

Brazil's Sovereign Ratings: Investment Grade

**Lisa M. Schineller
Director, Sovereign Ratings
Standard & Poor's**

Brazil's Emerging Economic Power: Now Investment Grade and Why It Matters

WILSON CENTER on the Hill

Woodrow Wilson International Center for Scholars

Brazil Institute

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Agenda

- **What are sovereign credit ratings?**
- **Brazil's rise to investment grade**
- **Country risk versus sovereign risk**
- **Sovereign ratings methodology**
- **Brazil and its peers**
- **Global & Regional Economic Backdrop**

What are S&P sovereign credit ratings?

S&P's sovereign ratings are

- Our assessment of the government's ability, willingness to service its debt on time, in full
- A globally comparable, forward-looking estimate of default probability
- We focus on medium-term fundamentals -- through growth, interest-rate, commodity, political cycles

S&P's sovereign ratings are not

- *Country* risk ratings or country *investment* rankings
- Not a recommendation to buy or sell a security, or a prediction of the volatility of a security

Global Scale x National Scale Ratings

<i>Global Scale</i>	Investment grade	AAA ... BBB-
	Speculative grade	BB+ ... SD

Local currency, foreign currency debt, +/- in each rating category, rating outlooks

National Scale

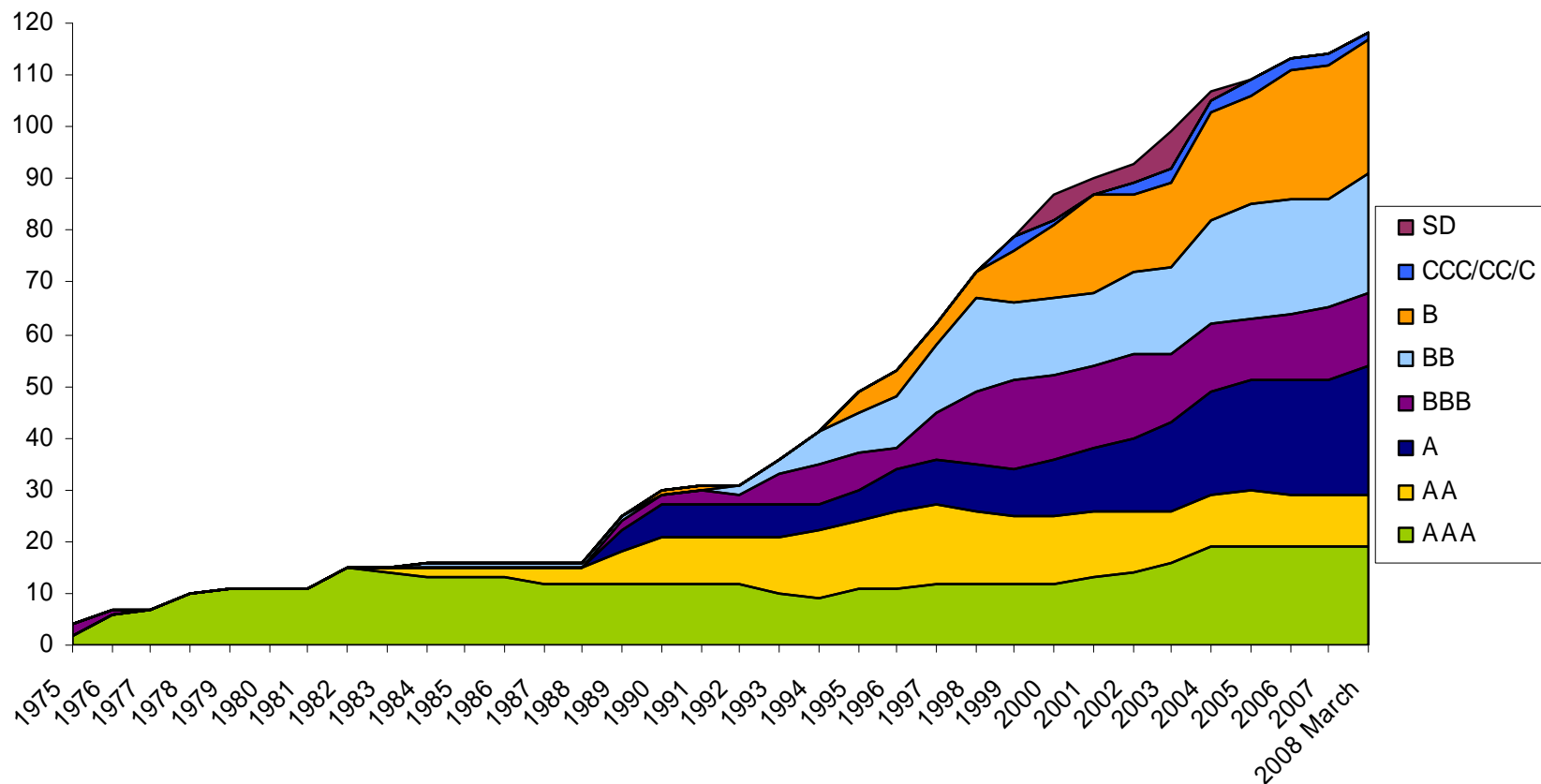
- Brazil br+Rating
- Mexico mx+Rating
- Russia ru+Rating

Note: National Scales not comparable among themselves or to the Global Scale

S&P Sovereign Credit Ratings

- **119 rated sovereigns worldwide**
- **25 rated sovereigns in Latin America & the Caribbean**
- **Ratings are a measure of governments' *relative* credit standing vs. each other & other issuers globally**

Number & Distribution of Ratings: Sovereigns 1975-2008



Sovereign Ratings: Latin America & Caribbean (June 2008)

- Aruba *A-/A-*
- Chile *A+/AA*
- Bahamas *A-*
- **Trinidad & Tobago *A-/A+***
- Barbados *BBB+/A-*
- Mexico *BBB+/A+*
- Montserrat *BBB-*
- **Brazil *BBB-/BBB+***

- Colombia *BB+/BBB+*
- El Salvador *BB+*
- Panama *BB+*
- **Peru *BB+/BBB-***

- Costa Rica *BB/BB+*
- **Guatemala *BB/BB+***
- Venezuela *BB-*
- **Uruguay *B+***
- **Argentina *B+***
- **Dominican Republic *B+***
- Suriname *B+/BB-*
- Belize *B*
- Jamaica *B*
- Paraguay *B*
- Grenada *B-*
- Bolivia *B-*
- Ecuador *B-*

Outlook: Stable, Positive, Negative

Rating: Foreign Currency / Local currency

Brazil's credit profile

- **Eight consecutive positive rating actions beginning May 2003**
- **Pragmatic policy commitment**
- **Decline in fiscal and external vulnerabilities**
- **Stronger outlook for economic growth**
- **Transformation underway in local capital markets**

Brazil's Sovereign Ratings History

	<i>Local currency</i>	<i>Foreign currency</i>
30 April, 2008	BBB+/Stable/A-2	BBB-/Stable/A-3
16 May, 2007	BBB/Positive/A-3	BB+/Positive/B
22 Nov., 2006	BB+/Positive/B	BB/Positive/B
28 Feb., 2006	BB+/Stable/B	BB/Stable/B
8 Nov., 2005	BB/Positive/B	BB-/Positive/B
17 Sep., 2004	BB/Stable/B	BB-/Stable/B
11 Dec., 2003	BB/Stable/B	B+/Positive/B
29 April, 2003	BB/Stable/B	B+/Stable/B
2 July, 2002	BB/Negative/B	B+/Negative/B
9 Aug., 2001	BB+/Negative/B	BB-/Negative/B
3 Jan., 2001	BB+/Stable/B	BB-/Stable/B

Most recent ratings actions

- **May 16, 2007, Brazil's foreign and local currency sovereign credit ratings upgraded:**

- Foreign currency by one notch to 'BB+' from 'BB'
- Local currency by two notches to 'BBB' from 'BB+

...and maintained the positive outlook on the long-term ratings

- **Reaffirmed December 21, 2007 following the defeat of the CPMF**

- **April 30, 2008, Brazil's foreign currency rating upgraded to BBB- & local currency rating to BBB+ ; outlook revised to stable**

Prospects for Investment Grade

- **Achieving, and maintaining, investment grade depends on the government's policy stance and commitment and upon the performance of various economic indicators**
- **Only 14 sovereigns (of 119 total) have moved from BB+ to BBB-**
 - Mexico
 - Brazil
- **Nine sovereigns were downgraded from investment grade to speculative grade**
 - Colombia
 - Uruguay

