

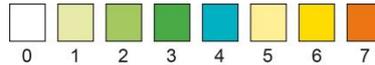
Brazil



COUNTRY RISK CATEGORY

3/7

The country risk categories range from 0 to 7. The lower the number the better the credit rating the country has.



EKN'S OUTSTANDING GUARANTEES IN THE COUNTRY

Short-term transactions: SEK 20.2 million
Medium and long-term transactions: SEK 2,863.4 million

EKN'S POLICY

Sovereign risks: Normal risk assessment
Other public risks: Preferably government guarantee
Bank risks: Normal risk assessment
Corporate risks: Normal risk assessment

See "EKN'S POLICY" section

DATE

12/02/2014

Faltering growth exposes structural problems

Economic development in Brazil has stalled in recent years and the growing discontent with economic policy among the population become more apparent. Fundamental problems such as low levels of investment, poor infrastructure, an inefficient tax system and excessive government controls have placed constraints on the country's growth potential. On the other hand, Brazil continues to pursue responsible economic policies that include reforms intended to give a larger portion of the population access to the benefits of growth. Continued confidence in the incumbent president at next year's election seems very likely. Brazil is thus retaining its basic orientation towards market economics point to further development in a disciplined manner without any abrupt changes.

STRENGTHS

- Diversified economy
- Political consensus on economic policies
- Strong confidence in market economics
- Stable banking system

WEAKNESSES

- The inefficient tax system and extensive bureaucracy
- Inadequate infrastructure and education system
- Excessive constitution and government controls that are too far-reaching
- Protectionism

POLITICS

Equalisation of incomes but also protests

President Dilma Rouseff has continued with the relatively orthodox economic policies she began in the mid-1990s, and she still enjoys the confidence of the Brazilian population. Her tight fiscal policy has also been combined with a restrictive monetary policy, while welfare reforms have spread growth to a larger portion of the population. This has to some extent reduced the extremely unequal distribution of income in the country. The heavy popular protests in the summer therefore came as a bit of a surprise. However, these expressions of discontent should be seen as a reaction to poor public services and corruption, in light of the conspicuous spending on facilities for the upcoming major sporting events in the country, the World Cup and the Olympics. Brazilian democracy has been firmly established since the mid-1980s and its relatively strong political and civil institutions reduce the risk of instability.

On the other hand, from a more long-term perspective, many structural reforms are conspicuous by their absence. Although some major changes have been implemented, including the extremely costly state pension system, much remains to be done. A rigid and outdated system for the allocation of public expenditure, very high tax rates, a substandard education system, a large deficit in the social security system and an inflexible labour market have severely constrained any prospects for faster growth. Another major factor contributing to this is the extremely detailed provisions of Brazil's constitution, which greatly complicate the political decision-making process in the country and impede structural reforms. Corruption is relatively widespread which is also impeding the possibilities for change.

Rouseff has been working hard to reduce corruption which has strengthened her legitimacy but also made her enemies in the alliance that is the foundation of the government. However, her position is relatively strong and it is very likely that she will be re-elected in the presidential election in 2014, particularly as there is no effective option among rival candidates as things stand now.

The combination of a market economy with social overtones and responsible economic policies has laid the foundation for the country's successful growth over the last decade. The country's orientation toward market economics therefore enjoys nearly full political support. This minimises the risk of abrupt changes in economic growth and a repeat of previous recurring financial crises.

