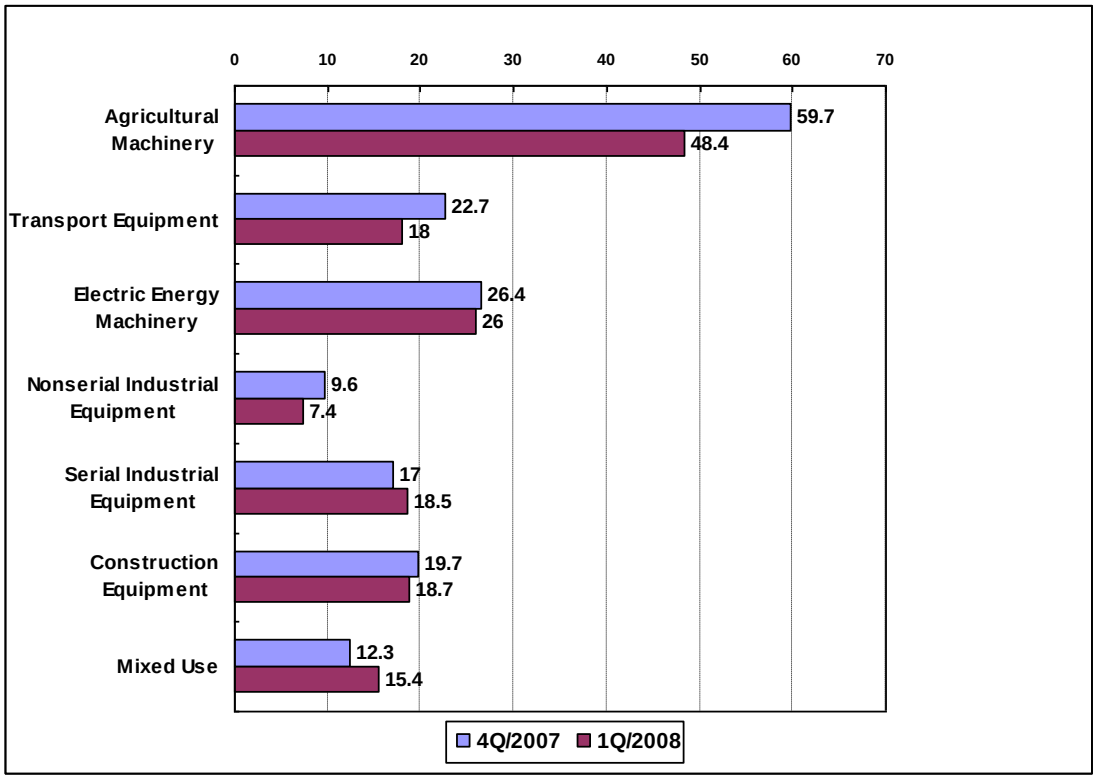
As already mentioned, the capital goods sector continued leadership in industrial production growth in the first quarter of this year confirms the incentive that comes from investment acceleration in several sectors of the economy.

All segments in capital goods[2] continued to show an extremely accelerated growth in the first quarter of 2008, some of them even produced, over the last four quarters, higher accumulated rates than at the end of 2007 (Chart 4).

We must underline the greater importance of the growth in transportation equipment, because of its large weight (36.2%) in the special index for the capital goods industry regarding physical production. Likewise, we must emphasize the decrease in growth in the segment of mixed-use capital goods, which also has a large share (33.1%) in the mentioned index. Other segments have a relatively lower weight in this special index for capital goods, but their joint growth confirms the trend of investment increase in several sectors of activity: agriculture, energy, and construction.

[2] This analysis of the behavior of capital goods segments is based on data from IBGE, which issues a special index, composed of different segments and several products. However, it must be stressed that some products in this special index – such as parts and pieces for agricultural machinery – are not usually included in the use category "capital goods", whose physical production behavior is also issued by the same institution.

Chart 4 – Segments of the Capital Goods Industry
(rate accumulated over the last 12 months – 4Q/2007 and 1Q/2008) (In %)



Source: NEIT/IE/UNICAMP based on data from PIM-PF/IBGE.

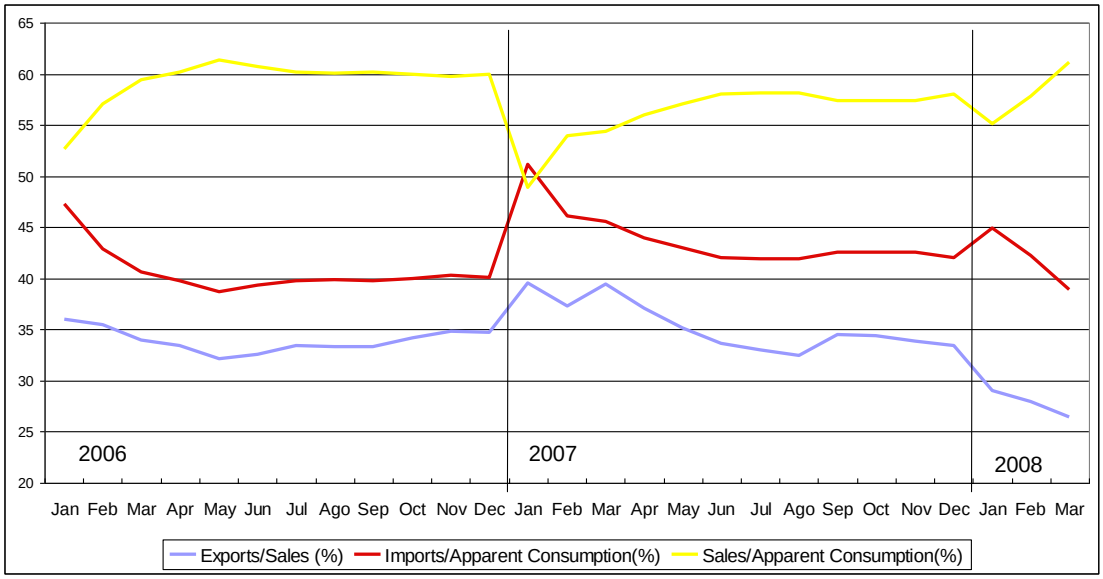
The evolution of real sales in the capital goods sector issued by ABIMAQ[3] also confirms this positive scenario. In 2007, sales reached R$ 61,9 billions (at constant prices in December 2007 – deflated by IPA-DI: machinery and equipment – original source: ABIMAQ). In the first quarter of 2008, real sales reached R$ 17,1 billions, revealing an increase of 27.4% in relation to the same period in the previous year.

