Euler Hermes Economic Research

Country Risk Analysis

Brazil

Headwinds

General Information

GDP	USD2476.7bn (World ranking 6, World Bank 2011)
Population	196.66 million (World ranking 5, World Bank 2011)
Form of state	Federal Republic
Head of government	Dilma ROUSSEFF (PDT)
Next elections	2014, presidential and legislative

Strengths

- Diversified economic base, including minerals, agriculture and developed manufacturing sector.
- Large domestic market, expanding middle class, attractive for FDI
- Flexible exchange rate regime with inflation targeting as basis of monetary policy
- High level of FX reserves, moderate external debt and access to international financing and support if necessary
- Durable political system with established effective democratic transfers of power.

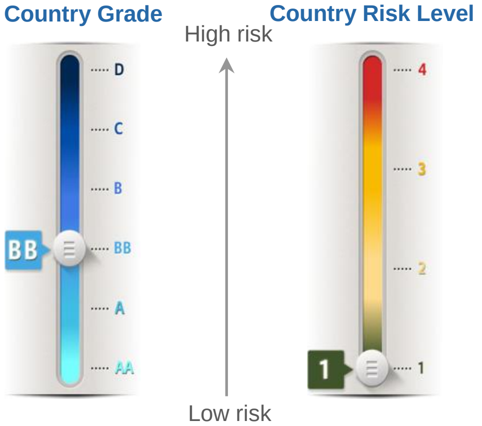
Weaknesses

- Sensitive to global commodity demand and prices
- Relatively low domestic savings
- Public debt still high
- Inequalities of income distribution, but expanding middle class with rising expectations. Social pressures to improve education, health and transport create potential public spending stresses without sustained economic growth.
- Fragmented political system, which can slow progress on structural reforms.
- Infrastructure constraints

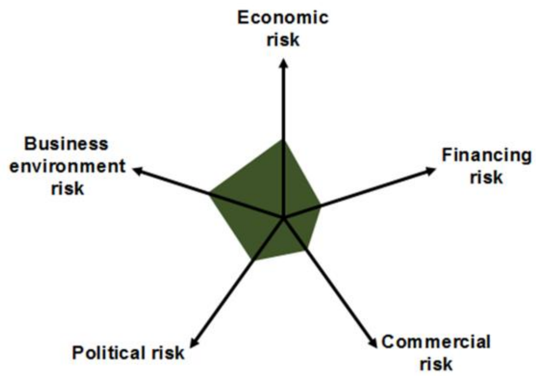
Country Rating

BB1

Country Grade **Country Risk Level**



Risk Dimensions



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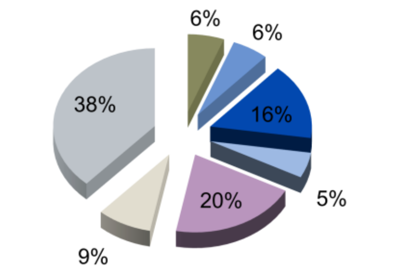
Economic Structure

GDP breakdown (% of total)



Sources: Chelem, UnctadStat, IHS Global Insight, Euler Hermes

Trade structure (% of total)

By destination / origin

Exports		Rank		Imports
China	16%	1	17%	United States
United States	12%	2	14%	China
Argentina	9%	3	8%	Argentina
Germany	5%	4	8%	Germany
Japan	4%	5	4%	South Korea

By product

Exports		Rank		Imports
Iron Ores	15%	1	6%	Refined Petroleum Products
Other Edible Agricultural Prod	11%	2	5%	Cars And Cycles
Crude Oil	10%	3	5%	Crude Oil
Sugar	6%	4	4%	Basic Organic Chemicals
Meat	5%	5	4%	Engines

Economic Forecast

	2009	2010	2011	2012	2013f	2014f
GDP growth (% change)	-0.3	7.5	2.7	0.9	2.7	3.3
Inflation (%, end-year)	4.3	5.9	6.5	5.8	5.9	5.4
Fiscal balance (% of GDP)	-3.1	-2.5	-2.6	-2.5	-3.0	-3.0
Public debt (% of GDP)	66.9	54.7	54.2	58.7	61.0	62.0
Current account (% of GDP)	-1.5	-2.2	-2.1	-0.2	-2.7	-2.7
External debt (% of GDP)	12.2	16.5	16.3	19.5	20.0	17.0