ECONOMY

Market orientation with strong state controls

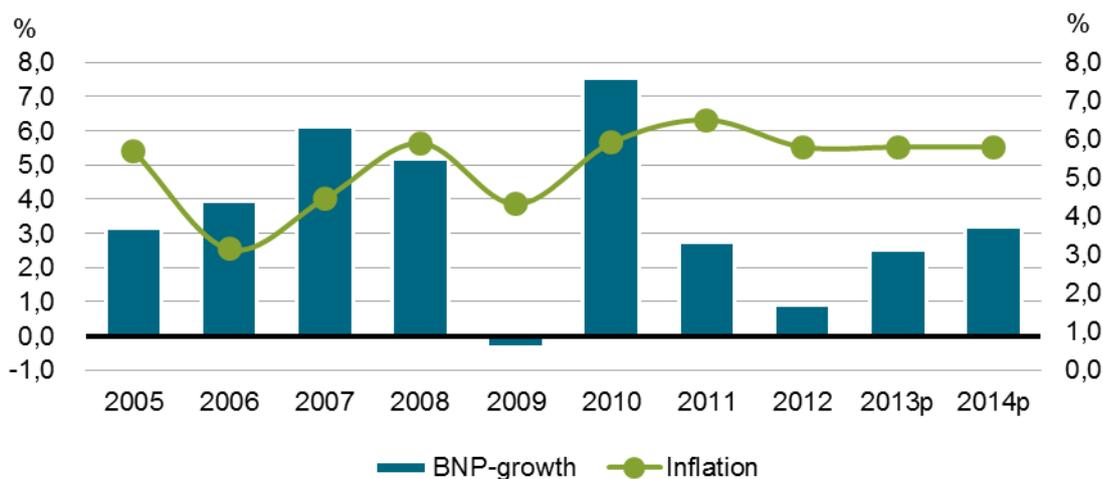
Brazil has experienced remarkable economic growth following the financial crises that hit the country in the late 1990s and early 2000s. Growth has remained steady, the external debt has been substantially reduced, inflation has remained in single digits, the current account balance has been in surplus and the central government deficit has been reduced. The high commodity prices have made a major contribution to the positive economic growth as commodities represent more than one-third of exports.

Brazil's economic base remains relatively broad, and the country is competing internationally in heavy processing industries such as aerospace, chemicals and paper. Recently discovered (but technically difficult to access) major oil reserves would make the country a major oil exporter following successful extraction.

Brazil has been strongly influenced by the bond purchases that the U.S. Federal Reserve has made in recent years. The quantitative easing led to substantial foreign capital inflows, an appreciated exchange rate and a fall in international competitiveness. Conversely, the currently proposed de-escalation of these liquidity operations has led to depreciation and inflation pressure. This has led to tighter fiscal and monetary policies, which is restricting growth. However, depreciation will restore some of the lost competitiveness which will particularly favour the country's industrial sector. This is something that may be needed as growth in recent years has been at a low level and demonstrated fundamental problems in the Brazilian economy, such as a low level of investment, an inefficient taxation system, protectionism and an excessive degree of government control.

Likewise, the inflexible labour market is also a major growth-inhibiting factor. A substandard legal system, and a complex and large-scale regulatory system also make all transactions expensive. The country's large income inequality has also created a breeding ground for very high crime rates which, in the long run, could impede orderly economic growth. While confidence in solutions in accordance with market economics is high, there is also a strong tendency towards state control of the economy. This has led to an inadequate investment climate with investment quotas hovering around 18 to 20 per cent, which are insufficient if the country's growth potential is to be fully exploited. On the other hand, the welfare reforms implemented have enabled more people to benefit from the economic growth. This greatly improves the prospects for sustainable economic growth. Low income groups have migrated to the ranks of the middle-class which has greatly increased consumption and the local consumer goods industry is expanding.

GDP – GROWTH AND INFLATION



The Brazilian economy has fallen into a negative growth spiral – low growth and troublesome inflationary pressure.

The Brazilian public sector has long been struggling with large deficits, although the situation has gradually improved since the turn of the millennium. But the situation has once again

deteriorated over the past year, which partially reflects the lower rate of economic activity in the country. A significant part of the deficit originates from the various states, which in many respects are relatively autonomous in relation to the federal government. The state governors have frequently adopted clearly populist tendencies, where defaults on external debt occasionally constituted an element of their policies. However, the poor administrative procedures and lack of fiscal discipline have improved through the introduction of the law on fiscal responsibility some ten years ago.