In its turn, apparent consumption (sales + imports – exports) increased 37.7% in the same period, fuelled by increases in both sales and capital goods imports. Data on the first quarter of 2008 reveal that foreign purchases raised 44.6% in relation to the first quarter of 2007, from US$ 3,194,1 millions to US$ 4,617,7 millions, whereas exports showed a relatively lower increase (5.1%) in the same period, going from US$ 2,481,7 millions to US$ 2,607,2 millions (ABIMAQ). However, observing the latest behavior of physical production, sales share, and capital goods imports over apparent consumption, we can see that imports increase has not displaced domestic production; on the contrary, they are complementary. Imports share over apparent consumption remained relatively stable throughout 2007, reducing slightly in the first quarter of 2008 (from 44.9% in January to 38.9% in March).

On the other hand, exports share in sales ended up translating into a virtually continuous decrease in the last 12 months, reflecting higher domestic demand, exchange appreciation, and reduction in foreign demand (Chart 5).

[3] ABIMAQ includes only mechanical capital goods in its statistics, subdividing them into machinery and equipment for: consumer goods industry; capital goods industry; infrastructure, logistics and primary industry; construction; agriculture and agro-industry; and oil and renewable energy industry.

Chart 5 – Capital Goods Industry: Evolution of Imports Share over Apparent Consumption and of Exports over Sales (Jan./2006-Mar./2008) (In %)

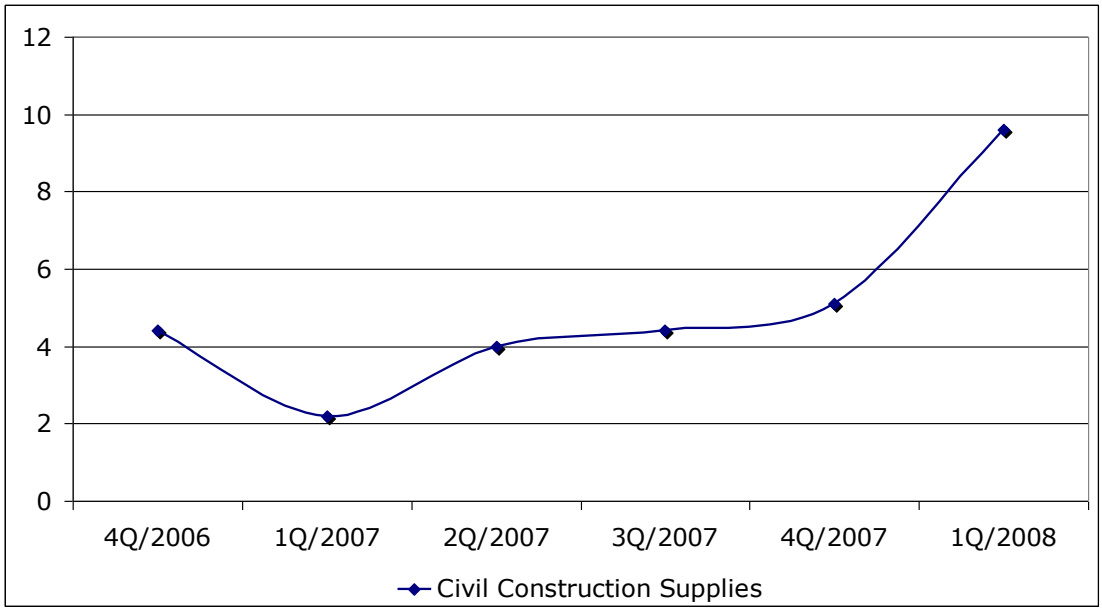


Source: NEIT/IE/UNICAMP based on data from ABIMAQ.

From the point of view of gross fixed capital formation, there is evidence that, in addition to machinery and equipment, the construction sector has been performing brilliantly since last year, a performance remarkably intensified in the beginning of this year. A more careful analysis of growth in this activity becomes interesting to shed light on the vigor of domestic economic activity.

Initially, a very favorable behavior of the production of supplies typical to construction must be stressed. There was a gradual intensification of its growth throughout last year, which reached 5.1% in the yearly total and 9.6% in the first quarter of 2008 alone (Chart 6).

Chart 6 – Growth Rate of Construction Supplies Production (rate accumulated over the year – 4Q/2006 to 1Q/2008) (In %)



Source: NEIT/IE/UNICAMP based on data from PIM-PF/IBGE.

This growth in construction can also be observed in the evolution of formal employment creation in all its segments (building construction, infrastructure works, and specialized services for construction). In 2007, construction created about 180,000 job vacancies (which corresponds to almost half of vacancies created in industry in the same period). Building construction was the highlight in hiring, but the highest balance was in the infrastructure works segment (almost 82,000 job vacancies) (Table 4).

