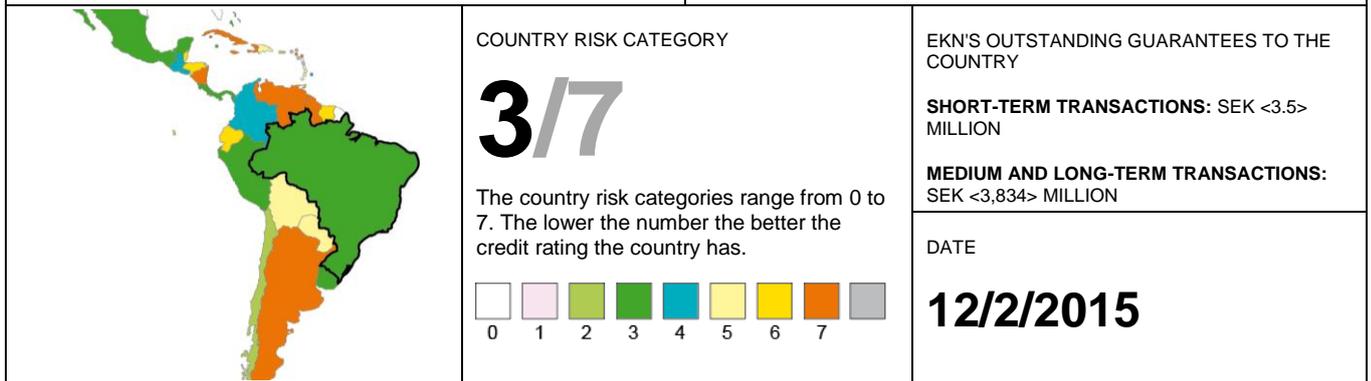


Brazil



Low investments and low growth

Brazil's economic growth has come to a grinding halt over the past years and the growing discontent of the population with the country's economic policies has become increasingly manifest. Fundamental problems such as low investment levels, deficient infrastructure, the inefficient tax system and far too strong government control are limiting the country's growth potential. On the other hand, Brazil continues to pursue responsible, overall economic policies, including reforms seeking to spread the country's growth to more of the population. The sitting government was re-elected this past autumn by the smallest possible margin. Brazil continues to have an essentially market economy orientation, but it seems less and less likely that the government is capable of reversing the negative trend of the past years.

THE COUNTRY'S STRENGTHS AND WEAKNESSES

Strengths

- Diversified economy
- Political consensus on the frames for economic policies
- Responsible economic policies
- Stable banking system

Weaknesses

- Inefficient tax system and extensive bureaucracy
- Deficient infrastructure and educational system
- Too far-reaching government control and an excessively complicated constitution
- Protectionism negative for international competitiveness

EKN'S POLICY

Same country risk category for a long time

Brazil has been placed in country risk category 3 since 2007 for both short-term and long-term guarantees. There are not any special restrictions on transactions with the private sector. A government guarantee is normally required for transactions with the public sector as a result of weaknesses in parts of the country's public administration.

WHAT MIGHT CAUSE A CHANGE IN THE COUNTRY POLICY?

The policy may be made less restrictive in the event of

- Rigorous economic reforms to stimulate investment activity
- A simplified regulatory framework and less protectionism

The policy may be made more restrictive in the event of

- The lack of structural reforms to enable increased investment
- Continuing state interventionism in various markets

EKN'S EXPOSURE AND EXPERIENCE

High exposure

EKN's exposure to Brazil totals over SEK 3.7 billion and is divided up between several industries, but EKN's strongest exposure is to the paper industry. EKN has good experiences of Brazil.

COUNTRY ANALYST



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DISCLAIMER

The country analysis is based on a range of sources and reflects information that is relevant to EKN at the time of publication. The responsibility for how the information is used or interpreted rests solely with the user, and EKN cannot be held responsible for any loss or damage.

Welfare reforms and protectionism

President Dilma Rouseff has continued the relatively orthodox economic policies that began in the mid-1990s. She has had the support of the Brazilian population, although she barely won in the presidential elections last autumn. Her popularity is however falling significantly. The country's policies of fiscal austerity have been combined with restrictive monetary policies, while welfare reforms have spread growth to the majority of the population. This has partially reduced the extremely unequal distribution of income in the country. The discontent expressed over the past years should however be seen as a reaction to poor public service and corruption, in light of the conspicuous investments in facilities in the run up to the major sports events in the country, the FIFA World Cup and the Olympic Games. Brazilian democracy has however been well-anchored since the mid-1980s and the country's relatively strong political and civil institutions reduce the risk of instability.