Source: IHS Global Insight, National sources, Euler Hermes

Economic Growth

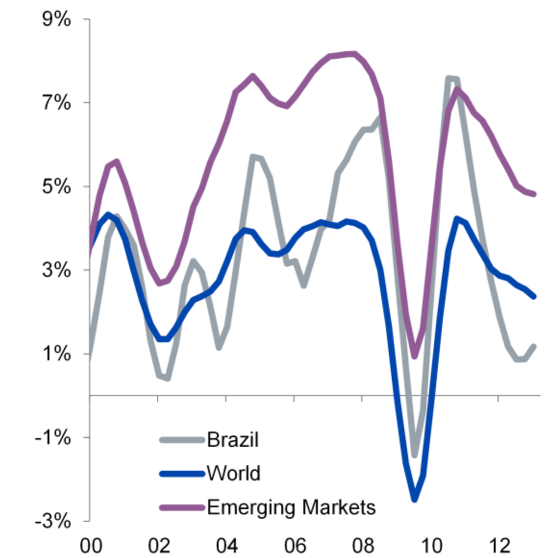
Diversified base

The economy is large and diverse, with a large internal market and a rapidly expanding middle-class. Exports are geographically well spread, though commodities form a large proportion of exports and China has become the largest export market reflecting its' expanded demand for raw material inputs. Consequently developments in commodity prices and China will have a significant impact on Brazil's economic performance. Annual average growth of real GDP per capita in the past ten years was a moderate 2.6%. Income inequalities are high, and though there has been considerable progress, will continue to exert social pressure on government policies. Medium term issues include further reforms to improve fiscal sustainability, low national savings (less than 20% of GDP and improvements to infrastructure, particularly transport, and bureaucracy.

Sluggish recovery after sharp slowdown

The economy slowed sharply in 2012 as GDP increased by only 0.9%. Household consumption remained buoyant in 2012 and although growth will moderate, will again be the main driver in 2013. Investment will return to growth, however, after contracting in 2012. Export growth will again be low. Overall, a modest pick-up in growth to +2.7% is likely in 2013, followed by +3.3% in 2014. Q1 data was in line with a soft recovery with GDP growth of 1% q/q.

GDP growth (%)



Sources: IHS Global Insight, Euler Hermes

Economic Policies

Policies prioritising macroeconomic stability – inflation targeting and a primary fiscal surplus - along with improved debt management, structural reforms and the strong performance of global commodity markets have allowed Brazil to weather the global crisis well. In the near-term, however, policymakers are facing the challenge of a slower than expected recovery at the same time as inflation has moved above the target range and the primary surplus target is becoming less transparent. The response suggests that they remain committed to prioritising stability, but this will need to be maintained, notwithstanding social pressures, expressed recently in mass demonstrations organized via social networking sites, and a slower than expected pace of growth.

Inflation above target

Monetary policy is based on inflation targeting and a flexible exchange rate. Inflation moved above the upper limit of the target range (4% +/-2%) in March 2013 (6.6%). In response, and re-asserting the prioritisation of inflation control, the central bank's monetary policy committee raised the policy interest rate (down from 12.5% in Aug 2011 to 7.25% in Nov 2012) in April (25bps) and May (50bps) to 8%. With tighter monetary policy (further rate increases are likely) and less food price pressure inflation should be back within target by end-2013, though capital flows and the exchange rate are a wild card.

The exchange rate has come under pressure in both directions from capital flows since the global financial crisis as global liquidity has increased. The strong appreciation through to end-2011 has been reversed however, and the nominal depreciation has continued in 2013, though the BRL is likely to face periods of volatility, reflecting policy moves on global liquidity. Reversal of recent appreciation, however, while complicating inflation control should help exports.

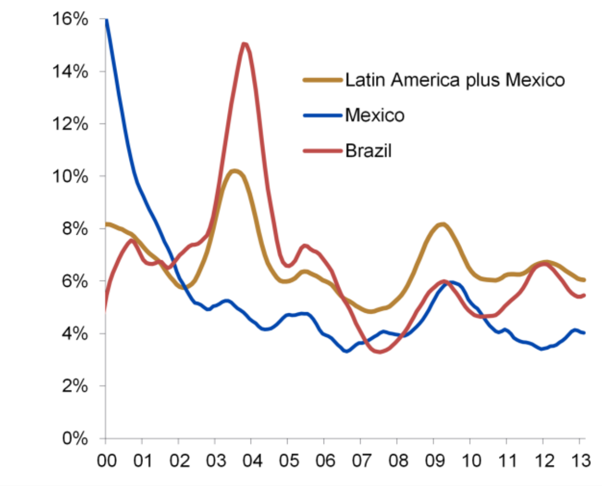
Credit expansion remains strong, but should be trimmed as monetary policy tightens, but the banking system is generally considered to be robust.

Fiscal responsibility

The overall fiscal deficit is moderate at 2.4% of GDP in 2012 (2.6% 2011) as a result of targeting a primary surplus (excluding interest payments). The average deficit since 2004 was -3.1%. The primary surplus eased to 2.6% in 2012, as lower interest rates reduced interest payments to 5.2% of GDP. As interest rates rise in 2013 and GDP growth remains modest it will be necessary to align expenditures accordingly to keep the overall fiscal deficit below 3% of GDP and contain public debt, limiting the scope for further fiscal stimulus.