This growth in employment creation in the first quarter of 2008 shows clearly the recent excellent performance of the construction sector. In three months, it created a little more than 103,000 jobs, almost tripling the result in last year's first quarter. Building construction led both absolute and relative growth of formal employment in the first quarter of this year, with more than 44,000 job vacancies (almost fivefold the level in last year's first quarter), representing 43% of total formal employment growth in construction. The number of jobs in other segments also raised significantly, doubling in infrastructure works and almost tripling in specialized services.

Table 4 - Evolution of Employment Creation in Construction (I/2007 and I/2008)

	Hired (thousands)			Dismissed (thousands)			Job Vacancies Created (thousands)		
	Total 2007	1st qu. 2007	1st qu. 2008	Total 2007	1st qu. 2007	1st qu. 2008	Total 2007	1st qu. 2007	1st qu. 2008
Construction	**1,426,2**	**330,3**	**460,4**	**340,7**	**295,1**	**357,2**	**179,9**	**35,2**	**103,2**
Building construction	**680,1**	160,3	208,1	**163,7**	150,5	163,7	**65,2**	9,8	44,4
Infrastructure works	**528,5**	119,3	170,2	**125,7**	100,5	130,0	**81,8**	18,8	40,2
Specialized services	**217,6**	50,6	82,1	**51,3**	44,1	63,5	**32,9**	6,6	18,6

Source: NEIT/IE/UNICAMP based on data from CAGED/MTE.

Therefore, data on construction, too, show that growth rhythm in gross fixed capital formation was vigorous in the first quarter of the year. Thus, there is a prospect that economic growth will remain being encouraged by investment expansion. From a

macroeconomic point of view, investment expansion is essential so that income and demand increases are not limited by the domestic production capacity in different sectors. However, it is also important to stress that, from a microeconomic point of view, increase in inversions is usually related to modernization and technological update of machinery, equipment and facilities, resulting in greater production efficiency and competitive capacity.

The Productive Development Policy (Política de Desenvolvimento Produtivo – PDP – 2008), recently launched by the government, may have positive effects on this process, especially because of measures taken to encourage investment, such as spreads reduction and deadline extension in BNDES operations for capital goods. Measures taken to develop innovation and competitiveness, too, are largely important, given a scenario of less favorable world growth than in the last years, which may result in less heated foreign demand and fiercer competition in the foreign market. In this sense, investment expansion itself plays a fundamental role, since an increase in capacity can prevent production for the market to replace exports, besides providing technological modernization. However, over a longer term, an increase in international competitiveness also depends on an increase in expanded in-depth innovation and on the capacity to differentiate products as a way to increase foreign market penetration for products designed to outperform their main competitors in quality and value. These questions are dealt with in the PDP, and its effective implementation may generate important effects to prevent future disequilibriums, especially in trade balance, in a less favorable international scenario.

Leather and Footwear Industry: characteristics, performance and competitive challenges

Main features and world trends

The leather and footwear industry belongs to a comprehensive production chain that extends from the production of supplies (such as leather and chemical products) to the manufacturing of final products (footwear).

One of its characteristics is a relatively simple production process, marked by a mature technology, sometimes with handmade features, and by an intensive use of poorly skilled labor. The possibility of fragmenting the production process in different and discrete stages must be highlighted, for it contributes to ease geographic displacement, both nationally and internationally. The final product of the footwear industry is available in assorted designs and styles, as well as different materials (such as leather, fabric, and synthetic materials), following fashion trends. Products can also serve multiple consumption purposes (dress, athletic, casual, or safety) and directed to different types of consumers (men, women, children), resulting in an excellent possibility for segmenting the consumer market.

A relevant characteristic of the world leather and footwear industry is its heterogeneous structure, marked by the coexistence of a large number of small and medium companies, which focus on their respective countries, with a small number of large companies that operate internationally, being responsible for a substantial part of production and supply to the world market. Large international companies are leading a global reorganization process in the production, commercialization and distribution chain. The possibility of fragmenting the production process has been enabling the geographic displacement of its stages within each producing country and also worldwide, motivated by the search for new sources of lower-cost supplies, especially costs related to labor. It is worth stressing the relevance of global purchasers, responsible for distributing purchase orders among different producers located in different countries, who end up by coordinating the global production chains.

The trend to reorganize globally the footwear production, commercialization and distribution chain has been followed by an increasing displacement of world production to Asian countries, mainly to China, where large purchasers find suppliers of relatively simpler and cheaper products. China certainly has advantages related to reduced labor cost; economies of scale at the plant and firm level, which generates capacity to fulfill huge backlogs of orders at low costs; and, finally, the maintenance of national currency depreciation against the American dollar, which encourages the exports of a large part of local footwear production (Garcia and Madeira, 2007).

In 2005, the main footwear manufacturers were, in descending order: China (9 billions of pairs), India (900 millions), Brazil (762 millions), Indonesia (580 millions), and Vietnam (525 millions) (ABICALÇADOS, 2007). China has been confirmed as the main world manufacturer, and increase its production of 6 billions of pairs in 2000 to 9 billions of pairs in 2005. China's significant footwear production is primarily for export (approximately 80% of the volume produced), ranking the country as the main world exporter of footwear in volume (7 billions of pairs in 2005). Brazil remained as the third largest world manufacturer of footwear, reaching 762 millions of pairs in 2005, of which 217 millions for export (28.5% of the national production).

Concerning world trade, we should stress the substantial increase in world exports in all segments of this sector. The total traded by industry raised from about US$ 83 billions in 2000 to US$ 126 billions in 2006 (Comtrade). The highlight is the footwear segment, which represents more than half of world trade in this sector in the current decade (US$ 67 billions in 2006).