Prospects for Investment Grade

- **Since 1975, on average one in five sovereigns in the ‘BB’ category had its ratings raised to investment grade within a five-year period**
 - Mexico 7 years
 - South Africa 6 years
 - India 16 years
 - Brazil 4 years

Country Risk vs. Sovereign Risk

- Sovereign risk refers to the government's credit risk
- Country risk refers to the risks of doing business in a country, directly and indirectly related to government policies
- Some industries are more affected by country risk than others
- Banks, regulated utilities are good examples of ones most exposed; export-oriented companies least exposed
- There is no “sovereign ceiling” at S&P
- S&P rates companies higher than the sovereign based on their demonstration of fundamental credit characteristics, that are sheltered from country risk factors, and when they are likely to keep servicing debt if/when the government defaults

Other Rating Actions April 30

	<i>Local Currency</i>	<i>Foreign Currency</i>
➤ Petróleo Brasileiro S.A. – Petrobras	‘BBB-/CW Positive/--’	‘BBB-/CW Positive/--’
➤ BNDES	‘BBB+/Stable/--’	‘BBB-/Stable/--’
➤ Banco do Nordeste do Brasil	‘BBB-/Stable/A-3’	‘BBB-/Stable/A-3’
➤ Eletrobras-Centrals Eletricas Brasileiras S.A	‘BBB+/Stable/--’	‘BBB-/Stable/--’
➤ Banco do Brasil	‘BBB-/Stable/A-3’	‘BBB-/Stable/A-3’
➤ Banco Santander Banespa S.A.	‘BBB-/Stable/A-3’	‘BBB-/Stable/A-3’
➤ HSBC Bank Brasil S.A.	‘BBB-/Stable/A-3’	‘BBB-/Stable/A-3’
➤ Unibanco SA	‘BBB-/Stable/A-3’	‘BBB-/Stable/A-3’
➤ Itaú	‘BBB/stable/A-3’	‘BBB/stable/A-3’
➤ Itaú BBA	‘BBB/Stable/A-3’	‘BBB/Stable/A-3’
➤ Bradesco	‘BBB/stable/A-3’	‘BBB/stable/A-3’

Ratings Above the Sovereign (June 2008)

Local Currency

Foreign Currency

Corporates

➤ Ambev	‘BBB/Stable/--’	‘BBB/Stable/--’
➤ Aracruz	‘BBB/Stable/--’	‘BBB/Stable/--’
➤ Companhia Vale do Rio Doce	‘BBB/CW Pos./--’	‘BBB/CW Pos./--’
➤ Petrobras	‘BBB/Stable/--’	‘BBB/Stable/--’
➤ VCP	‘BBB/Stable/--’	‘BBB/Stable/--’
➤ Votorantim Participações S.A.	‘BBB/Stable/--’	‘BBB/Stable/--’

Banks

➤ Itaú	‘BBB/stable/A-3’	‘BBB/stable/A-3’
➤ Itaú BBA	‘BBB/Stable/A-3’	‘BBB/Stable/A-3’
➤ Bradesco	‘BBB/stable/A-3’	‘BBB/stable/A-3’

How does Brazil compare with other Sovereigns?

- Brazil **BBB-/BBB+**
- **Russia BBB+/A-**
- India **BBB-/BBB-**
- **China A/A**
- Mexico **BBB+/A+**
- **South Africa BBB+/A+**
- **Peru BB+/BBB-**

Outlook: Stable, Positive, Negative

Brazil: Sovereign credit ratings

Supports

- **A consistent macroeconomic framework and track record of policy continuity through political transitions;**
- **Net external debt less than 10% of current account receipts**
- **Profile of government debt becoming in line with investment grade credits.**

Constraints:

- **Large net general government debt and interest burdens;**
- **Budgetary inflexibility amid high current spending; and**
- **Structural impediments that limit investment and growth compared with other emerging market economies.**

Sovereign Ratings Methodology

Approach is quantitative *and qualitative*

- **Political Risk**
- **Economic Structure & Growth Prospects**
- **Fiscal Policy/Stability**
- **Monetary Stability**
- **External**
 - **Liquidity**
 - **Public & Private Sector Debt Burdens**

Political Stability

- Do political institutions enhance ability and willingness to pay debt?
- Policy predictability and consensus through political transition?
- What are prospects for prudent policy to support investment, growth, trade, and fiscal improvement?
- In Brazil, politically difficult *ideal* policy reform agenda

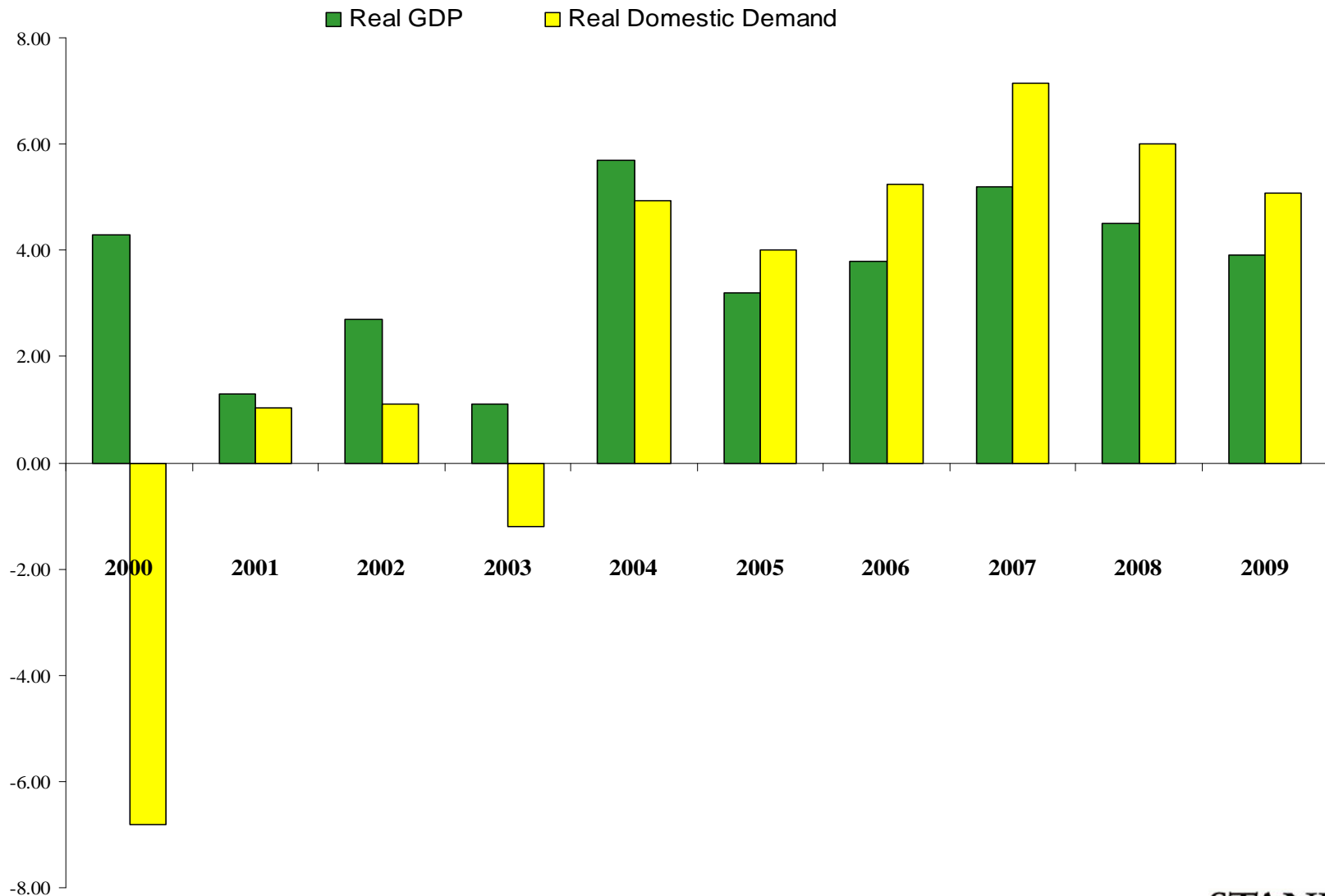
Growth Structure & Prospects

- **“Trend” or “medium-term” growth prospects, versus one year of growth**

- **Is the economy?**
 - Diversified, competitive, trade-oriented
 - Strength of the private sector
 - Depth of local capital markets