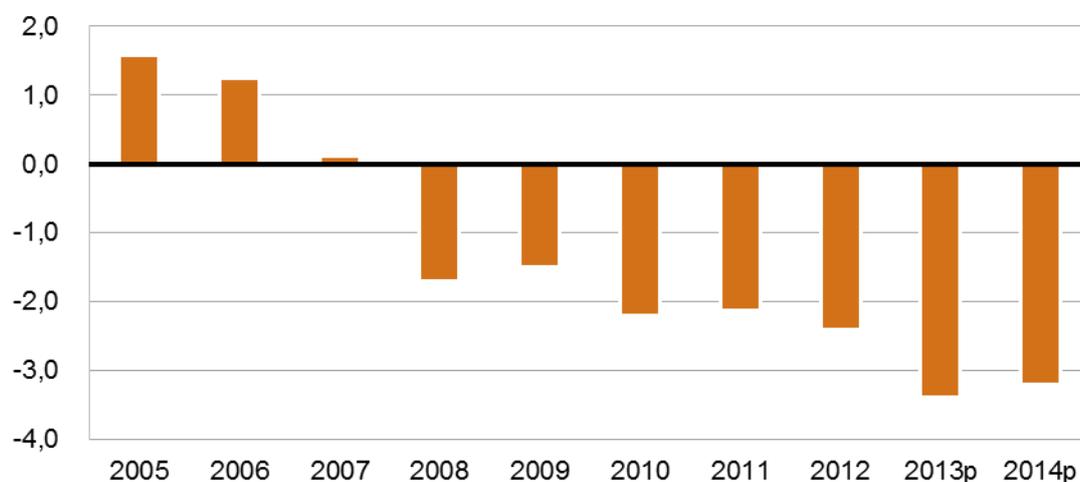
The structural problems that have become more apparent in the Brazilian economy will have a negative impact on economic growth in the future. The government must by all accounts continue to pursue a tight fiscal policy in order to deal with government deficits. Despite the fact that 2014 is an election year, it is very likely that politicians will actually do this. However, the currency depreciation that has taken place and the arrangements for the 2014 World Cup and the 2016 Olympics will give the economy a boost. The Government has also responded to the recent political and economic challenges by introducing reform measures, including tax changes, budgetary commitments and infrastructure investments. The country's skilful use of various economic policy instruments are also characteristic of the Brazilian administration. Brazil has previously proven to be relatively well equipped to face economic downturns, and it is therefore very likely that its responsible economic policies will continue to distinguish the country.

BALANCE OF PAYMENTS AND DEBT ISSUES

Less sensitive to financial headwinds

Brazil's debt has decreased significantly since the turn of the century which has contributed strongly to an improved credit rating. Early payments of external debt, improved government finances and the external balance have contributed to an improvement in the economic conditions. The floating exchange rate also reduces the risk of financial crash landings. In addition, Brazil now considers itself able to stand on its own two feet without any support from the IMF.

CURRENT ACCOUNT BALANCE (% OF GDP)