On the other hand, from a longer term perspective, many structural reforms are conspicuous by their absence. Although some major changes have been implemented, including changes to the extremely costly state pension system, much remains to be done. A rigid and outdated system for the allocation of public expenditure, high tax rates, protectionism, a deficient educational system, a large deficit in the social security system and an inflexible labour market have severely constrained any prospects for faster growth. The extremely detailed provisions of Brazil's constitution have also played a part in this, greatly complicating the political decision-making process in the country and impeding structural reforms. Opportunities for change are also being hindered by relatively widespread corruption.

Rouseff has taken a heavy hand to reducing corruption, which has strengthened her legitimacy, but also made her enemies in the alliance forming the government's base. The most recent corruption scandal in the state-owned oil company Petrobras has however markedly damaged Rouseff's credibility and also impacted negatively on the economy..

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 past decade. However, it has become increasingly clear that the effects of the country's detailed government control and protectionist orientation are blocking growth. On the other hand, essentially all political camps rely heavily on market economy solutions, which makes politically induced economic collapses less likely.

Market orientation with strong government control

Brazil has experienced remarkable economic growth following the financial crises that hit the country in the late 1990s and early 2000s. Growth has been steady, the country's external debt has been substantially reduced, inflation has remained in single digits, the current account balance has been running a surplus and the public finance deficit has been reduced. The high commodity prices gave a strong boost to this positive economic growth, as commodities account for more than one-third of the country's exports.

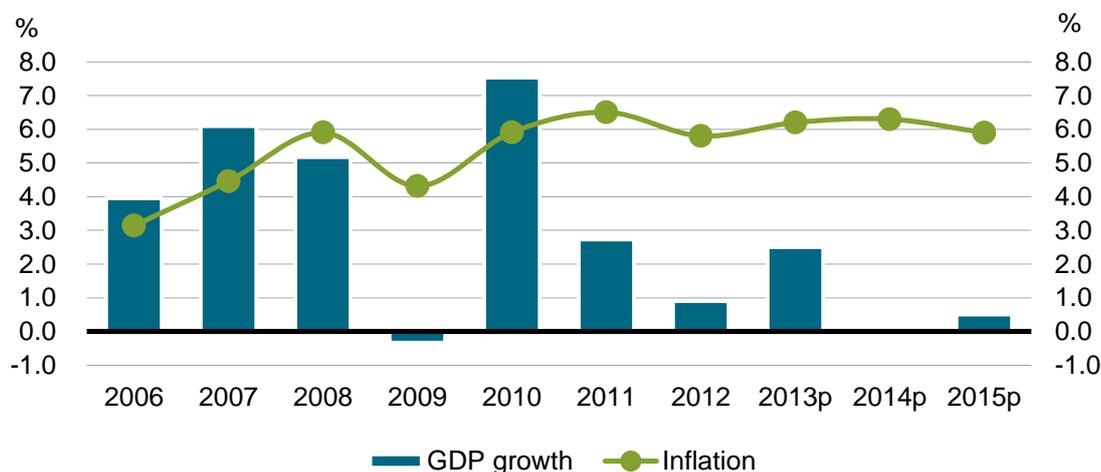
Brazil's economic base is relatively broad, and Brazil is competing internationally in heavy processing industries such as aerospace, chemicals and paper. Recently discovered (but

technically difficult to access) substantial oil reserves could make the country a major oil exporter following successful exploitation. However, the fact that oil prices are substantially lower at this time makes extracting this oil less profitable.

The negative economic trend of the past years has pinpointed two fundamental problems of the Brazilian economy – the excessively detailed level of government control and, in part as a consequence, the low level of investment (around 18-20% of GDP). Discontent with the government's policies is high in the Brazilian business community, and substantial structural reforms will be required to change this attitude. Certain steps in this direction have already been taken, but they are far from sufficient to get any traction with investments. Low investments have left Brazil in the dust in terms of productivity. This has reduced the country's international competitiveness and consequently increased its trade deficit. The reduction in demand from China and Argentina, which are key markets for Brazil, is another factor aggravating the deficit.