The concentration of exports on Asian countries can also be mentioned as an important trend of the world footwear industry, making competition fiercer in the international market and reducing the area of activity of traditional manufacturers and exporters. In 2006, the main footwear exporting countries (regarding value exported) were: China (32.5%); Italy (14.2%), and Hong Kong (9.0%) (Comtrade). China's share has been increasing continuously, to the disadvantage of its main competitors in the foreign markets, such as Italy. Brazil ranked seventh in value of footwear world exports in the last year analyzed, suffering a fall in its market share from 3.7% in 2000 to 2.9% in 2006.

With regard to the main technological trends (product and process) observed in industry, these stand out: development and use of new (synthetic) materials; development of footwear design, associated to the importance of fashion and product differentiation; increasing product customization to fill market niches; increasing use of electronic components both in products (athletic footwear with electronic devices in their soles, adding new functionalities to products) and processes, especially through increasing automation; and, finally, standardization of footwear production, aiming at normalizing some product features concerning type, design and size (Garcia and Madeira, 2007).

Characterization and analysis of the recent performance of the Brazilian leather and footwear industry

The Brazilian leather and footwear industry can be characterized by its heterogeneous structure, which reproduces domestically a feature observed internationally.

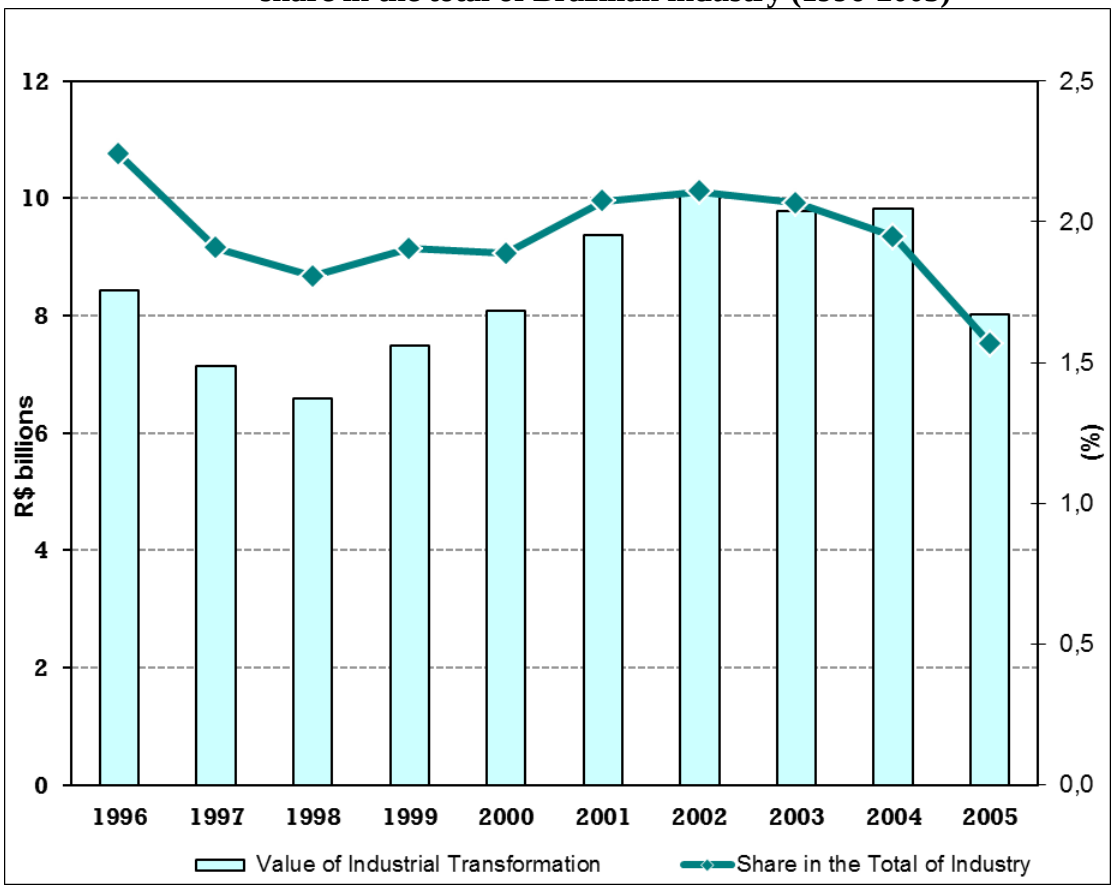
Data from the Annual Social Information Registry (Relatório Anual de Informações Sociais – RAIS)[4] of the Ministry of Labor and Employment (Ministério do Trabalho e do Emprego – MTE) point to the existence of more than 12,000 companies in the Brazilian leather and footwear industry in 2005. In the segment of footwear alone there was approximately 9,000 companies, about 75% of all companies in this industry. The prevalence of small and medium companies is easily observed: in the segments of footwear and other leather goods, the number of companies with up to nine employees represented 66.3% of the total in 2005. In its turn, in the segment of leather manufacturing, the number of companies with up to nine employees represented 50.7% of the total in the same year. However, there are large leading companies that concentrate a large part of production and employment and that have headed, on the one hand, a recent movement to acquire other national manufacturers and, on the other hand, the formation of partnerships with large foreign companies.

The Brazilian leather and footwear industry had unfavorable results in the period 1996-2005, based on the Value of Industrial Transformation (Valor da Transformação Industrial – VTI), an approximation of the added value, issued by the Annual

[4] RAIS/MTE includes all companies that declared to belong in a certain sector.

Industrial Survey (Pesquisa Industrial Annual – PIA)[5] of IBGE. There was a reduction in its added-value in the period mentioned (-0.6% per year), which definitely contrasts with the growth observed in the Brazilian industry (3.5% per year), leading to a fall of the VTI of the leather and footwear sector's share in the total VTI of industry (from 2.2% in 1996 to 1.6% in 2005) (Chart 1).