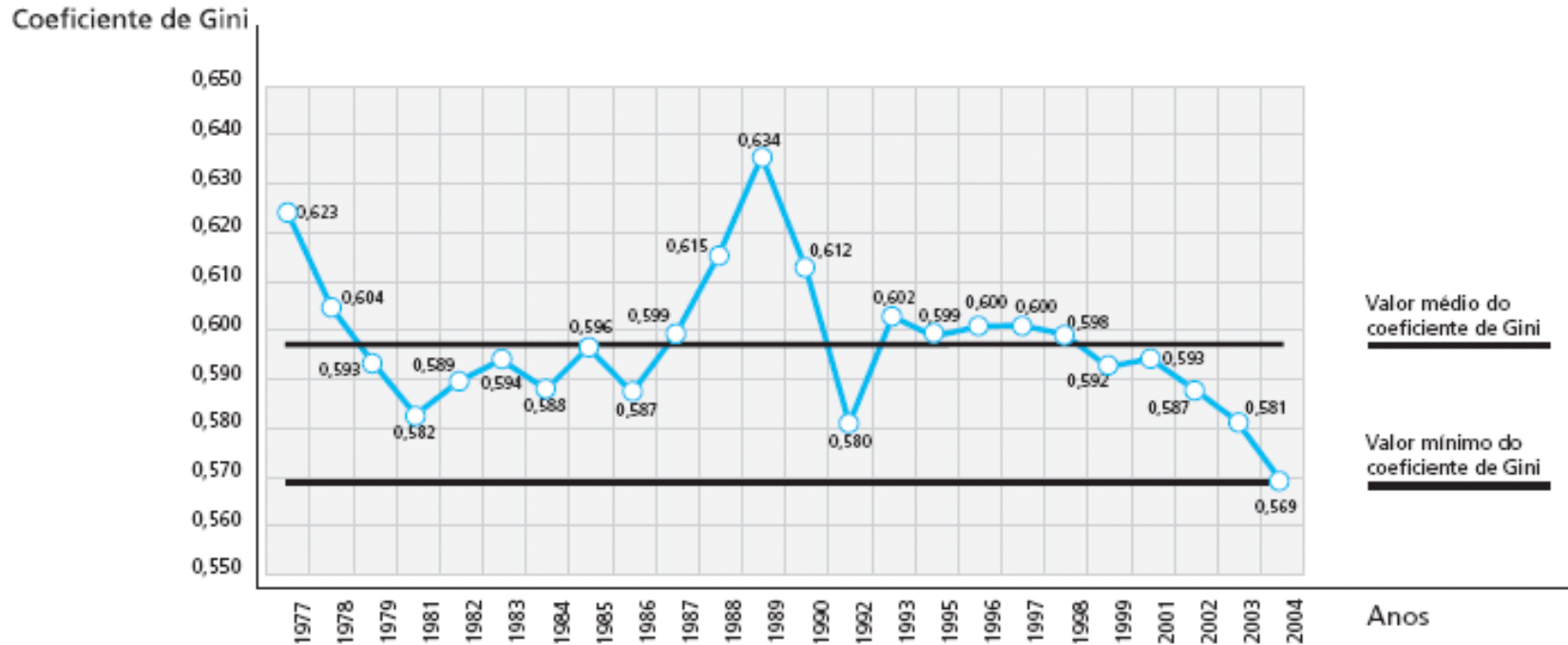
- **Is the investment climate stable with supportive macroeconomic and microeconomic policies ?**

Domestic Demand and Real GDP Growth (% change)



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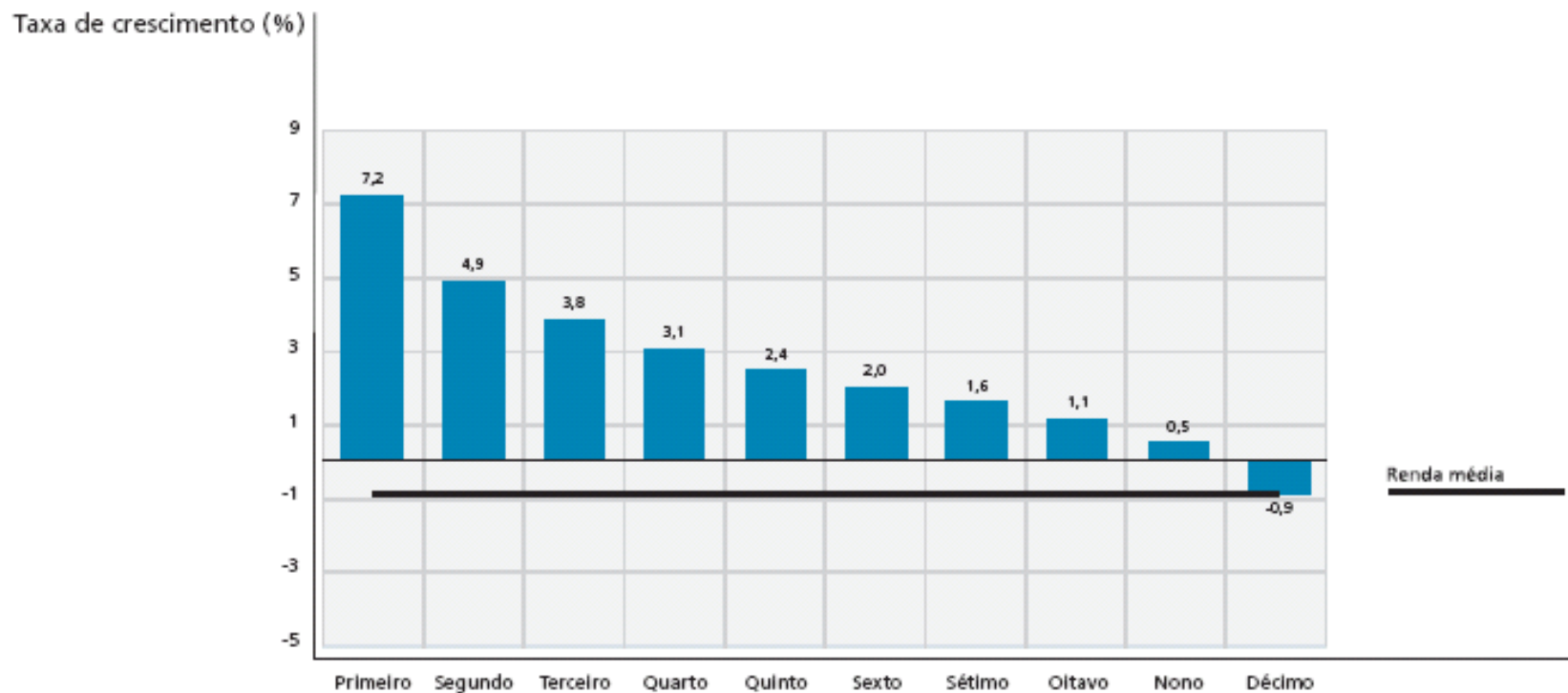
Inequality in Brazil