The country's inflexible labour market is also a factor blocking growth. A deficient legal system, and a complex and extensive regulatory system make all transactions expensive as well. The major income disparities in the country have also created a hotbed for high crime rates (the number of murders per 100,000 people is 25, in comparison to Mexico's 21 and Sweden's 1). In the long-term, this can get in the way of orderly economic growth. On the other hand, the welfare reforms implemented have enabled more people to benefit from the country's economic growth. This greatly improves the conditions 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 (SOURCE: IMF, EKN)



The Brazilian economy has fallen into a negative growth trend – low growth and the burden of inflationary pressure.

The Brazilian public sector has struggled with sizable deficits for a long time, although the situation has gradually improved since the turn of the millennium. However, the situation has once again deteriorated over the past years, partially reflecting the lower level of economic activity in the country. A substantial portion of the deficits originate from Brazil's states, which have a relative degree of autonomy from the federal government. The state governors were no strangers to outright populist tendencies, where payment problems were not unusual. However, the country's low administrative capacity and lack of fiscal discipline have improved thanks to the adoption of a law on fiscal responsibility around ten years ago.

The structural problems that have become increasingly pronounced in the Brazilian economy will weigh down economic growth in the future. The government must by all indications continue to pursue a policy of fiscal austerity to be able to cope with the public finance deficits – which the government is estimated to be highly likely to actually do. The government has also responded to the political and economic challenges of the recent period with reforms, including tax changes, budgetary commitments and infrastructure investments. The country's skilled hand in the use of various economic policy instruments is also a feature of the Brazilian administration. Brazil has previously proven to be relatively well-equipped to face economic downturns, and it is therefore highly likely that responsibility on overall economic policies will continue to be a hallmark of the country.

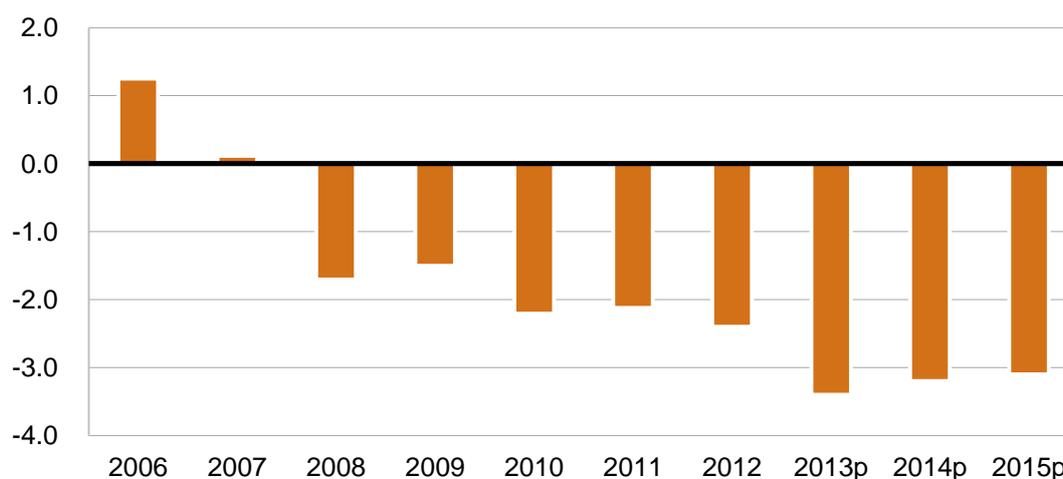
BALANCE OF PAYMENTS AND DEBT ISSUES

Less financially exposed

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

Brazil's sensitivity to fluctuations on the international financial markets is reduced by the fact that a very limited amount of the national debt has been accumulated via borrowings in foreign currency. The local capital market is both deep and liquid, which enabled it to finance the majority of the public finance deficits. The country's large international reserves serve as an additional financial buffer (currently equal to approximately 11 months of imports). The increase in the current account deficit is concerning, but it is likely that the depreciation of the exchange rate that

CURRENT ACCOUNT BALANCE (% OF GDP) (SOURCE: IMF)