Chart 1 – Leather and Footwear Industry: evolution of the value of industrial transformation and its share in the total of Brazilian industry (1996-2005)



Note: Values in R$ billions of 2005. Deflator: manufacturing industry – National Accounts.
Source: NEIT/IE/UNICAMP based on data from PIA/IBGE.

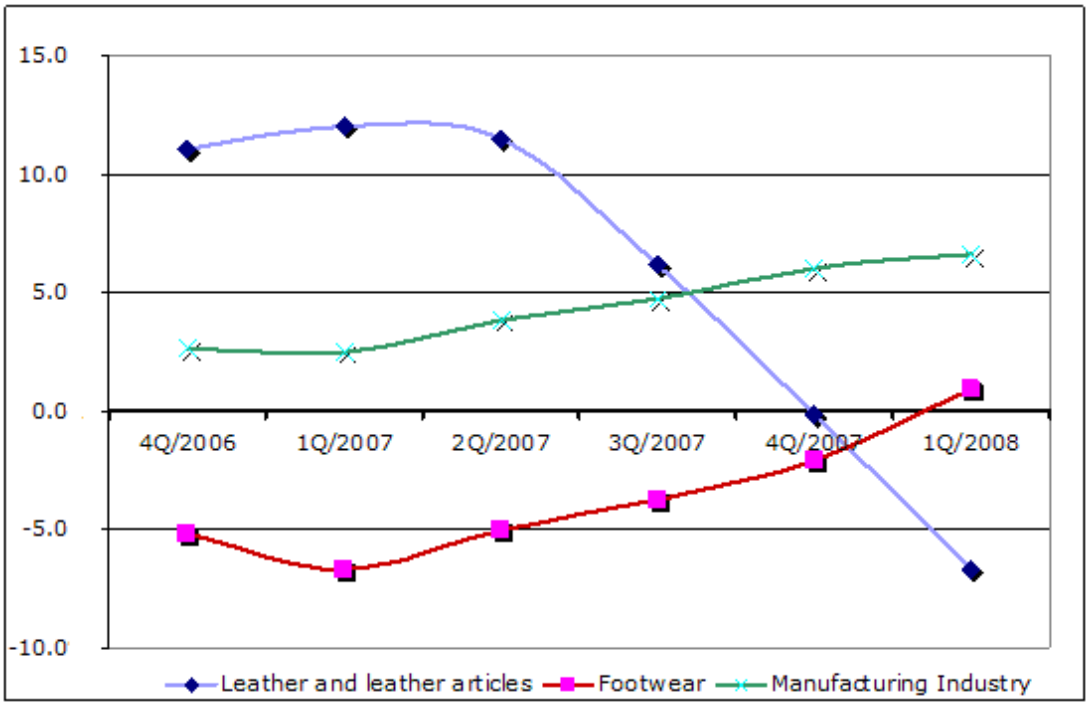
Some elements provide explanation for the poor performance of this sector in the period under study. First, because it is a sector of nondurables, income evolution affects production directly. The period examined was marked by a semi-stagnation in income and consumption, unfavorable for the expansion of footwear production. On the other hand, this sector directs a relevant portion of its domestic production to the foreign market. It means that the exchange rate affects exports considerably and, consequently, production. Thus, it is possible to observe that, for example, in periods of exchange appreciation, such as 1996 to 1999, and more recently from 2004 on, the exchange rate affected this sector negatively.

In the biennial 2006-2007, according to data from the Monthly Industrial Survey-Physical Production (PIM-PF/IBGE), the total production of leather and footwear performed negatively (-2.7% in 2006 and -2.2% in 2007), contrasting with the

[5] PIA/IBGE uses as a basis for information only companies with more than four employees.

positive evolution of physical production in the manufacturing industry (2.6% in 2006 and 6% in 2007). The performance of the joint production in the segments of leather and other leather goods (excluding footwear), which corresponds to 16% of the products considered in the survey, was extremely positive in 2006 (increase of 11%), as well as in the first three quarters of 2007 (Chart 2). The large amounts of leather exported contributed to this performance in domestic production. However, there was a clear reversion of production behavior in the last quarter of 2007, when a fall in leather exports quantum can be observed. The year of 2007 ended up closing with a small reduction in the production of leather and other leather goods (-0.5%). In its turn, the production of footwear, which represents a large part of the products under study (84%), accumulated a fall of -5,2% in 2006, gradually lessened during 2007, yet closing with a negative performance in physical production (-2,1%).

Chart 2 – Manufacturing Industry and Leather and Footwear Industry: fluctuation in physical production
(rate accumulated in the past four quarters – 4Q/2006 to 1Q/2008) (In %)



Source: NEIT/IE/UNICAMP based on data from PIM-PF/ IBGE.

Therefore, the leather and footwear sector was an exception to the generalized industrial growth in 2007. This performance in physical production, given its dependence on foreign demand, may possibly have reflected a loss of foreign market and a reduction in exports quantum, resulting, on the one hand, from increasing competition, especially Asian, in world consumer markets and, on the other hand, from exchange overvaluation, which represents a difficulty to overcome, so as to reach a better insertion into world trade.

Foreign market loss has encouraged many Brazilian companies to redirect sales to the domestic market, mainly the small and medium ones, which cannot face fiercer international competition. However, last year's heated domestic demand could not counterbalance this foreign market loss, because it was, in addition, followed by an increase in footwear imports – more significant in imports quantum – to the detriment of domestic production.

The latest data on physical production show a sharp fall in the total accumulated in the last four quarters (March 2007 to March 2008) in leather and other leather goods (-6.7%) and a raise, although modest, in footwear (0.9%). The sharp fall in leather and other leather goods exports quantum observed in the last quarter of 2007 and in the first quarter of 2008 contributed to the negative result of this segment's production.