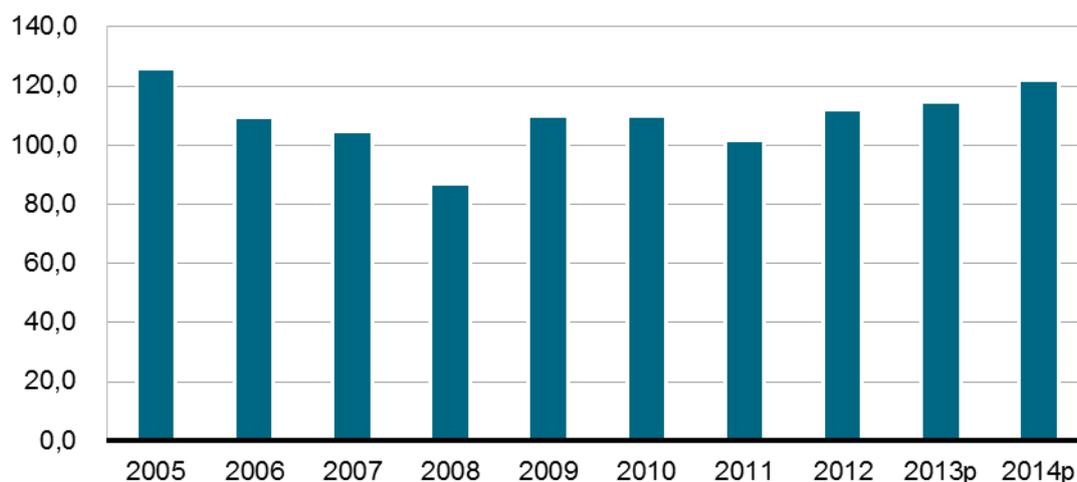


The current account balance deficit has increased but this is offset to some extent by a massive influx of direct investment.

Sensitivity to fluctuations on the international financial market is brought down by the state debt's very limited reliance on foreign borrowing. The local capital market is both extensive and liquid, which has enabled the funding of the lion's share of government deficits. An additional financial cushion is formed by the large foreign currency reserves (currently equivalent to approximately eleven months of imports). The rise in the current account deficit is concerning but it is likely that the depreciation of the exchange rate will reverse this trend. The experience from the global financial crisis in 2009 also shows that the country now maintains a strong position even in financial headwinds.

Brazil has become an increasingly important player in the international financial community, and is now starting to assume a political role as well, which is more commensurate with the economic prowess of the country. At the same time, the Brazilian authorities are keen to protect their domestic industries, which has also led to increased import restrictions and Brazil beginning to approach the limits of WTO norms. The country's growing international political ambitions are therefore not reflected in increased openness in terms of trade policy.

EXTERNAL DEBT (% OF EXPORTS)



Following the last decade's sharp reduction in external debt, it is now increasing again, mainly due to increased economic activity in the private sector.

CURRENCY POLICY

Major currency exchange rate fluctuations

Since 1999, Brazil has had a floating exchange rate for its currency (real/reais), with an inflation target as the fixture of its monetary policy. This has created macroeconomic stability and an ability to adapt to external shocks. The recent increase in inflation, despite low growth, has hampered this adaptation. However, the authorities have not hesitated to introduce more restrictive monetary policy measures to curb this trend.

The central bank occasionally intervenes to prevent excessive, short-term fluctuations in the exchange rate. Following the outbreak of the global financial crisis in 2008, the Brazilian currency, along with many other minor currencies, fell relatively sharply in value. But after a few months, the exchange rate recovered to pre-crisis levels.

A strong inflow of capital in connection with US monetary easing some years ago led to appreciation of the Brazilian currency. The announcement of the future phasing out of this easing policy has resulted in a reversal of capital flows and depreciation of the currency. This led to some of the country's international competitiveness being recovered. This development has been enhanced by the central bank being less prone to intervention over the last year, which is why exchange rate fluctuations have had a greater impact. The lack of financial dollarisation has also made it easier for the central bank to allow the adjustment to occur via the exchange rate, while is also an expression of domestic confidence in the currency. This can be assessed by EKN in local currency transactions. However, the Brazilian currency is not fully convertible and it may not be transferred outside the country.

FINANCIAL SECTOR**Strong banks**

The Brazilian banking system is very concentrated – the five largest banks own about 70 per cent of assets. Structurally, the system is dominated by two groups of institutions.

The first group consists of the state banks, with Banco de Brasil at the forefront, where lending has often had political overtones. The share of bad loans has therefore been relatively high, and Banco do Brasil in particular has been forced to undergo multiple restructuring programs which have led to improvements. Banco do Brasil, which is Latin America's largest bank, is also expanding significantly internationally and the state banks have increased their share in recent years. These state-owned banks also include the development bank BNDES. To all intents and purposes, it is an extension of the Ministry of Finance and gives loans with favourable terms for various types of investments. The second group comprises about a dozen large, well-run commercial banks that are very influential in the private sector.