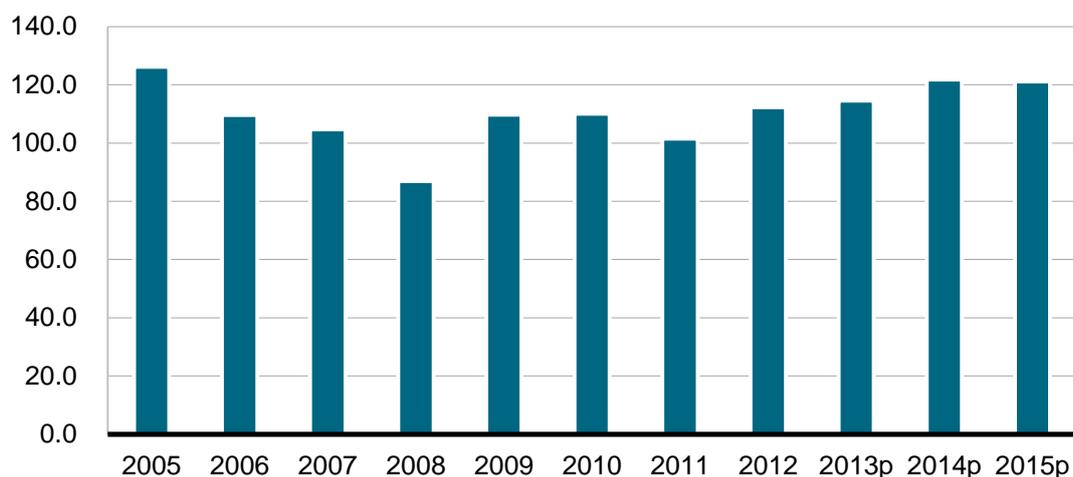


The current account balance deficit has increased but is counterbalanced for the most part by a massive influx of direct investment.

has occurred will reverse this trend. The experience of the 2009 global financial crisis also shows that the country now stands strong even in the face of financial headwinds.

Brazil has become an increasingly important player in the international financial community, and is starting to assume a political role which is more in line with the economic importance of the country. The Brazilian authorities are however keen on preserving the country's domestic industry, which has been expressed in the form of increased import restrictions and Brazil is beginning to approach to limits of the WTO standards. The country's increasing international political ambitions are thus not reflected in a more open trade policy.

EXTERNAL DEBT (% OF EXPORTS) (SOURCE: IMF)



Following a considerable decrease of Brazil's external debt in relation to exports over the past decade, it is now increasing again, partly as a result of an increase in the private sector indebtedness.

CURRENCY POLICY

Major currency fluctuations

Brazil has had a floating exchange rate for its currency (real/reais) since 1999, with an inflation target as the fixture of its monetary policy. This has created macroeconomic stability and the ability to adapt to external shocks. However, this adaptation has been complicated by the recent increase in inflation, in spite of low growth. The authorities have however not hesitated to adopt more restrictive monetary policy measures to reverse this trend, such as interest rate hikes.

The central bank intervenes on occasion to prevent too excessive, short-term exchange rate fluctuations. Similarly to many other minor currencies, the Brazilian currency dropped relatively sharply in value after the onset of the global financial crisis in 2008. But the exchange rate was restored to pre-crisis levels after a couple months.

A considerable inflow of capital in connection with the quantitative easing in the US a few years ago led to appreciation of the Brazilian currency. The announcement that this easing will be phased out in the future has reversed the trend of capital flows and the currency depreciated. This has given the country back some of its international competitiveness. This trend has been reinforced by the fact that the central bank has been less inclined to intervene over the past year, which is why exchange rate fluctuations have had a greater impact. The lack of informal dollarization has made it easier for the central bank to allow adjustments to occur via the exchange rate. This is also an expression of domestic confidence in the currency that was established firmly long ago. The currency can be assessed by EKN in transactions

financed in local currency. 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 heavily concentrated, with the five largest banks holding approximately 70% of the assets. The system is structurally dominated by two groups of institutions.

