Country Report Brazil

Recession bottoming out soon

General Information

GDP	USD2346.118bn (World ranking 7, World Bank 2014)
Population	202.03mn (World ranking 5, World Bank 2014)
Form of state	Federal Republic
Head of government	Michel TEMER (Acting President since May 2016)
Next elections	2018, presidential and legislative

Strengths

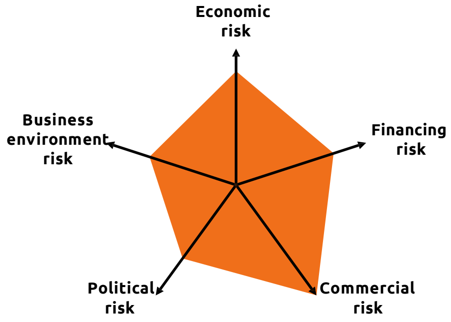
- Overall size of the economy
- Large domestic market and expanding middle class
- Diversified economic base (minerals, agriculture, manufacturing sector)
- Robust foreign direct investment, high level of foreign exchange reserves, moderate external debt
- Established political system with effective democratic transfers of power

Weaknesses

- Insufficient domestic investment and infrastructure bottlenecks
- Vulnerable to global commodity demand and prices
- Lack of qualified workforce and high production costs
- High taxation and bureaucracy undermine competitiveness
- Social tensions, persistent insecurity, allegations of corruption and inequalities of income distribution

Country Rating

C3



Source: EulerHermes

Trade Structure

By destination / origin (% of total)

Exports		Rank		Imports
China	19%	1	18%	China
United States	12%	2	15%	United States
Argentina	6%	3	6%	Argentina
Germany	4%	4	6%	Germany
Japan	3%	5	4%	Nigeria

By product (% of total)

Exports		Rank		Imports
Edible Agri Prod	15%	1	8%	Refined Petroleum
Iron Ores	12%	2	6%	Crude Oil
Crude Oil	9%	3	5%	Fertilizers
Meat	6%	4	4%	Engines
Sugar	5%	5	4%	Basic Organic

Source: Chelem, UNCTAD (2013)

ECONOMIC REPORT
solunion
by Euler Hermes Economic Research

Economic Overview

Recession continues while inflation decreases

Brazil recorded in 2015 the worst economic recession in 25 years. Real GDP contracted by -3.9%, after stagnating in 2014 (+0.1%). investment plunged by -14% y/y, down to 2009 level. Although the fall is slowing down with -9.2% y/y in Q2 2016 after -17.2% y/y in the previous quarter, investment remains the main drag on growth.

Financing conditions have tightened, with companies bearing the brunt. National credit outstanding for non-financial corporations has decreased by -3.4% y/y in July 2016, after a +10% average rise in 2014 and +15% in 2013. At the same time, banking interest rates have shot up. These now stand at above 20% on average for companies.

Rates for non-earmarked resources are above 30% while earmarked resources stand at 12%. Companies struggle to repay loans. Non-performing loans have risen to 5.2% of the total credit for non-earmarked non-financial companies in July 2016 up from 4.5% in January 2016.

The contraction in private consumption slowed down in Q2 2016: -4.9% y/y after -6.3% y/y in Q1 2016 and -6.9% y/y in Q4 2015. The labor market keeps deteriorating, with the unemployment rate reaching 11.6% in July 2016 after 8.6% a year earlier.

Inflation has eased somewhat, but remains high at +8.7 y/y % in July 2016, a rate still far above the Central bank's target (4.5% +/- 1pp). The key rate (SELIC) been hiked by +300bps between October 2014 and July 2015. It stands at 14.25% ever since. However, because inflation abated, the local currency faces less pressure. With budgetary austerity measures in place, monetary policy could ease in coming months.

In 2015, net exports contributed positively to growth on the back of a moderate growth in exports (+6%), and collapsing imports, which plunged -14% y/y. Over the first half of 2016, this trend remained. Exports kept growing: +8.5% in Q1 2016 (y/y) and +4.2% in Q2 2016 (y/y). Imports remained on a decreasing trend with -23.2% in Q1 2016 and -10.6% in Q2 2016.

