

Brazil

	<p>COUNTRY RISK CATEGORY</p> <p>4/7</p> <p>The country risk categories range from 0 to 7. The lower the number the better the credit rating the country has.</p> 	<p>EKN'S OUTSTANDING GUARANTEES TO THE COUNTRY</p> <p>SHORT-TERM TRANSACTIONS: SEK 12 MILLION</p> <p>MEDIUM AND LONG-TERM TRANSACTIONS: SEK 54,157 MILLION</p>
	<p>DATE</p> <p>07/04/2016</p>	

Economic setback

Brazil's economic growth has come to a halt in recent years. Growth will be negative this year and, at best, slightly positive next year. The fundamental problems are low levels of investment, excessive government control, a growing public sector, and inefficient tax system and deficient infrastructure. These problems have become more pronounced since the deflation of the commodities boom, which was previously propping up growth. The necessary adjustments are still conspicuous by their absence.

On top of that, there is a major corruption scandal involving state oil company Petrobras, which is significantly impeding investment activity in the country. Brazil's economic outlook is further complicated by the low level of confidence in the political leadership. On the other hand, it is a strength for Brazil that the country's legal system is getting to grips with the corruption problems. The coming years will be difficult economically, while the country's efforts to establish good relations with multilateral organisations and the international financial markets signal orderly development.

THE COUNTRY'S STRENGTHS AND WEAKNESSES

Strengths

- Diversified economy
- Fundamental market orientation
- Sound and well-regulated banking sector

Weaknesses

- Large and inefficient public sector
- Too far-reaching government control and overly complicated constitution
- Deficient infrastructure and educational system

Country risk categorisation downgraded

In line with the rest of the OECD, EKN decided to downgrade Brazil from country risk category 3 to 4 in November 2015. The downgrade was based on the gradual weakening of the country's economy, greater economic imbalances and the fact that no end to this trend is in sight. There are no special restrictions on transactions with the private sector. As a result, transactions are assessed on their own merits without any special requirements or conditions. The policy for transactions with the public sector is restrictive to a certain extent.

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 interventionism from the government – government intervention in various markets

EKN'S EXPOSURE AND EXPERIENCE

JAS Gripen dominant

EKN's outstanding guarantees total SEK 54.2 billion and consist largely of an export transaction for JAS Gripen. The other guarantees are divided between several industries, but the paper sector is dominant. In 2015, EKN guaranteed 48 new transactions in Brazil worth SEK 50.7 billion.

EKN's experience in guaranteeing transactions with Brazil has been good. There have been some commercial delays and minor cases of claims adjustment in the private sector. There are also problems concerning some transactions related to the public sector. The total amount of these claims is SEK 45 million.

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Background

The financial crisis in the early 2000s was followed by a long period of very sound economic performance for Brazil, with relatively solid growth, limited inflation and balanced public finances. Various welfare programmes also ensured that this growth reached the broad population. The economic progress was largely based on the favourable trends for international commodity prices. The commodity price decline in recent years has therefore had a major impact on the Brazilian economy and the country is now in a deep recession. This has also been exacerbated by the government's unwillingness to make the necessary adjustments.

Rigid system

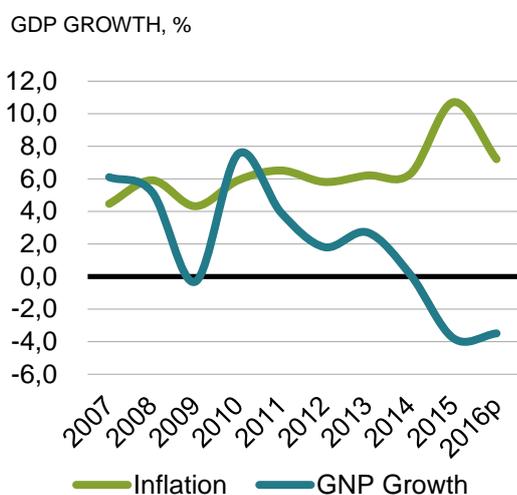
Many structural reforms are conspicuous by their absence. Although some major changes have been implemented, including changes to the extremely costly state pension system, much remains to be done. A rigid and outdated system for the allocation of public spending, high tax rates, protectionism, a deficient 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 hampered by relatively widespread corruption. On the other hand, the combination of a market economy with social overtones and responsible economic policies laid the foundation for the country's successful growth over the past decade. However, this growth model has hit a ceiling as it has become increasingly clear that the effects of the country's detailed government control and protectionist orientation are blocking growth.

Most recent trends

The economic trend over the past years has been weak. The Brazilian economy was at a standstill in 2014 and experienced negative growth in 2015 and 2016. Deterioration in external conditions and the lack of adjustments have sent the country into the recession it is currently facing. In addition, the enormous corruption scandal involving state oil company Petrobras has impeded government investments and could also have repercussions at the highest political levels. However, the fact that the legal system is getting to grips with the

corruption problems is a factor of strength for the country.