The first group consists of the state-owned banks, with Banco de Brasil at the forefront, where lending has often had political overtones. The proportion of bad loans has therefore been relatively high, and Banco do Brasil in particular has been forced to undergo multiple restructuring programmes which have led to improvements in its loan portfolio. Banco do Brasil, which is the largest bank in Latin America, is also undergoing a major international expansion and the state-owned banks have increased their share in recent years. These banks include the development bank BNDES. For all intents and purposes, it is an extension of the ministry of finance and grants loans with favourable terms for various types of investment. The second group consists of a dozen large, well-run commercial banks that completely set the tone in the private sector.

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

The Brazilian banking system must be generally considered relatively stable and developed. The system corresponds to over 130% of the country's GDP, which is above average for comparable countries. The banks finance themselves mostly locally, which is a strength. The proportion of bad loans has fallen to 3.1%. This level is expected to be maintained in the future, given that especially the private banks have now cleaned up their portfolios after a substantial increase in lending a couple years ago. However, the country's weak economic growth will likely have future repercussions for the banks. The banking system is also very well capitalised with sizable provisions for bad loans. In addition, government regulators have been very thorough in their supervision and have been strict to ensure the banks meet their regulatory requirements. The Brazilian authorities can be expected to provide support to large systemically important banks, but support for small or medium-sized banks is not likely.

BUSINESS ENVIRONMENT

Bureaucracy difficult to penetrate

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 low. Private ownership is respected and well-defined. State-owned companies previously dominated most sectors of the economy, but the 1980s and 1990s saw extensive privatisation and liberalisation. The governments of the past 10 years have however not continued these

privatisation policies. Instead, they have advocated a more active role for the government, such as via shared public and private ownership in various projects. The regulatory environment of Brazil must be considered relatively favourable, since the authorities are largely guided by technocratic aspects in their supervision instead of political aspects.

As a result of Brazil's floating currency, the financial position of companies is subject to rapid change, especially for companies with large borrowings in foreign currencies. Another distinctive feature of the Brazilian market is the fact that the Brazilian authorities sometimes have provisions on external financing that are not in harmony with the OECD's rules for export credit guarantees, such as with respect to the repayment of loans. Brazilian legislation also stipulates dividend requirements that deviate from international standards. Environmental licences are another problem, as they can be issued by one authority, only to be appealed later by another, which creates legal uncertainty. The badly-organised and convoluted tax system is another aggravating factor for the business sector, as is the deficient infrastructure. Moreover, the complicated legal system can make legal proceedings lengthy and expensive as well. As a result, the country appears relatively far down on the list of the World Bank's Doing Business Indicators – 116th out of 189 countries. On the other hand, Brazil does relatively well when it comes to economic transparency, control of corruption and rule of law. This is in particular manifested in the strong position of civil society, especially NGOs (non-governmental organisations), local organisations and social movements.

EKN'S EXPOSURE

High exposure, not always visible

EKN's guarantees totalled over SEK 3.8 billion, while offers amounted to nearly SEK 59.3 billion. The latter are largely for SAAB's transaction to export its Gripen aircraft.

The guarantees are mainly for exports of equipment to the Brazilian paper industry and telecom transactions. In addition, there is substantial exposure to Brazil attributed to the home country of the debtors, Spain. This was around SEK 3.5 billion.