Regarding the footwear segment, it is useful to stress that the recent evolution of income and domestic demand seems to have contributed to its recovery since last year, which shows more clearly in the first quarter of 2008, tough still timid. This possibly will consolidate a reversion in the negative behavior observed last year, depending on the future evolution of income and domestic demand. Redirecting the domestic demand stimulus to domestic production may be the major difficulty to be faced, considering the recent increase in footwear imports in the Brazilian market, also encouraged by local currency appreciation (although imports do not carry a significant weight in domestic apparent consumption: about 3% in volume in 2006 – ABICALÇADOS).

Another characteristic of the Brazilian leather and footwear industry is its enormous potential to generate employment. According to data from PIA/IBGE, this industry employed 277,400 workers in 1996, increasing to 384,000 in 2005 (growth of 38.4% or 4.3% per year). In the Brazilian industry, increase in people employed was relatively more modest: 25.3% in the period mentioned (2.8% per year). Thus, the leather and footwear sector's share in Brazilian industry concerning people employed raised from 5.4% in 1996 to 6.0% in 2005.

In 2007, the leather and footwear sector created formal employment, especially in the leather footwear segment. Data from the General Registry of Employed and Unemployed Persons (Cadastro Geral de Empregados e Desempregados – CAGED/MTE)[6] show a balance of about 9,000 job vacancies between people hired and dismissed in this sector last year. There were fluctuations throughout the four quarters of the year, with a significant fall in the last one. However, the total accumulated over the year revealed a positive balance. We must emphasize that, in spite of this favorable behavior, the sector's share in job creation in the Brazilian industry (387,000) was greatly reduced last year (approximately 2.3%).

More recent data show that the recovery of footwear production has been reflecting strongly on formal employment creation (Table 1). In the first quarter of 2008, the leather and footwear sector created about 15,000 job vacancies (the footwear segment alone created more than 13,000 vacancies), representing an increase of 22.7% in relation to the first quarter of the previous year. Growth in formal employment in the sector analyzed in the first quarter of this year exceeded substantially the creation of job vacancies observed last year. Small companies (with up to nine employees), of timid international insertion, were the main responsible for job vacancies creation in the period examined (45%). Therefore, 2008 begins with the leather and footwear sector holding a large share of job creation in the Brazilian industry (nearly 10%).

[6] CAGED/MTE shows results from all companies that hired/dismissed formally employed individuals in the period under study, therefore providing a census coverage. This database proves more adequate to analyze formal employment creation in sectors in which smaller companies prevail.

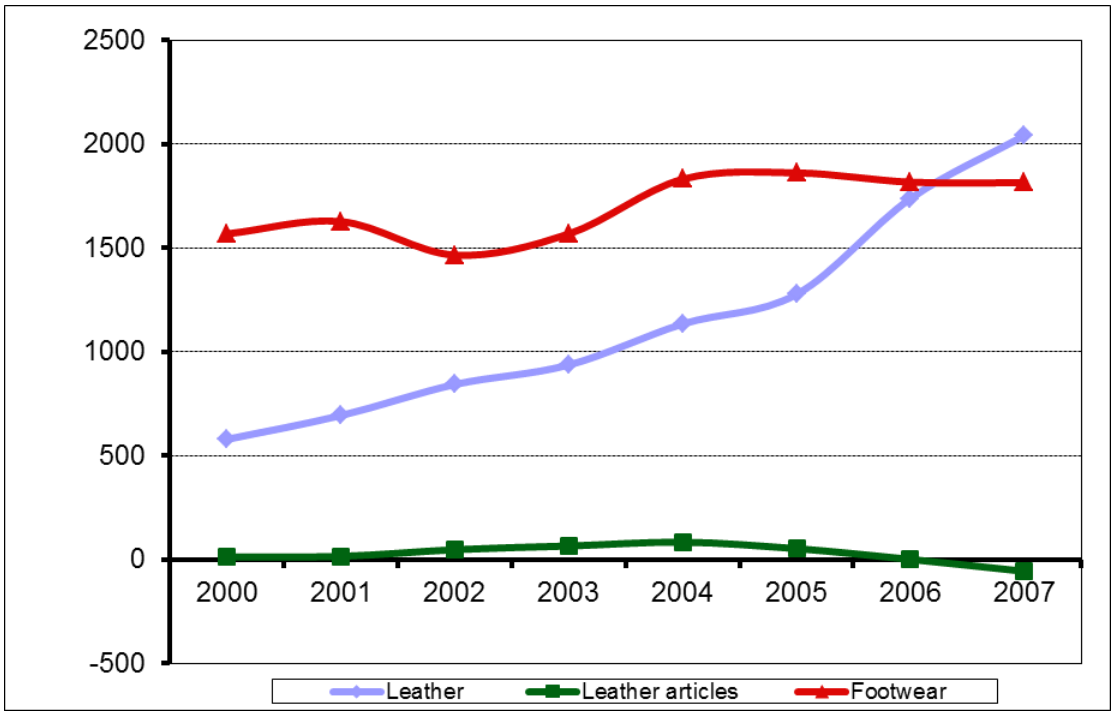
Table 1 – Brazilian Industry and Leather and Footwear Industry: evolution of formal employment creation (1Q/2007 to 1Q/2008)

	1Q/2007	2Q/2007	3Q/2007	4Q/2007	Total 2007	1Q/2008
Brazilian Industry	108,986	188,246	175,903	-86,531	386,604	153,090
Leather and Footwear Industry	12,326	1,047	7,372	-11,845	8,900	15,122
Footwear	11,474	1,504	7,306	-11,107	9,177	13,724
Other leather goods	290	-216	-76	-1,166	-1,168	207
Leather	562	-241	142	428	891	1,191

Source: NEIT/IE/UNICAMP based on data from CAGED/MTE.