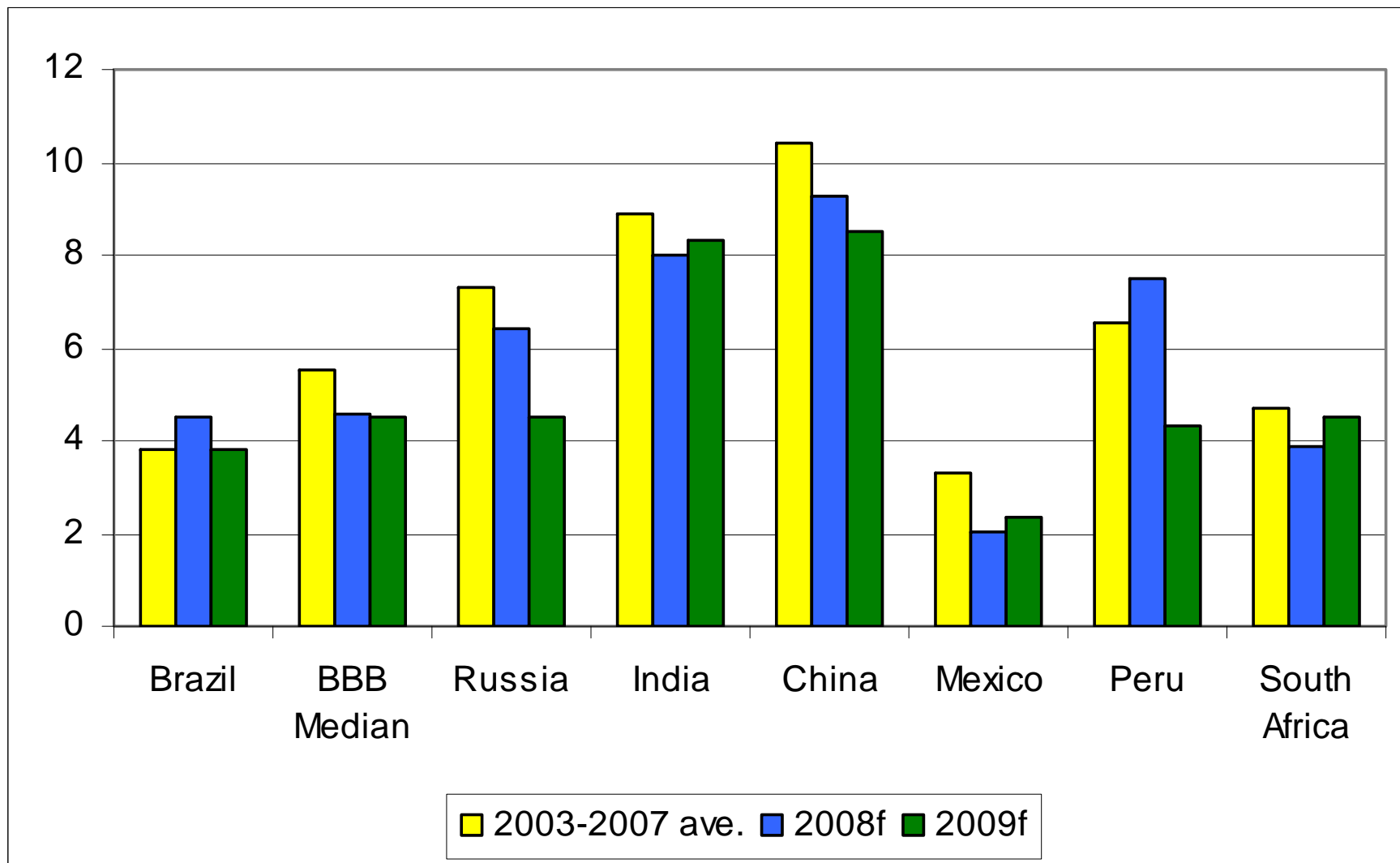
Fonte: Barros et al. (2006a e b).

Higher Real Income Growth Among Poor

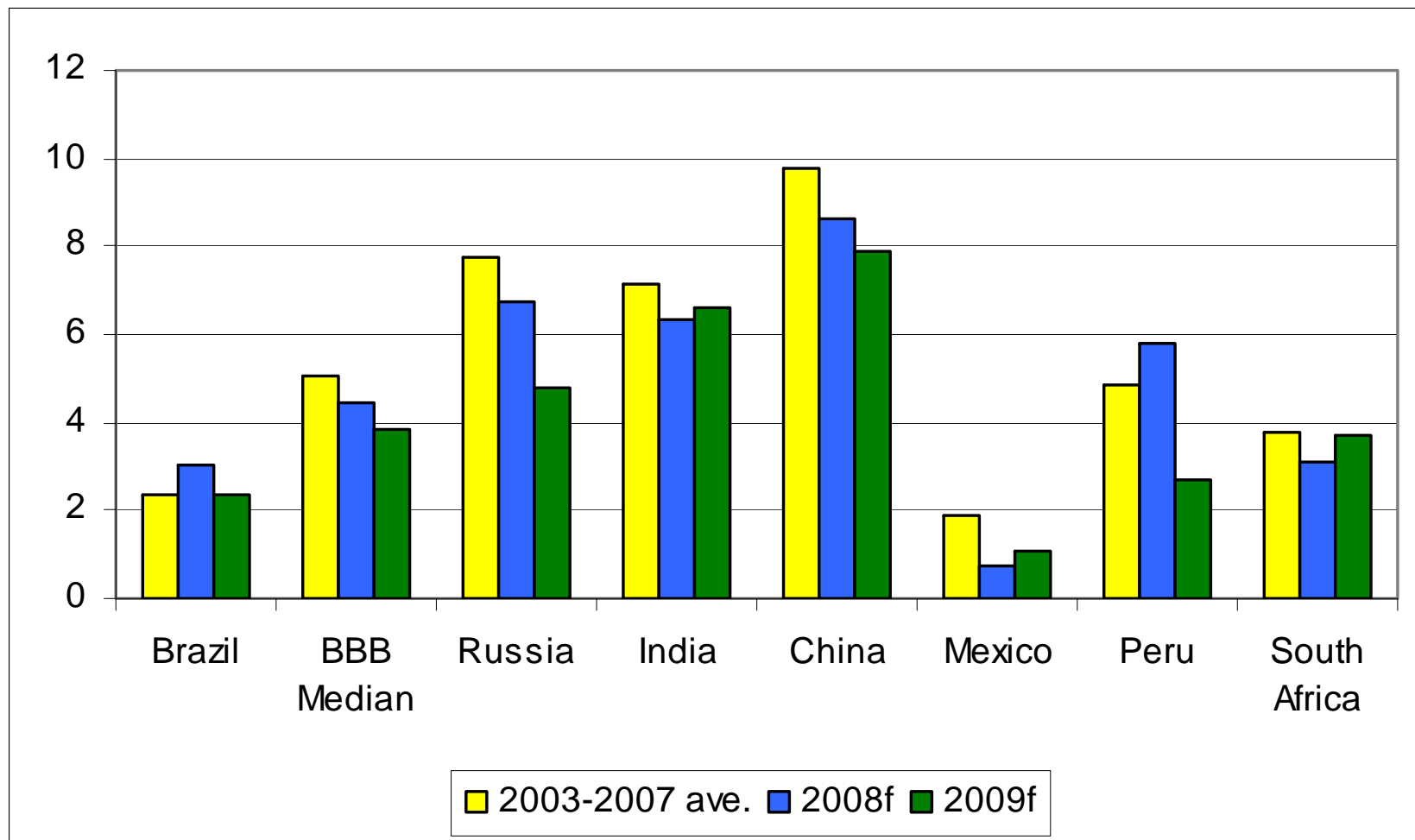
Taxa de crescimento anual da renda *per capita* dos décimos acumulada pelos mais pobres entre 2001 e 2004



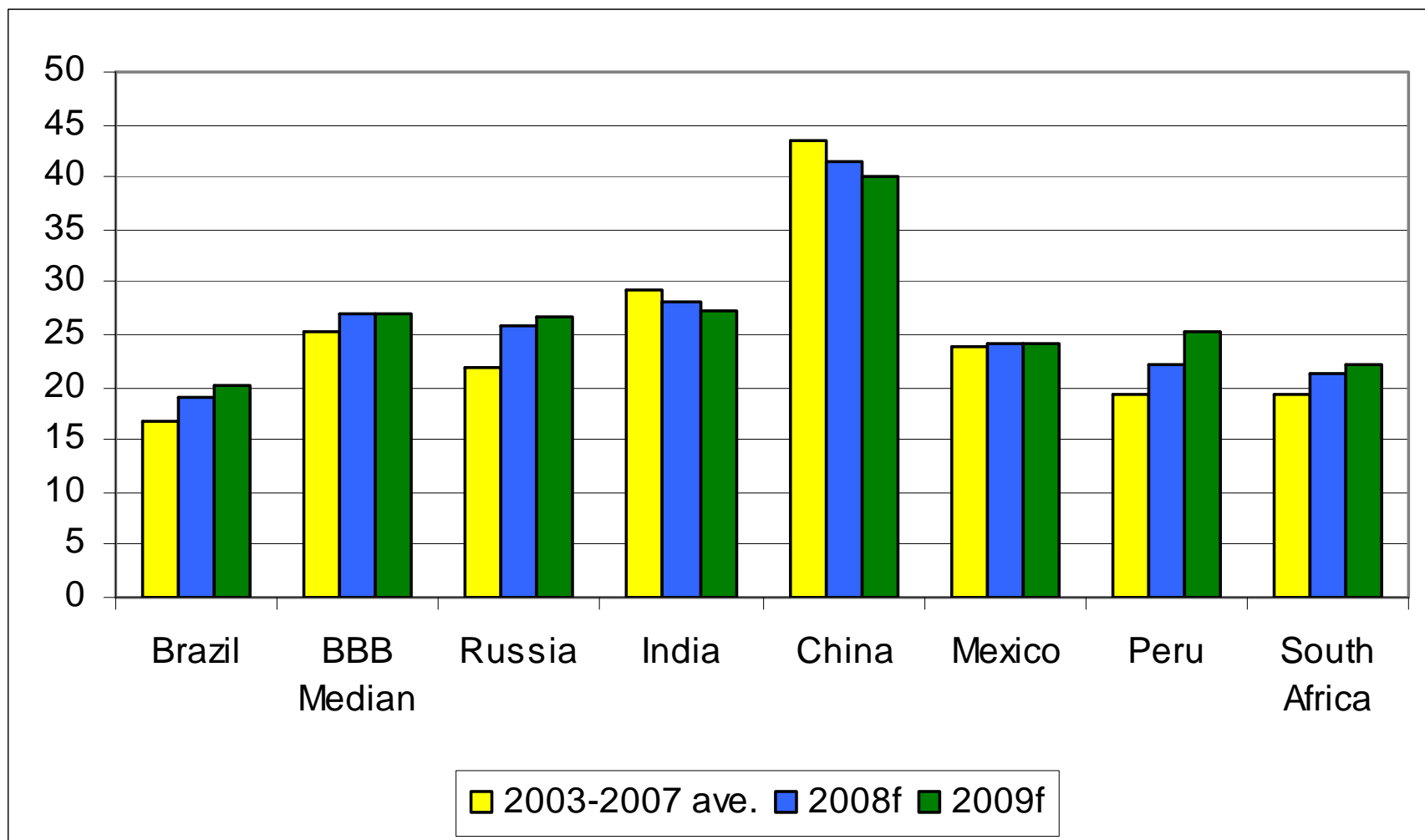
Real GDP (% change)