These two groups each account for about 40 per cent of the banking system. The largest banking merger in Brazil's history took place a few years ago when the Itau and Unibanco banks were merged to form the largest private bank in the country. The remaining 20 per cent consists of a numerically very large, albeit declining, host of banks whose business is largely built on making inflationary gains. The foreign share of the banking system is below 20 per cent, which is low in a Latin American context.

The Brazilian banking system must generally be regarded as relatively stable. Banks finance themselves mostly locally which is a strength. The share of bad loans has fallen to 3.4 per cent. This level is expected to be maintained in the future bearing in mind that, in particular, the private banks have now cleaned up their portfolios after a sharp increase in loans a few years ago. The banking system is also very well capitalised with proportioned provisions for bad loans. In addition, government regulators have been thorough in their supervision and been strict to ensure the banks meet their regulatory requirements. The Brazilian authorities are likely to give support to large and systemically important banks, but are unlikely to support smaller or medium-sized ones.

BUSINESS ENVIRONMENT

Difficult to penetrate bureaucracy

Access to financial information is generally good in Brazil. Imports on open credit are frequent and EKN's experiences are generally good. The demand for letters of credit is also low. Private property rights are respected and well-defined. State enterprises previously dominated most economic sectors, but the 1980s and 1990s saw extensive privatisation and liberalisation. However, over the past ten years, governments have discontinued the policy of privatisation in favour of a more active government role, including through shared public and private ownership in a number of projects. The regulatory environment must be considered relatively favourable given that techno-economic aspects rather than political aspects are guiding factors for regulatory supervision.

The floating currency means that the financial position of companies can change quickly, especially for companies with large foreign currency borrowing. Another distinctive feature of the Brazilian market is that the Brazilian authorities often have provisions in force for external funding which are not in harmony with the OECD rules on export credit guarantees. The badly-organised and convoluted tax system is another aggravating factor for the business sector, as well as the lack of infrastructure. Moreover, the complicated legal system also means legal processes can often be lengthy and expensive. This puts the country relatively far down on the list of the World Bank's "Doing Business Indicator" – No. 126 out of 183 countries. On the other hand, it is doing relatively well in terms of financial transparency and corruption control, and the country is a functioning democracy. This is manifested in particular by the strong position of civil society, especially with regard to NGOs (non-governmental organisations), local organisations and social movements.

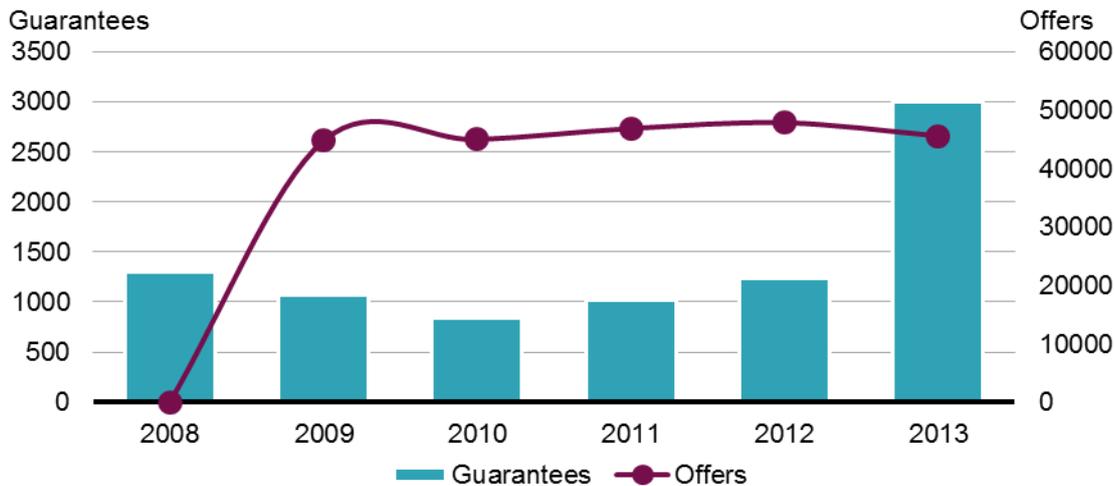
EKN'S EXPOSURE

Major exposure that is not always apparent

EKN's guarantees total almost SEK 3.0 billion while offers are nearly SEK 45.8 billion – the latter largely Saab's export business for the Gripen aircraft.