Regarding foreign trade[7], the leather and footwear segments have shown persistent trade surpluses in this decade (Chart 3). In 2007, exports amounted to about US$ 2,192 millions in leather and US$ 2,037 millions in footwear, whereas imports totaled just US$ 151 millions in leather and US$ 222 millions in footwear, producing a trade surplus of US$ 2,041 millions and US$ 1,815 millions, respectively.

Chart 3 –Trade Balance Evolution per Segment of the Leather and Footwear Industry (2000-2007) (US$ million)



Source: NEIT/IE/UNICAMP based on data from SECEX.

Trade surplus in the footwear segment has stabilized in the past few years, and was recently surpassed by a high positive balance in the leather segment. It reveals Brazil's increasing importance as a manufacturer and exporter of the basic raw material used by the sector, and the loss of purchasing markets for its final product (footwear) abroad. The segment of other leather goods was an exception in 2007, since it showed a negative trade balance of US$ 56 millions, caused by a considerable increase in imports, reverting the surplus observed in previous years (Secex).

[7] Considering the following products: NCM 41 (4104 to 4107 and 4112 to 4115), NCM 42 (4201 to 4206) and NCM 64 (6401 to 6406).

In the period 2000-2007, the leather segment showed an annual increase in the positive trade balance, fuelled both by a considerable raise in exports value (16.4% per year) and by a decline in imports value (-2.4% per year) (Secex). The main destinations of Brazilian exports of leather last year were: Italy (28.5%), China (22.4%), United States (10.9%), Hong Kong (10.8%), Indonesia (2.5%), and Vietnam (2.5%), some of them are important world footwear manufacturers and exporters that use Brazilian raw material. Major changes occurred in the main destinations of Brazilian leather in this decade, after the emergence of the largest world footwear manufacturer (China) and of other important Asian footwear manufacturers (Indonesia and Vietnam), whose imports of Brazilian leather increased appreciably, although in the form of products with lower added value (semi-finished leather).

Historically, Brazilian leather external sales were linked to exports of semi-finished leather (mainly wet blue), but there was a recent growth in exports of finished leather, which came to represent about 50% of Brazilian leather external sales in 2007 (Garcia and Madeira, 2007). It meant an increase in the added value of the leather exported by the Brazilian industry, which certainly contributed to an increase in its exports value in the past few years. One of the goals of the Productive Development Policy (Política de Desenvolvimento Produtivo 2008), recently defined in Brazil, is to increase finished leather exports value at an average rate of 10% p.a. until 2010, aiming at reinforcing value aggregation to leather external sales.

The footwear segment also showed increase in its trade surplus, especially between 2000 and 2004, in spite of the fact that raise in imports value (24.3% per year) has exceeded that in exports value (3.4% per year). The main destinations of Brazilian footwear exports last year were: United States (35.3%), United Kingdom (11.3%), Argentina (8.5%), Italy (4.6%), and Germany (4.5%) (Secex). The United States remained as the main market for Brazilian footwear, but with a decreasing share. The decline of exports to the American market mirrors the fierce external competition, and also Brazilian manufacturers's efforts to redirect external sales. The presence of European countries in the group of main destinations of Brazilian footwear exports reveals that markets considered more sophisticated and demanding have been reached by Brazilian products. Therefore, we can observe a recent diversification in the destination of Brazilian footwear exports, despite the still sizable, although declining, concentration on the United States.

The increase in footwear exports value has been followed by a raise in the average price of exported products. In the period 2000-2006, average export prices for Brazilian upper leather footwear raised for all main destinations, reaching higher levels in European countries (Table 2). The world average price of exported Brazilian upper leather footwear raised from about US$ 11 in 2000 to about US$ 16 in 2006 (Comtrade). Much lower world average prices were reached by Chinese leather footwear (US$ 5.3 in 2000 and US$ 6.3 in 2006), which, however, are proceeding to intermediate market ranges, with raising average prices in several external markets.

Table 2 – Brazil and China: evolution of average exports prices of leather footwear per main destinations (2000, 2004 and 2006) (US$)

Main destinations[(1)]	2000		2004		2006	
	Brazil	China	Brazil	China	Brazil	China
1. USA	11.4	5.4	11.5	5.6	15.8	6.3
2. United Kingdom	15.0	6.0	15.9	6.5	18.7	7.0
3. Argentina	10.0	8.6	11.0	8.5	14.9	9.4
4. Italy	16.3	5.7	14.9	6.7	19.9	8.5
5. Germany	11.2	5.8	17.8	6.8	20.8	6.7
World	11.4	5.3	11.8	5.5	16.3	6.3

(1) Main destinations of Brazilian footwear exports in 2007 (Secex). It was not possible to compare the average prices of Brazilian and Chinese leather footwear last year, since data from Comtrade for 2007 are not available yet.
Source: NEIT/IE/UNICAMP based on data from Comtrade.

On the one hand, it can be explained by the type of footwear considered – upper leather footwear –, which in general has a higher average exports price. As it answers for about 80% of the total external sales of Brazilian footwear in value, its increasing average price tends to raise the value of Brazilian footwear exports (Garcia and Madeira, 2007). On the other hand, Brazilian manufacturers have adopted a strategy of supplying differentiated products, with higher added-value, and diversifying foreign purchasing markets, including historically more sophisticated markets. However, we cannot forget the lower costs of production achieved by Chinese manufacturers, which also contribute to keep the low average prices of their products in the international market.

Nevertheless, the positive behavior of footwear exports in value, led by a raise in average prices, has been followed by a fall in its share in world exports (Comtrade). It reveals the difficulty certainly faced by Brazilian footwear industry in the international market, due to a growing competition with Asian manufacturers, especially the Chinese.