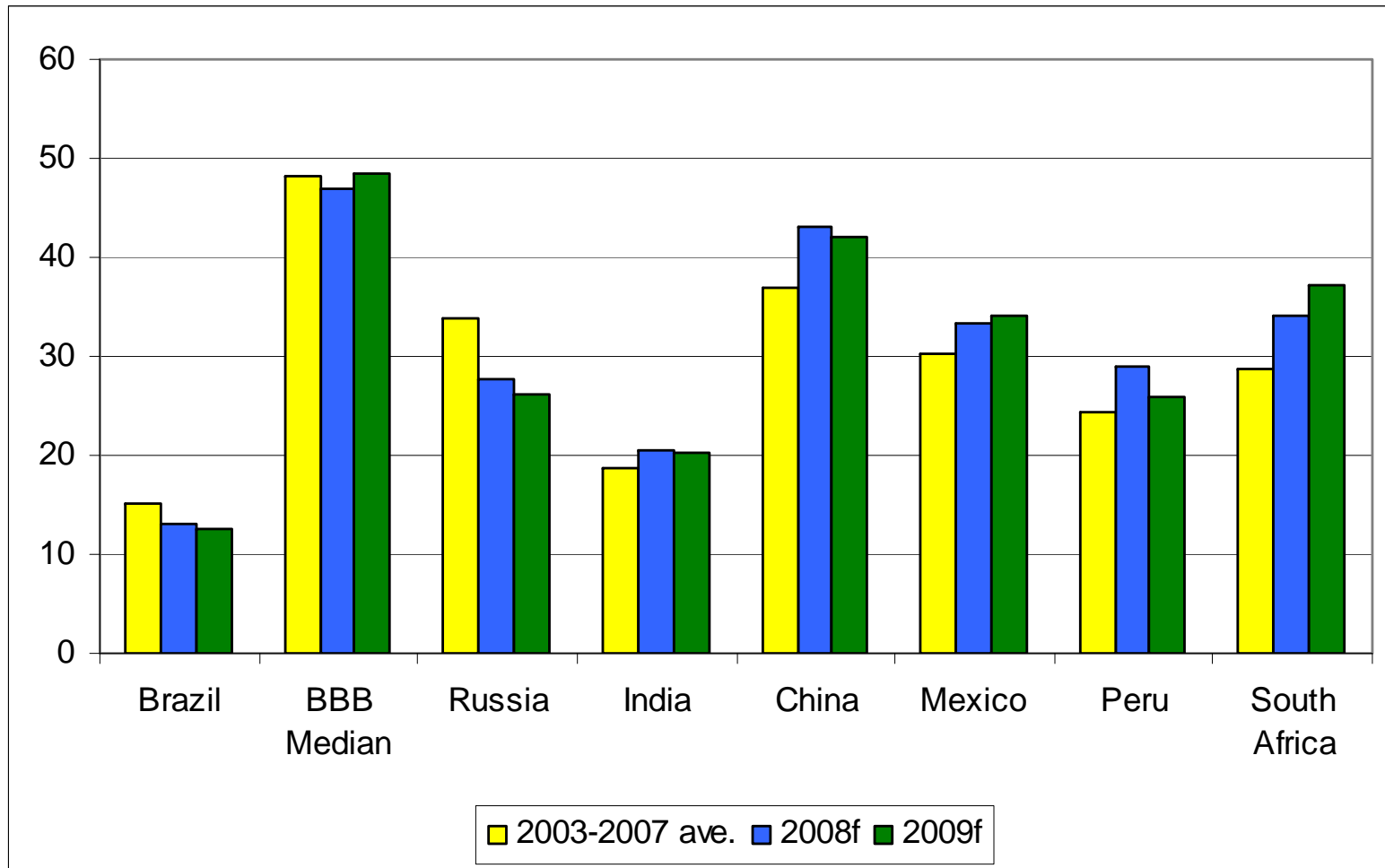
Real GDP per Capita (% change)