OFFERS & GUARANTEES, SEK MILLION



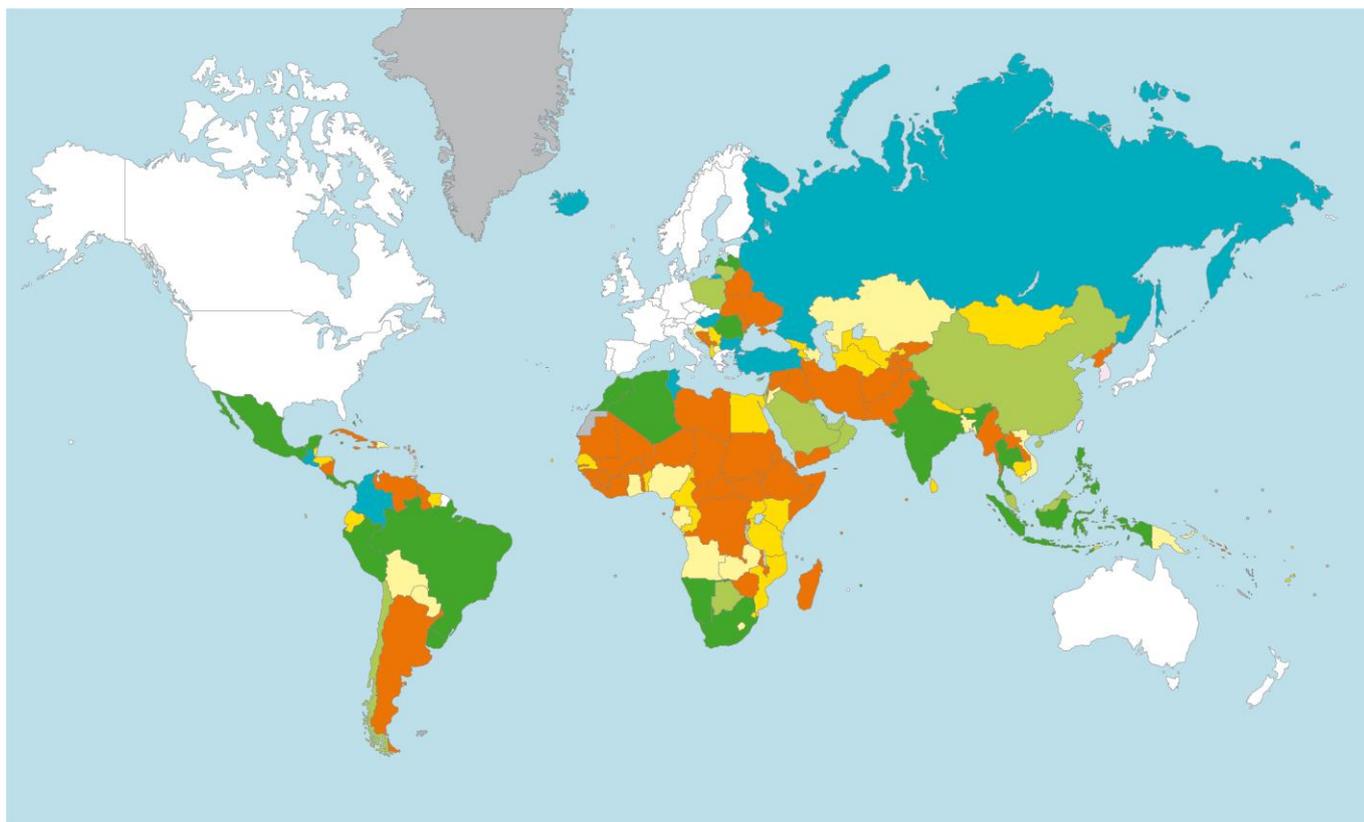
The volume of guarantees has increased in recent years, especially for transactions involving the paper industry.

Brazil meeting its obligations

EKN's payment experiences from Brazil are generally good. The debt problems that impacted the country during the 1980s were settled for the public creditors via Paris Club renegotiations. Brazil did an exemplary job in honouring this agreement. Subsequent Brazilian financial crises have not led to any payment defaults. Instead, they have been addressed through increased lending, primarily from multilateral institutions. The absence of financial crises over the past decade 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 delayed payments for smaller amounts – particularly in the textile sector recently. It has proven difficult to enforce these claims using the legal system, as the legal proceedings take an extraordinary amount of time. Consequently, the threat of pursuing a recovery process is not very deterrent to debtors, as they are well aware of the lengthy proceedings. EKN also has poor experiences using retention of title as security, as they seem to be difficult to enforce legally if the buyer opposes the sale of the goods. The tangled bureaucracy, as well as frequent changes to regulations and restrictions serve to further complicate business transactions in Brazil.

COUNTRY DATA	CREDIT RATINGS
Area: 8,547,404 km ² (19 times Sweden)	Moody's: Baa2/Baa1
Population: 203 million (Sweden 9.7 million)	S&P: BBB-/BBB+
GDP: USD 2,910 billion (Sweden USD 552 billion)	Fitch: BBB+/BBB
GDP/capita: USD 12,100 (Sweden USD 40,900)	



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 a government agency that supports Swedish exports and the internationalisation of Swedish industry. This we do by offering exporting companies and banks guarantees for payment and financing, together with advice on business structure and risk management.

Our services provide an extra level of confidence, increased competitiveness and more opportunities for successful export transactions.

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