On the other hand, sitting president Dilma Rouseff is experiencing a substantial crisis of confidence. Her popularity has fallen to historically low levels as economic performance has worsened. In addition, she is being threatened with impeachment, accusations that Rouseff allegedly used money from state banks to cover holes in the national budget in the run-up to the 2014 election campaign and that she allegedly did the same thing in 2015. The austerity measures the government has announced are



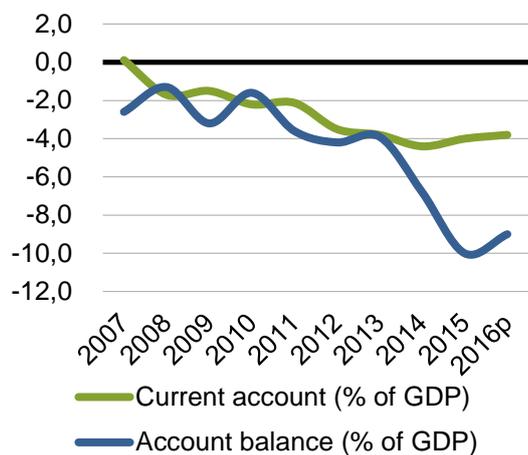
Growth on the decline and inflation on the rise. Source: IMF WEO

difficult to get through the parliament, especially in consideration of the low level of confidence in President Rouseff.

Long-term trends

Brazil faces a difficult period, both politically and economically. The exceptionally low

BUDGET AND CURRENT ACCOUNT BALANCE, % OF GDP



Higher external and internal deficits.

Source IMF, EKN

confidence in President Rouseff and the looming impeachment are preventing the adjustment of public finances required to start the process of economic recovery. The fundamental problem lies in the generous social insurance system and the social security payments to states and municipalities – all set out and earmarked in the constitution. These problems were less apparent during a period of high commodity prices and high government revenue

. Attempting to deal with this imbalance by raising taxes, as has been the case so far, is not sustainable in the long term – the Brazilian tax burden is already one of the highest in the world. Structural reforms are therefore necessary, but difficult to

implement, given the parliament's distrust of the government. In addition, reforms generally require constitutional amendments. It appears highly likely that there will be a very long and protracted political process in which it will take time to make the necessary economic decisions.

BUSINESS ENVIRONMENT

Bureaucracy difficult to penetrate

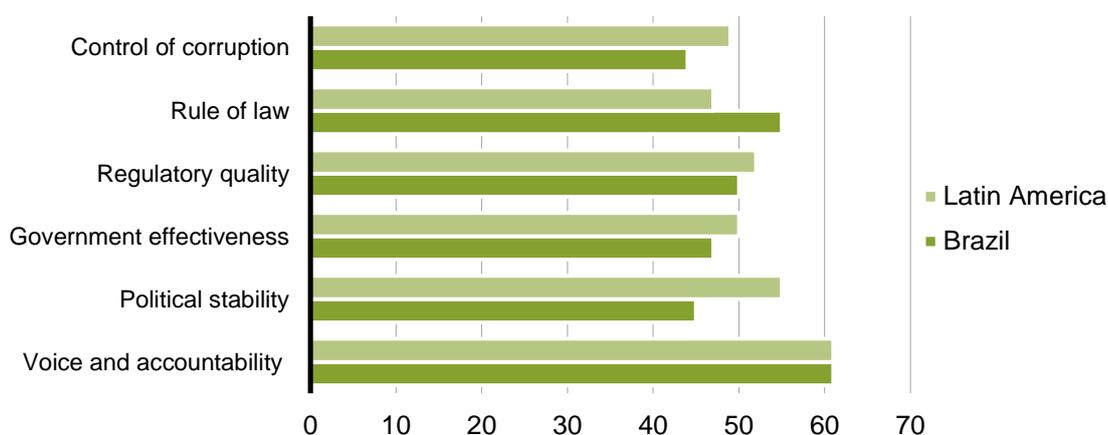
Access to financial information is generally good in Brazil. Imports on open credit terms are frequent and EKN's experience is generally good. The demand for letters of credit is low. Private ownership is respected and well-defined. State-owned companies previously dominated most sectors of the economy, but the 1980s and 1990s saw extensive privatisation and liberalisation. The governments of the past ten 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 largely rely on economic guidance from technocratic as opposed to political sources for their supervision.

As a consequence of Brazil's floating currency, the financial position of companies is subject to change quickly, especially companies with substantial foreign currency debt. Another distinctive feature of the Brazilian market is that the Brazilian authorities sometimes have external financing regulations 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 – no. 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.

BUSINESS ENVIRONMENT

Ranking from 0 (worst) to 100 (best)



The Brazilian business environment is slightly worse than the regional average. Source: World Bank 2015

The Brazilian banking system must be generally considered stable and developed. The system corresponds to over 130 per cent 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 per cent. However, the country's weak economic growth is likely to 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 strictly ensured that banks comply with the 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.