Gross Domestic Investment / GDP, %



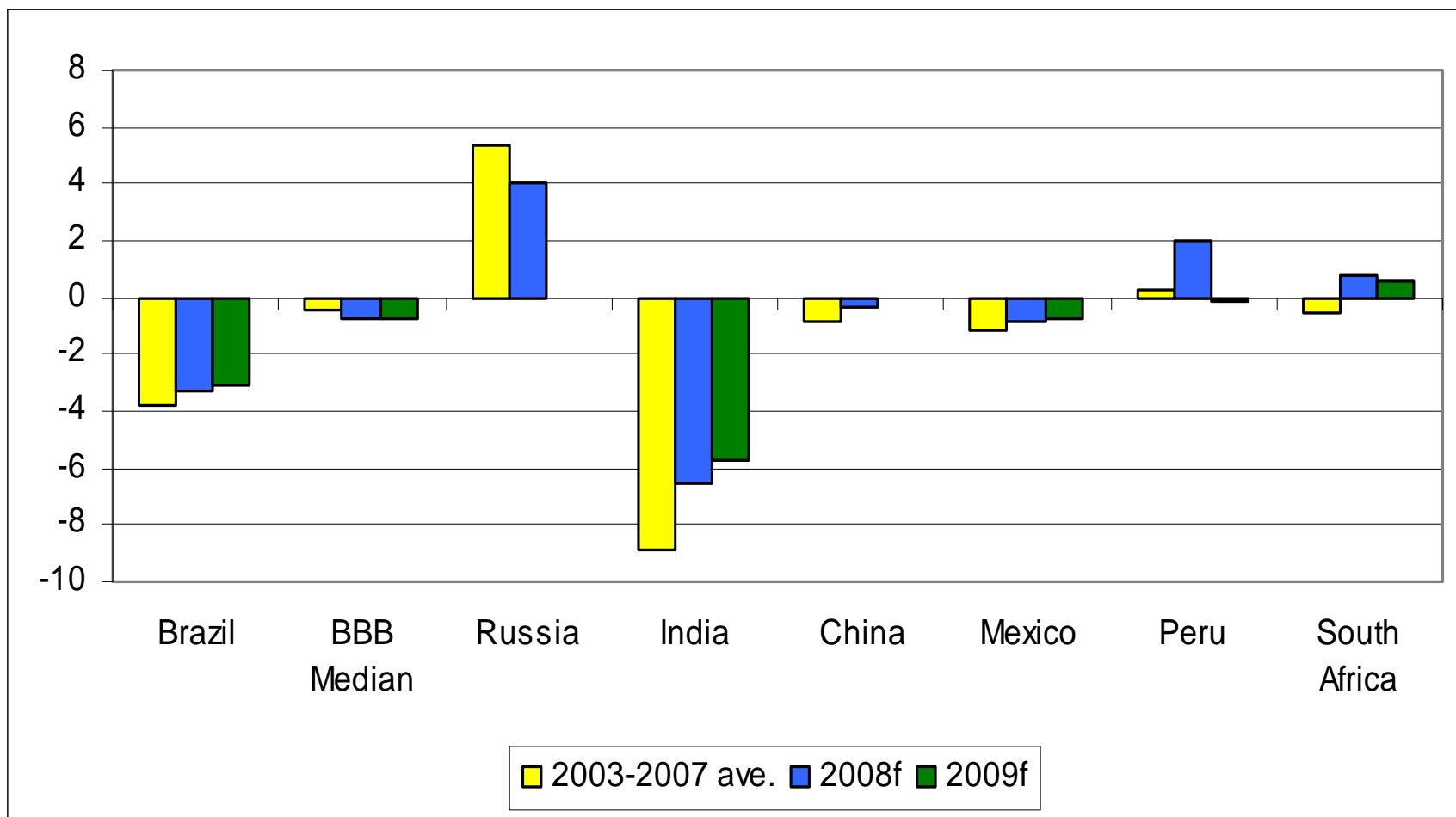
Exports / GDP, %



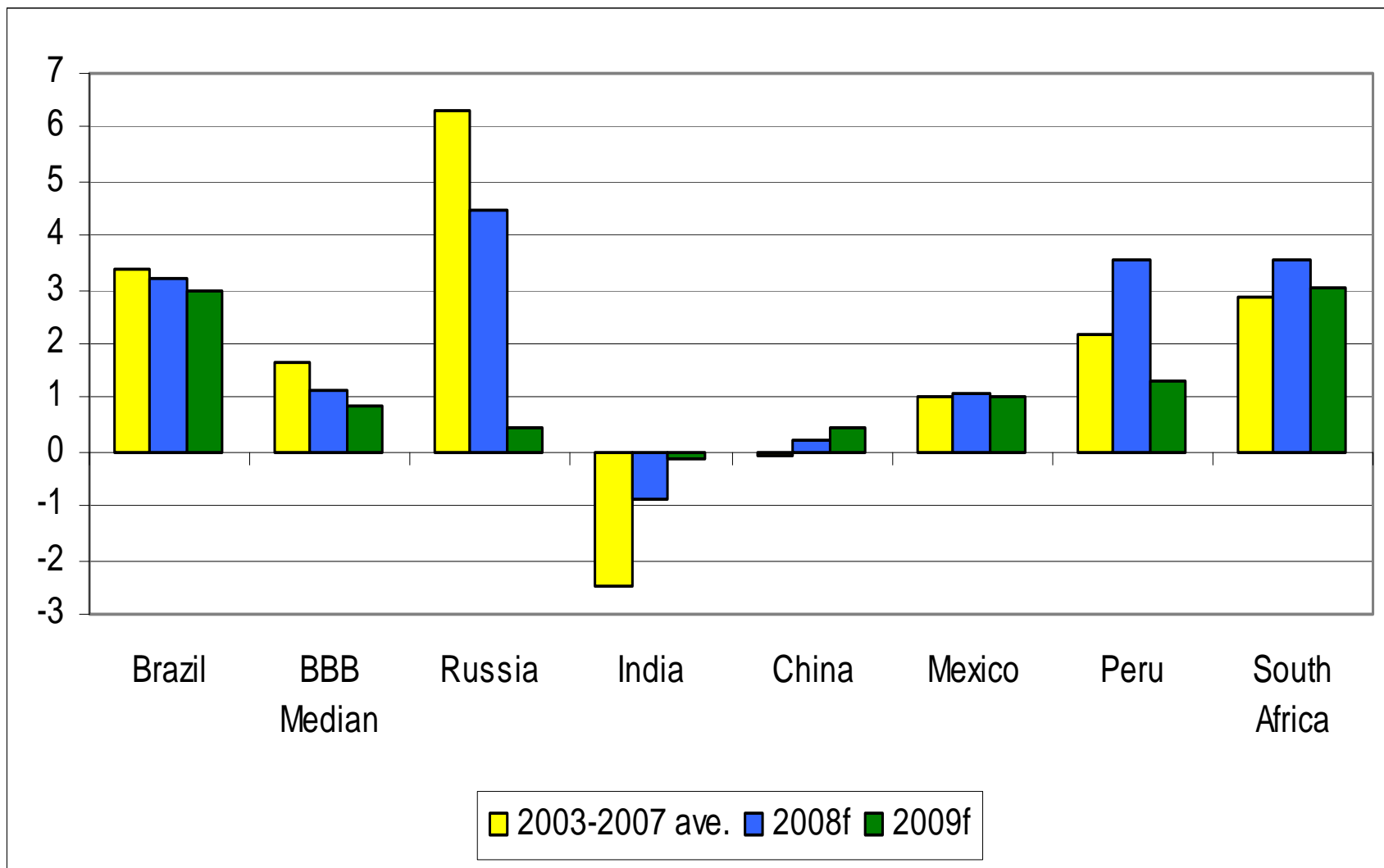
Challenges for higher medium-term growth

- **Infrastructure and Energy**
- **“Custo Brasil”**
- **Labor markets**
- **Trade liberalization**
- **Lower cost and greater availability of capital**
- **Tax burden – level and composition**

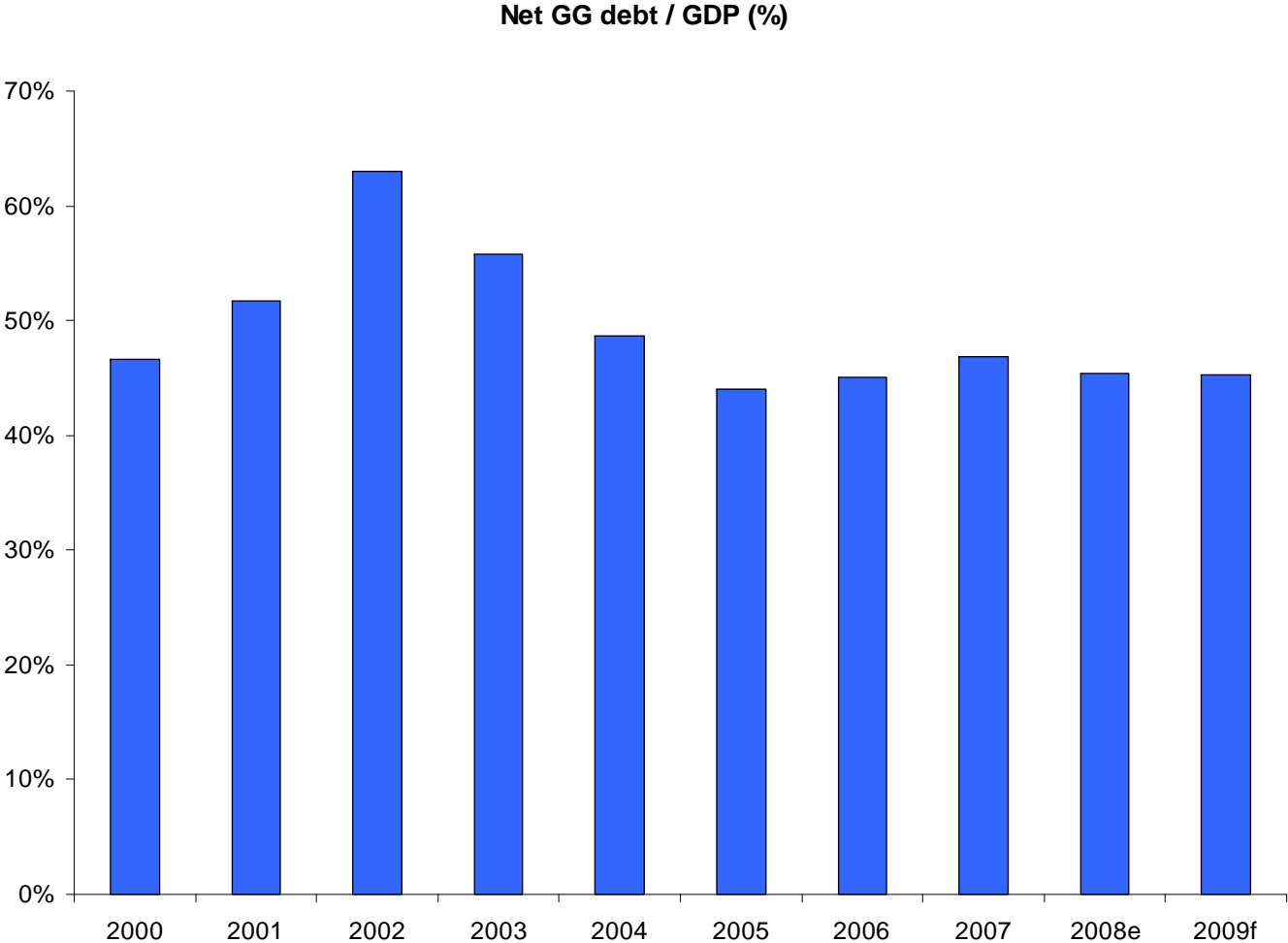
General Government Fiscal Balance / GDP, %