The guarantees consist mainly of exports of equipment to the Brazilian paper industry and for telecom transactions. Besides this, there is significant exposure to Brazil that is attributed to the debtors' home country of Spain. This was around SEK 4.1 billion.

OFFERS AND GUARANTEES, MSEK



The volume of guarantees increased over the past year, mainly due to a few large one-off transactions.

PAYMENT EXPERIENCE

Brazil is meeting its commitments

EKN's payment experiences from Brazil are essentially good. The debt problems that impacted the country during the 1980s were settled for the public creditors through a renegotiation in the Paris Club. Brazil handled this agreement in an exemplary fashion. Subsequent Brazilian financial crises have not led to any payment defaults but have been addressed through increased lending, primarily from the multilateral institutions. Over the last ten years, the absence of financial crises and a conscious debt restructuring policy have also yielded a significantly improved credit rating.

Despite generally good experiences from transactions with the private sector, EKN has had several commercial late payments for smaller amounts – in recent times particularly in the textile sector. It has proved difficult to enforce these claims using the legal system, as the legal process takes an extraordinary amount of time. Consequently, the threat of a recovery process is not very intimidating to the debtors as they are well aware of the lengthy expenditure of time. EKN has also had bad experiences from using title retention as collateral. This seem to be difficult to enforce legally if the buyer disputes the sale of the goods. The tangled bureaucracy as well as frequent changes to the regulations and restrictions are additional complicating factors related to commercial transactions in Brazil.

EKN'S POLICY

Rapidly improving credit rating

EKN has placed Brazil in country risk category 3 for short and long-term guarantees. For six years, the country has been placed in country risk category 3 at the OECD after promptly moving up from the highest-risk categories. The policy also contains specific constraints on transactions with public buyers. These can be traced back to the problems that were prevalent in the public sector, especially in the various states where borrowing has had strong political overtones. However, this has improved in recent years, due in part to tighter legislation.

For transactions with buyers in the private sector (banks, companies), EKN has no specific, general limitations. Instead, each transaction is examined on its own merits. The same applies to transactions with central government debtors, such as the Central Bank or the Ministry of Finance.

However, when it comes to other public purchasers such as other ministries or municipalities, EKN is more restrictive. EKN usually demands state guarantees for such transactions – in addition to the transaction normally being examined on its own merits.

OFFICIAL COUNTRY DATA AND CREDIT RATINGS

OFFICIAL COUNTRY DATA	CREDIT RATING	
Area: 8,547 t km ² (19 times Sweden)		
Population: 198.7 million (2012)		
Population growth: 0.9 % (2010)		
GDP: USD 2,253 billion in 2012 (Sweden USD 526 billion in 2012)		
GDP/capita: USD 11,340 in 2012 (Sweden USD 56,210 in 2012)		
	Moody's:	COUNTRY CEILING
	S&P:	SOVEREIGN RISK
	Fitch:	
		Baa1
		Baa2
		A-
		BBB
		BBB+
		BBB