The recession is forecast to continue easing over the coming quarters. The Brazilian economy should go back to positive growth in the first quarter of 2017. All in all, we expect real GDP to contract by -3.5% in 2016, and to resume moderate growth in 2017 (+0.6%). Corporate insolvencies will continue their sharp rise: +22% in 2016 after +25% in 2015.

Public finances in rapid deterioration

After more than 6 months of political turmoil, the Brazilian Senate removed Dilma Rousseff from the presidency in late August. We do not expect new elections to take place anytime soon. Interim President Michel Temer, who took the office in May 2016, should thus complete his term as president and remain in the position 2018. This is despite lackluster approval ratings - below 15%.

The country's fiscal accounts deteriorated sharply in 2015. Public deficit widened to -10.3% of GDP, up from -6.0% in 2014 and -3% in 2013. This decline can be traced back to a spike in payment of interests on public debt, which reached 8.5% of GDP in 2015 (vs. 5.5% in 2014).

The primary fiscal balance was in deficit in 2014

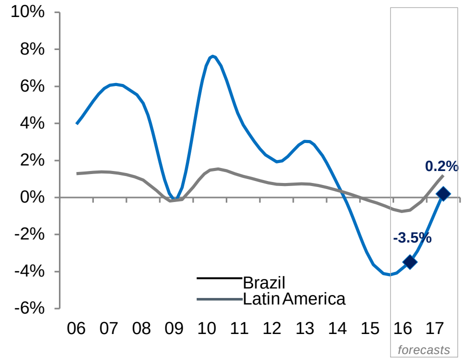
Key economic forecasts

	2014	2015	2016	2017
GDP growth (% change)	0.1	-3.9	-3.5	0.6
Inflation (%, yearly average)	6.3	9.0	8.7	5.8
Fiscal balance* (% of GDP)	-6.0	-10.3	-10.0	-9.0
Public debt* (% of GDP)	63.3	73.7	86.7	95.7
Current account (% of GDP)	-4.3	-3.3	-1.2	-1.8
External debt (% of GDP)	14.6	19.8	20.6	21.4

**Includes Local Government; Nonfinancial Public Corporation; Social Security Funds; State Government*

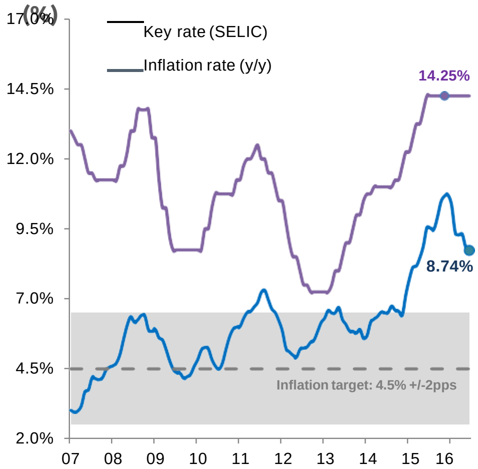
Sources: National sources, IHS, Euler Hermes

GDP growth (%)



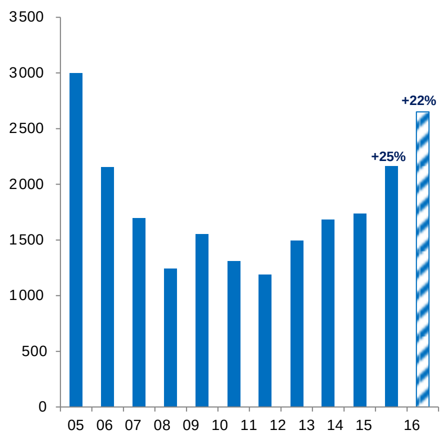
Sources: National sources, IHS, Euler Hermes

Inflation rate and Monetary policy rate (%)



Sources: National sources, IHS, Euler Hermes

Insolvencies



Sources: National sources, IHS, Euler Hermes

(-0.6%), the first in the country's history. It widened to -2% of GDP in 2015. We expect it to near -10%
of GDP in 2016. The situation might improve a bit in 2017 thanks to better financing conditions that should help roll the public debt and the implementation of austerity measures. However, public debt is expected to remain on an upward trend, exceeding 95% in 2017.