China's increasing share in the world trade of footwear can also be observed in Brazil. The main countries of origin for Brazilian footwear imports last year were: China (69.7%), Vietnam (13.5%), Indonesia (5.6%), and Italy (4.3%) (Secex). The highlight of imports growth was unquestionably China, from where came US$ 41 millions in footwear in 2000 and US$ 154,9 millions in 2007. Asian countries's increasing share in Brazilian footwear imports reflects these countries's importance in the international trade, mainly in the production and exports of international brand-name athletic footwear. It can be observed in the main types of footwear imported by the Brazilian market – textile uppers and lasted plastics –, compositions typically found in the production of athletic shoes, which jointly corresponded to 60% of Brazilian imports in 2006 (Secex).

More recent data on foreign trade show the persistence of some trends from previous years. In the first quarter of 2008, the leather and footwear segments maintained a positive trade balance, with US$ 492,7 millions and US$ 469,8 millions, respectively, whereas a negative balance continued to show in the other leather goods segment in the beginning of this year.

Consequently, in spite of the poor performance of the Brazilian leather and footwear industry last year, we can observe a recent recovery in its production, with important effects in formal employment. Industry continues to contribute positively for the country's trade balance, even with recent imports acceleration and trade surplus decline. Brazil is among the largest world exporters of footwear, in spite of having lost relative ranking in foreign trade to its main competitors, mainly the Asian. However, this loss of domestic and foreign market should be carefully examined. It is

necessary to adopt a more aggressive strategy to strengthen Brazilian products's brands, image, and presence, primarily in foreign markets. These are some of the challenges emphasized in the Productive Development Policy (PDP – 2008), whose goals include making the Brazilian industry rank second in world production and third in world exports of footwear by 2010.

The prospect of stronger growth in the Brazilian economy this year and the movement to restructure and redirect external sales led by the main companies of the sector, especially those producing and supplying footwear for the international market, open up the possibility for a more positive performance of the Brazilian leather and footwear industry in the future. The main difficulties must continue to be Asian competition and exchange appreciation, which have been leading to market losses. To overcome them, the Brazilian leather and footwear industry needs to face its already identified weaknesses, finding new ways to become increasingly competitive to regain foreign market share. In this context, the role of public policies, such as the Productive Development Policy (PDP), recently defined by government, can be of fundamental importance.

Main competitive challenges

The seizure of potential opportunities opened up by the strengthening and maintenance of economy growth depends on eliminating some important bottlenecks on the part of the Brazilian leather and footwear industry. Some critical factors to enhance its competitiveness can be stressed: (1) capacity for product innovation and differentiation, mainly design improvement; (2) development of production process, associated to modernization and rationalization, as well as increase in production scale and scope, aiming at raising productivity and reducing costs; (3) expansion of product advertisement, commercialization, and distribution, both internally and externally, aiming at strengthening Brazilian brands and image, as well as sales channels; and (4) strengthening of local production systems.

The capacity for product innovation and differentiation is a key aspect of competitiveness in the sector under study. The design improvement delineates a significant field of activity for footwear manufacturers who wish to keep competitive advantages based on product differentiation capacity, and not only on price competition. This factor seems to become more important for the large companies that historically operate in foreign markets, which have been facing a more and more important threat coming from simpler and cheaper products manufactured chiefly by Asian companies, above all the Chinese. Product differentiation may be a way to counterbalance foreign consumer market loss by means of developing, producing, and selling more sophisticated products, with higher added-value and higher average prices, which could fill an intermediate range in the footwear consumer market. Policies especially directed to supporting the development of innovation capacity in small companies become relevant, aiming also at including them in market niches, notably those located in key footwear production complexes, which provide support for local productive arrangements.

One of the most critical factors for increasing competitiveness in the leather and footwear sector has been the production process development as regards the use of more modern equipment; greater rationalization and improvement of production processes; and expansion of production scale and scope, with the objective of reducing waste, increasing productivity, lowering costs and prices, and improving final product quality.

Large Brazilian companies have managed to change the production process, concerning both modernization and rationalization and the use of economies of scale and scope in production. They have also adopted partial or total outsourcing in production, internally and externally, and even production process relocation. Small companies have more difficulties to follow technological advances related to production process, either to buy and use more modern machinery and equipment or to organize and rationalize their productive process, and still maintain very artisanal features that function as limitations to increase their productivity and product quality and to decrease production costs. Policies to promote development in the production process of small companies are important, and should include measures to expand credit and relieve tax burden on equipment purchase, encouraging modernization and sophistication of products and processes.

A third competitiveness factor in the footwear sector concerns the development of advertisement, commercialization, and distribution of products. Strengthening Brazilian products's brand and image, by means of heavy investments in marketing, and consolidating commercialization and distribution channels, as well as diversifying them, became increasingly relevant initiatives in a competitive environment.

Large Brazilian companies, which conquered an important and diversified international insertion, certainly have commercial and distribution advantages for their products, even abroad. However, policies to promote local brands and the joint development of commercialization and distribution channels are necessary, aiming at, for example, filling a more sophisticated and demanding consumer market, also in international scale.

The last competitiveness factor to be considered is the strengthening of local production systems, improving agglomeration benefits, such as those related to workforce qualification, supplier specialization, and interaction of agents. The concentration of companies on local production systems is an essential aspect for footwear manufacturers's competitiveness, mainly the smallest, who eventually have the opportunity to take advantage of positive externalities generated locally.

The Brazilian complexes of footwear production have shown a significant production capacity, often flexible enough to fulfill small orders directed to intermediate market ranges, for they neither have the sophistication and the prices of Italian products nor compete directly with the simpler and cheaper Chinese footwear. However, it is still necessary to strengthen the agglomeration economies, the joint development of technology (product and process), the workforce qualification, the management of commercial assets (such as brands and sales channels), and the joint effort for international certification in the management of quality, environment, safety, and social responsibility, since they produce extremely positive effects on the competitiveness of companies, mainly the small ones.

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