COUNTRY ANALYST

EKN's country analyst for
Brazil

Claes Nordström

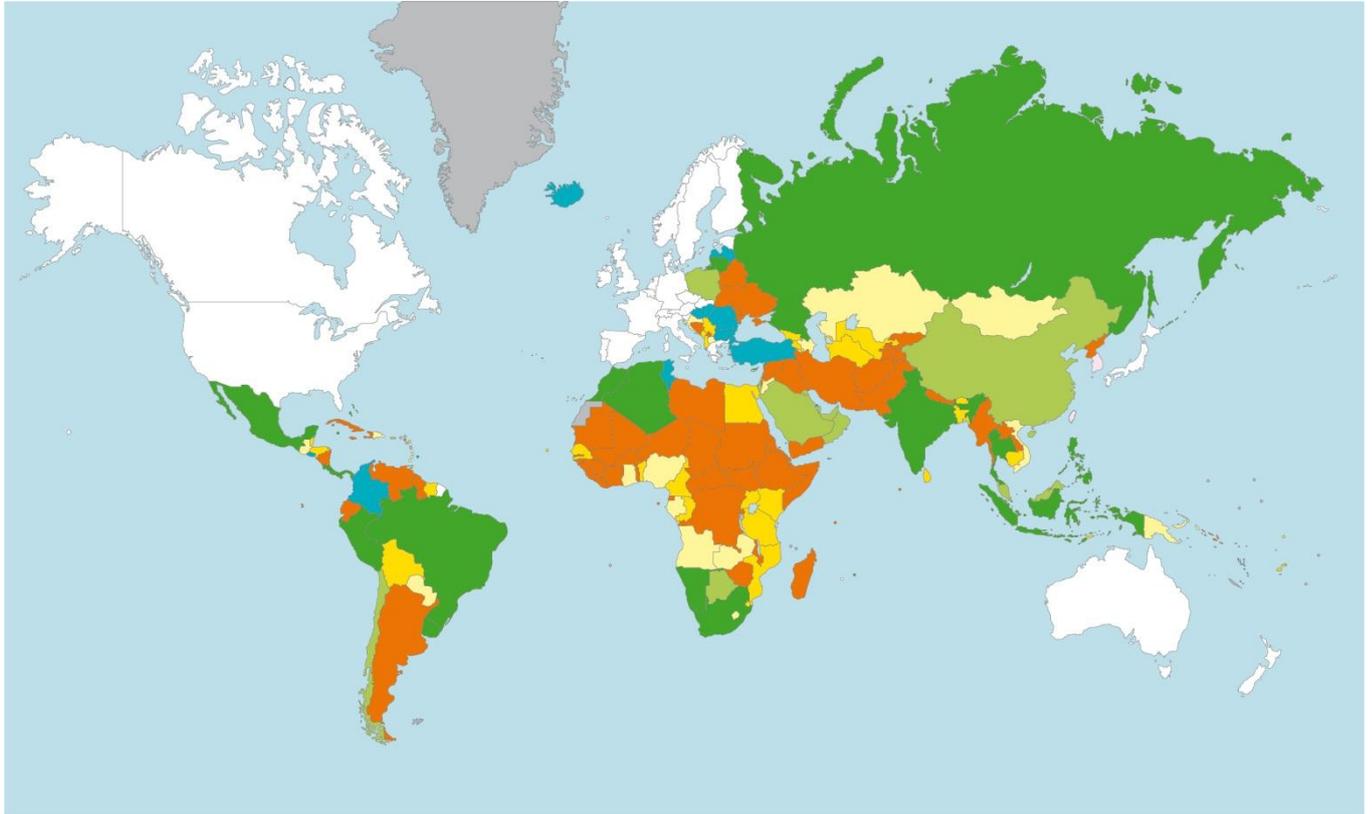
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**DISCLAIMER**

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EKN'S VIEW OF THE WORLD



The country risk categories range from 0 to 7.
The lower the number the better the credit rating the country has.

**EKN – CREATING CONFIDENCE IN YOUR EXPORTS**

EKN is an authority tasked with promoting Swedish exports and the internationalisation of Swedish companies. We do this by offering guarantees of payment and financing, together with advice on business structures and risk management. Our services provide you with greater security, increased competitiveness and more opportunities for successful export transactions.

The Swedish Export Credits Guarantee Board

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