The government presented to the Congress a constitutional amendment project in May 2016. It seeks to set a spending ceiling by limiting growth in primary spending to the inflation rate, reduce mandatory health and education spending, cut subsidies and tax breaks, and increase some taxes for some time. The program is still under discussion.

In early September, the government unveiled a new austerity package. The measures, which amount to USD17bn, include a freeze on new hires and wages in the public sector, a cut in the number of ministries, and reduced spending on social housing and health. Moreover, a privatization program was launched, It is focused on the oil sector, power rights, and infrastructure concessions.

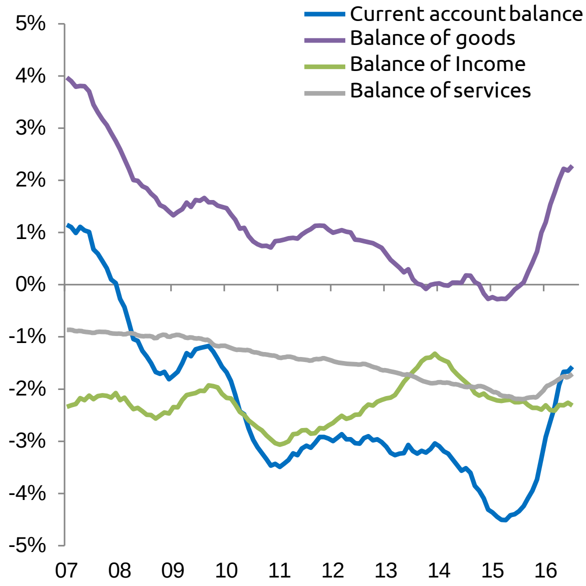
External imbalances are adjusting rapidly

The absorption of external imbalances has been impressive. The merchandise balance (of goods) reached in July a surplus of USD40.5bn over 12 months, a record since 2007. This is owed to the free fall in nominal imports (-30% since the last peak in Jan-14). As a result, the current account deficit has fallen to -1.6% of GDP in June, down from -4.5% a year ago.

Despite a downturn over the last months, strong FDI inflows have remained above USD60bn, enough to cover the entire current account deficit. However, net portfolio inflows tumbled since the beginning of the year and are now in negative territory. A similar fate befell other investment inflows since Q3-2015. Foreign exchange reserves remain at comfortable levels, and can cover more than 15 months of imports.

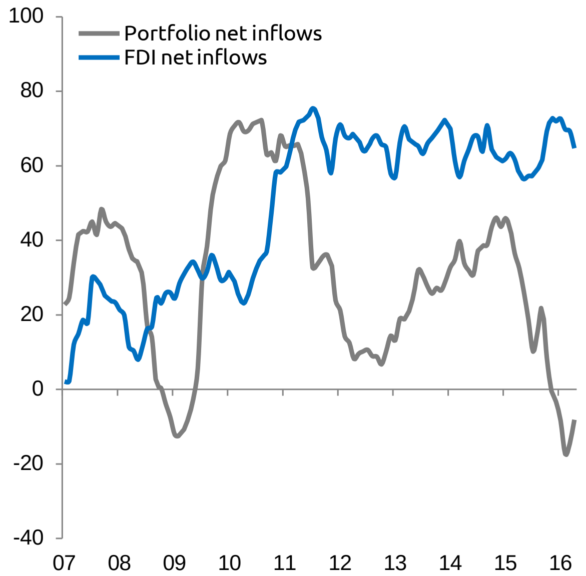
Investors' appetite seems to be recovering. After depreciating by more than -40% against the USD over 2015, the BRL has rallied since the beginning of the year (+11%). The stock market has been bullish with BOVESPA rising by more than +30%. Moreover, Brazil issued sovereign bonds worth USD1.5bn with a 2047 maturing date. The offer was a success. Order books reached USD6bn, and the offer was more than 4 times oversubscribed.

Current account balance breakdown (over 12 months, % of GDP)



Sources: National sources, IHS, Euler Hermes

Foreign investment inflows (USD bn, over 12 months)



Sources: National sources, IHS, Euler Hermes

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