General Government Primary Balance / GDP, %



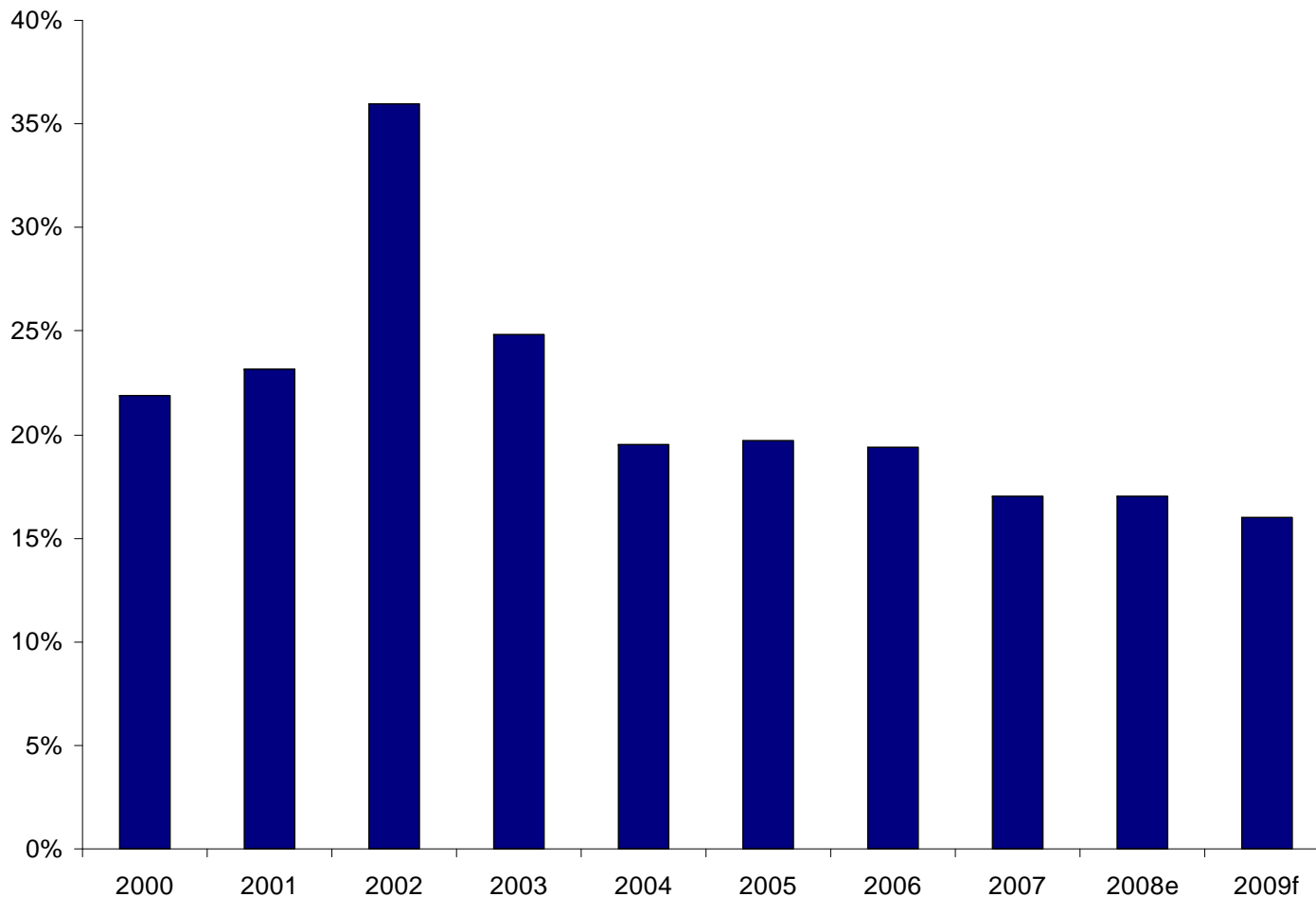
Net General Government Debt / GDP, %



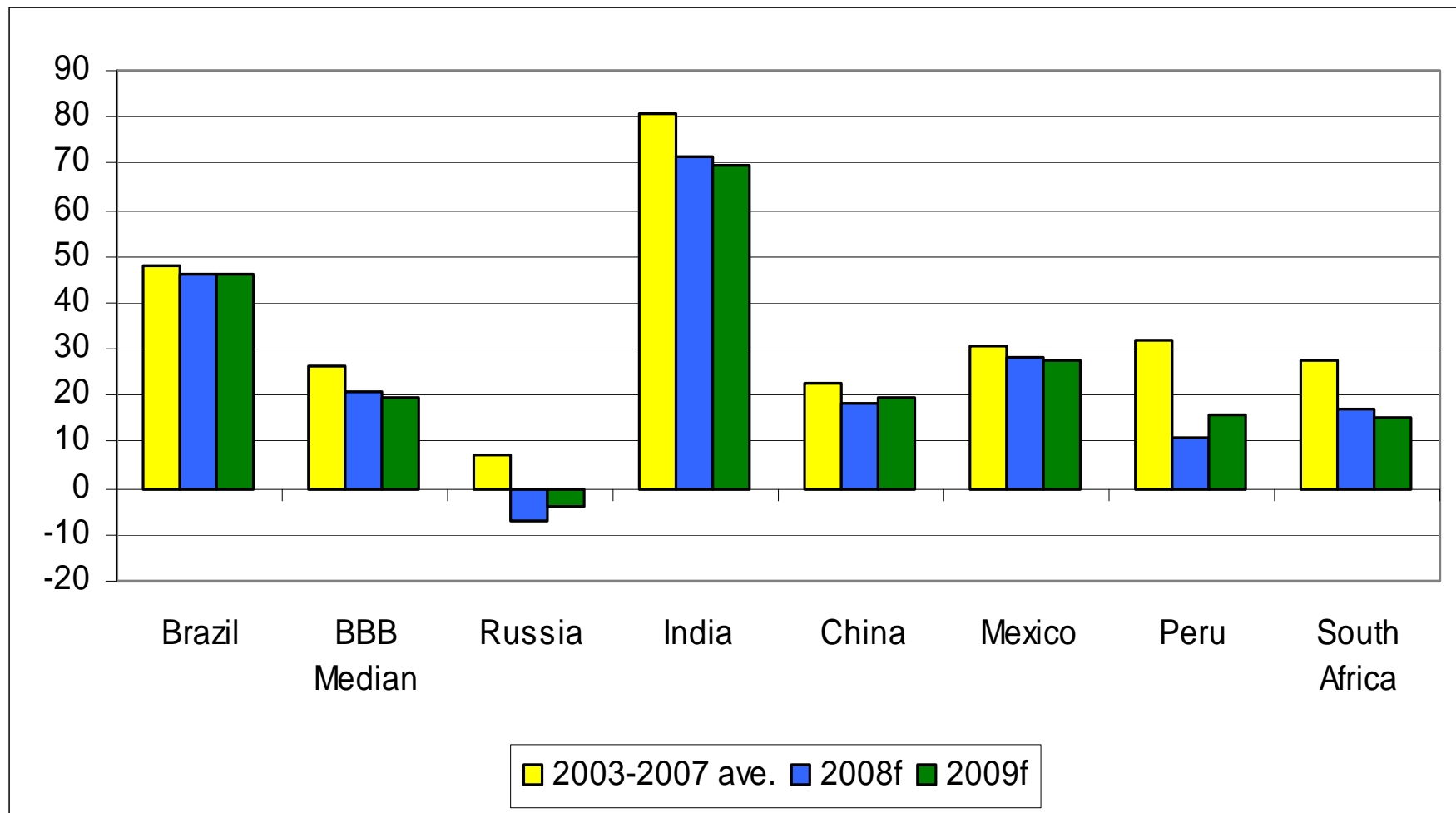
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General Govt. Interest / General Govt. Revenues, %

