

Country Report

Brazil

Unwinding the imbalances



General Information

GDP	USD1,774.725bn (World ranking 9, World Bank 2015)
Population	207.848mn (World ranking 5, World Bank 2015)
Form of state	Presidential republic
Head of government	Michel Temer (center), since 2016
Next elections	Presidential and legislative 2018 (4-year term)



Strengths

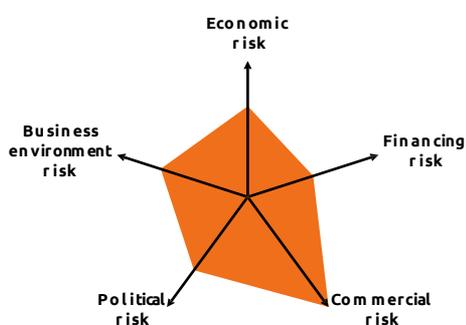
- International economic power
- Diversified economy
- Robust foreign direct investment, high level of foreign exchange reserves and moderate external debt
- Expanding middle class

Weaknesses

- Vulnerable to global commodity prices
- High production costs
- High taxation and red tape
- Persistent inflation and large fiscal deficits
- Political and social tensions, corruption and income inequality

Country Rating

B3



Source: EulerHermes

Trade Structure

By destination/origin (% of total)

Exports	Rank	Imports
China	19% 1	18% China
United States	13% 2	16% United States
Argentina	7% 3	6% Germany
Netherlands	5% 4	6% Argentina
Germany	3% 5	3% South Korea

By product (% of total)

Exports	Rank	Imports
Beans and seeds	11% 1	15% Mineral fuels
Ores	9% 2	14% Industrial machinery
Mineral fuels	7% 3	12% Electrical machinery
Meat	7% 4	8% Vehicles
Industrial machinery	6% 5	5% Organic chemicals

Source: Comtrade(2015)

Economic Overview

The hangover

Brazil has not yet emerged from a two-year long recession, the worst on record. Optimism about a vigorous rebound in production is taking an increasingly dim view. Investment plunged by -10.3% and has been the worst performing component in 2016. Private and public consumption decreased by -4.3% and -0.6% respectively. Imports contracted -10.4% while exports expanded by +1.6%.

However, the fall in real GDP moderated and confidence and production indicators that hit rock bottom early in 2016 are now gradually bottoming out. Both private consumption and investment are estimated to become the engines of growth in 2017 and push the economy back into positive territory.

Relax

In what can be seen as a promising turning point, the Central Bank cut its key policy interest rate for the first time in four years, no longer running counter to the current recessive environment. *Banco Central do Brasil* lowered its key policy interest rate by 200bps to 12.25% from 2016. The easing cycle is expected to be extended with additional cuts throughout 2017 to fuel growth in the battered economy.

The rapid fall in consumer prices enabled the Central Bank's move. Headline inflation moderated to +8.8% in 2016 on average, down from a peak of +10.7% y/y recorded in December 2015. Inflation continued its downward trend in February with +4.7%. This brought inflation back into the Central Bank's 4% +/-1pp target range for the second consecutive month.

The hidden face of debt

Businesses and households have accumulated debt below other emerging economies, 43.9% and 22.9% in contrast to 36.6% and 105.9% of GDP in Q3 2016, respectively. Meanwhile, public debt continued the rally initiated two years ago and escalated to 74.2% of GDP, compared to 47.5% of GDP on average for emerging economies.

However, it is crucial to put into context the sustainability of Brazil's public debt. Among emerging economies, the country is one of the best when it comes to reserve adequacy. This allows Brazil to hold the current level of indebtedness. In the case of a negative tail risk event, reserve adequacy covered 231% of the country's needs in 2016, both on the debt sustainability and liquidity sides.

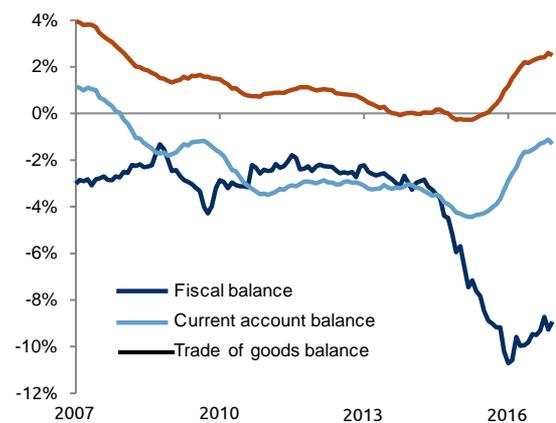
The fiscal balance could prompt a deficit of -9.2% of GDP in 2016. Accounting for interest debt payments, Brazil is expected to have the second largest deficit in the region. In order to contain public finances loss making, the lower house recently passed a proposal to limit the real increase of government spending to zero for the next twenty years.

Key economic forecasts

	2015	2016e	2017f	2018f
GDP (real,%)	-3.8	-3.5	0.6	1.9
Inflation (average-of-period,%)	9.0	8.8	5.1	4.8
Inflation (end-of-period,%)	10.7	6.7	4.5	4.6
Fiscal balance (% of GDP)	-10.3	-9.2	-8.5	-7.5
Public debt (% of GDP)	73.7	75.3	80.2	82.9
Foreign debt (% of GDP)	19.9	19.3	17.6	17.6
Current account (% of GDP)	-3.3	-1.1	-1.3	-1.5

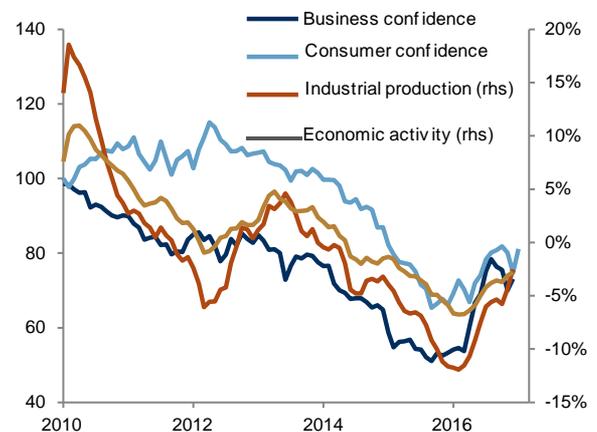
Sources: IMF, EulerHermes

External and government balances (% of GDP)



Sources: IHS, EulerHermes

Confidence and production indicators (y/y, 3m ma)



Sources: CNI, FGV, IBGE, BCB, EulerHermes

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