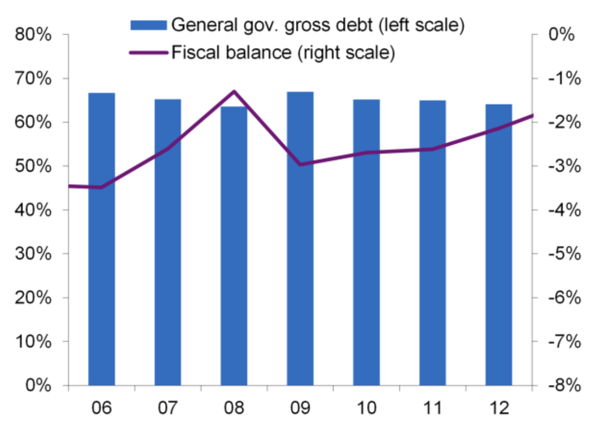
General government debt (national definitions) remains relatively high at 59.2% in April 2013.

Inflation, y/y (12 mo average)



Sources: IHS Global Insight, national sources, Euler Hermes

Fiscal balance and government debt (% GDP)



Sources: IHS Global Insight, national sources Euler Hermes

External Sector

Moderate current account deficit and strong FDI inflows

The current account balance is in moderate deficit, at –2.4% of GDP in 2012 (after -2.1% in 2011 and -2.2% in 2010). The deficit is likely to slightly wider in 2013 and 2014 at -3.0% and -2.7% in 2013, as global commodity market strength fades. The trade account will remain close to balance.

FDI inflows have recovered strongly after a short sharp fall in 2009 during the global financial crisis and inflows are more than 50% higher than the pre-global crisis peak in 2008. Net FDI flows more than covered the current account deficit in 2012 and should cover almost 90% in 2013, limiting the need for debt financing

Importantly from a financing perspective Brazil had access to an IMF FCL in the 2008-9 global financial crisis, which is given only to economies with sound policies and sustainable debt indicators and providing policymakers continue to priories macroeconomic stability would be well placed to obtain international support should it be necessary.

Moderate external debt

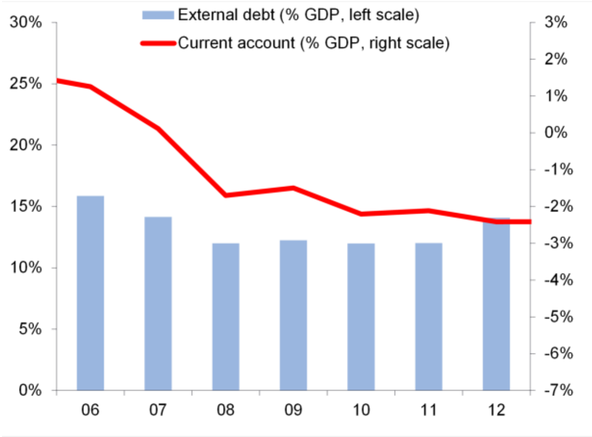
External debt is moderate. External debt is 20% of GDP, 160% of exports of goods and services and interest payments are 5.4% of exports of goods and services.

Foreign exchange reserves increase

Foreign exchange (FX) reserves increased rapidly since 2009 to provide a buffer against further global shocks. Reserves cover more than 13 months imports of goods and services and more than 400% of external debt falling due (including ST) in 2013. M2 as a proportion of FX reserves is also moderate.

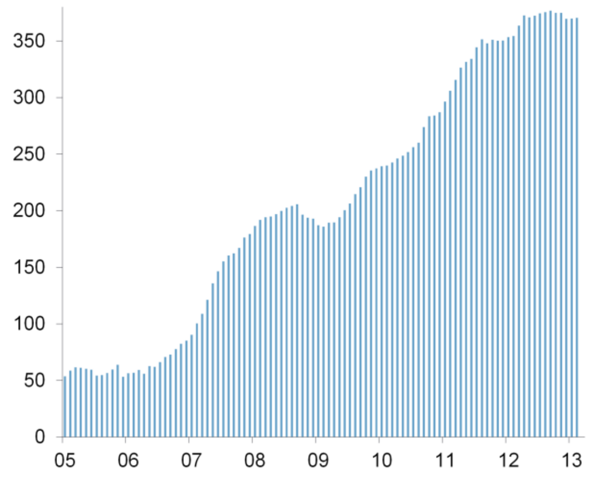
Overall, the external balance is sound.

Current account and external debt (% GDP)



Sources: IHS Global Insight, national sources, Euler Hermes

Foreign exchange reserves (USD bn)



Sources: Central Bank of Turkey, Euler Hermes

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