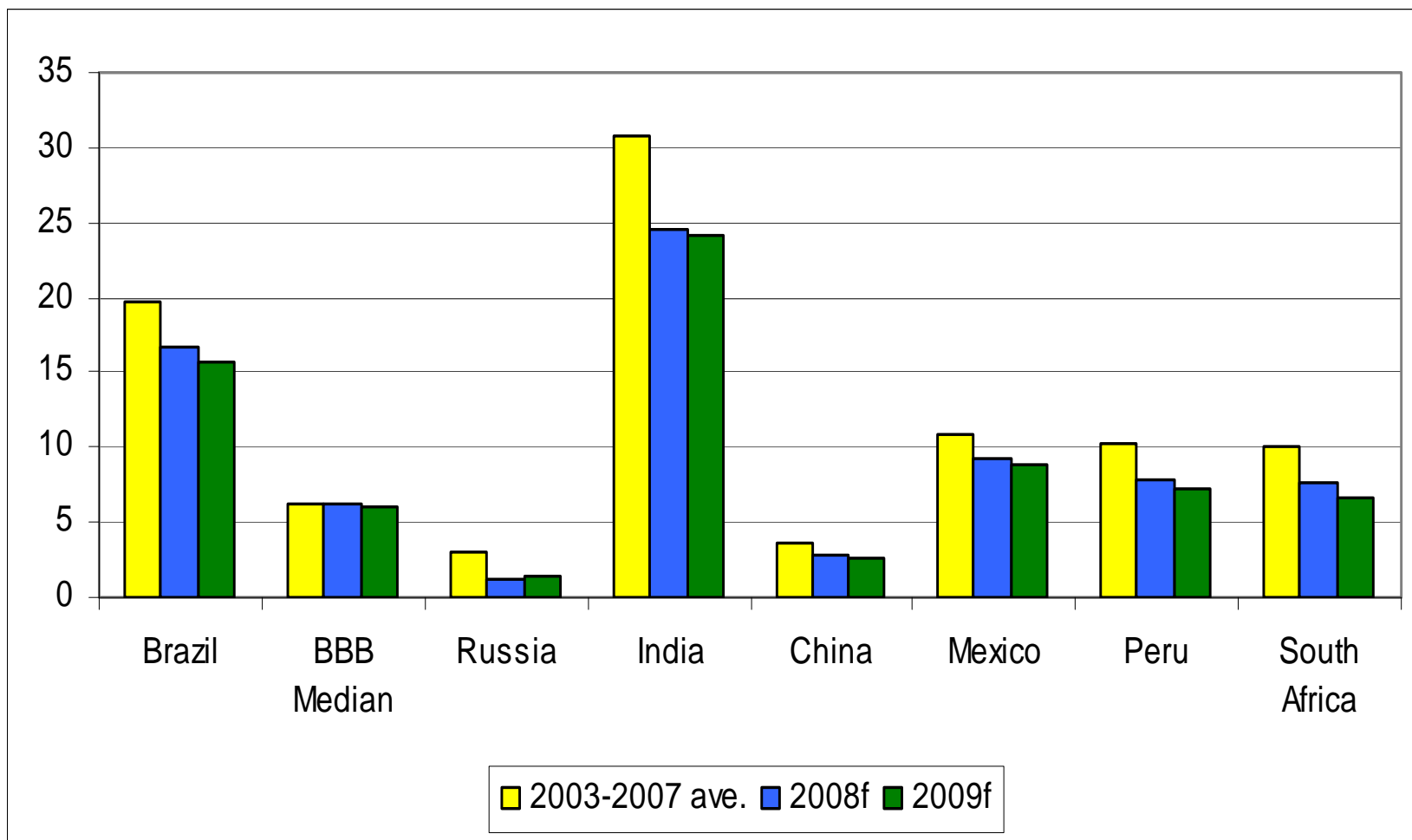
GG interest paid / GG revenues (%)



Net General Government Debt / GDP, %



Interest / General Government Revenues, %



Fiscal Policy Challenges

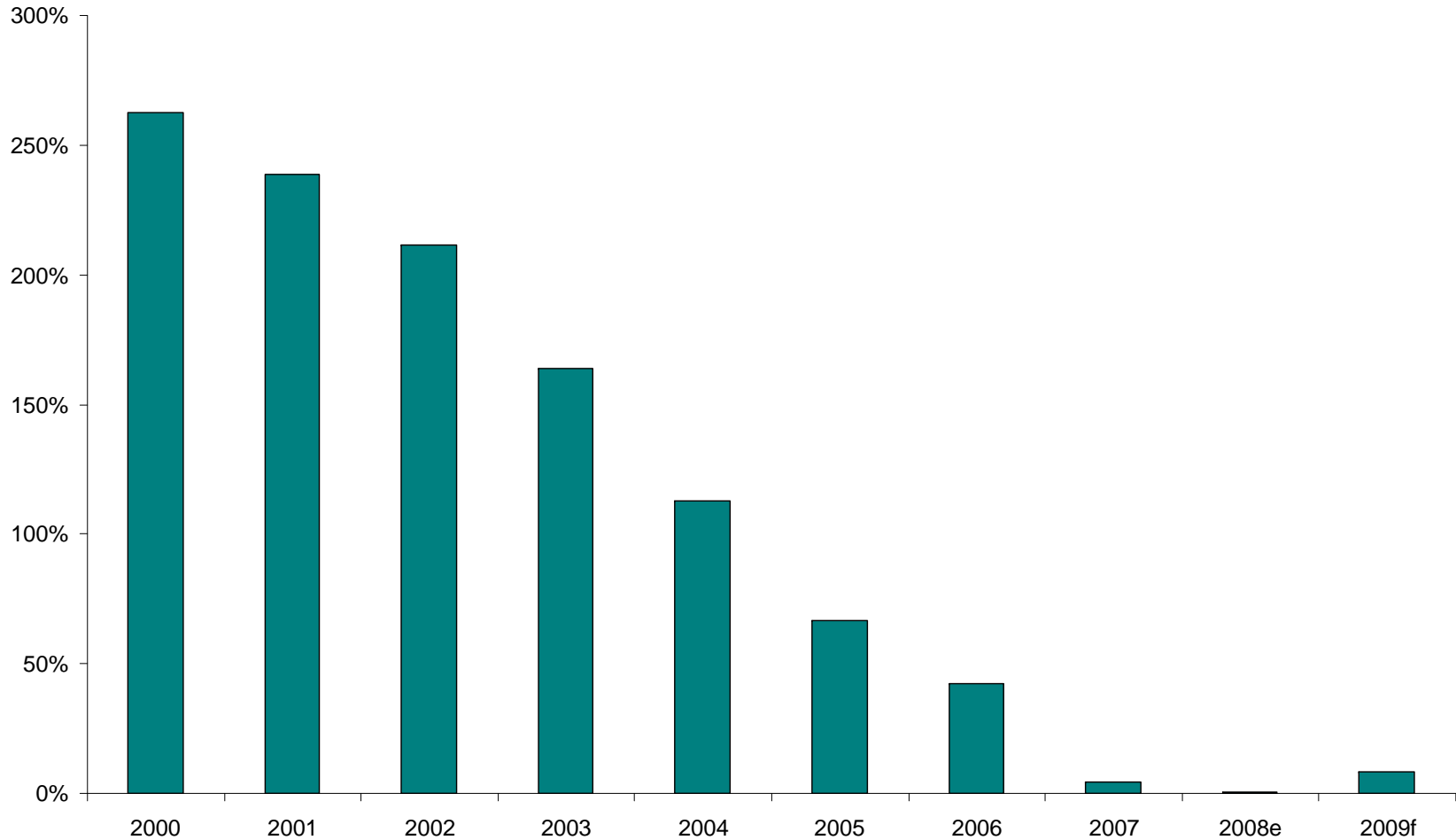
- **Further reduction in debt burden**
 - Continued commitment to primary surplus
 - Less expansionary fiscal policy
- **Fiscal Flexibility**
 - Composition and level of spending
 - Earmarking of revenues
 - Social security
- **Less distortionary tax regime and eventually lower tax burden**
- **Extend maturity and duration of domestic debt**

External Performance

- Remarkable turnaround in Brazil's trade balance and current account position reflects structural and cyclical factors
- Return to a modest current account deficit is *not necessarily* problematic
- What type of financing -- FDI, debt, equity ?

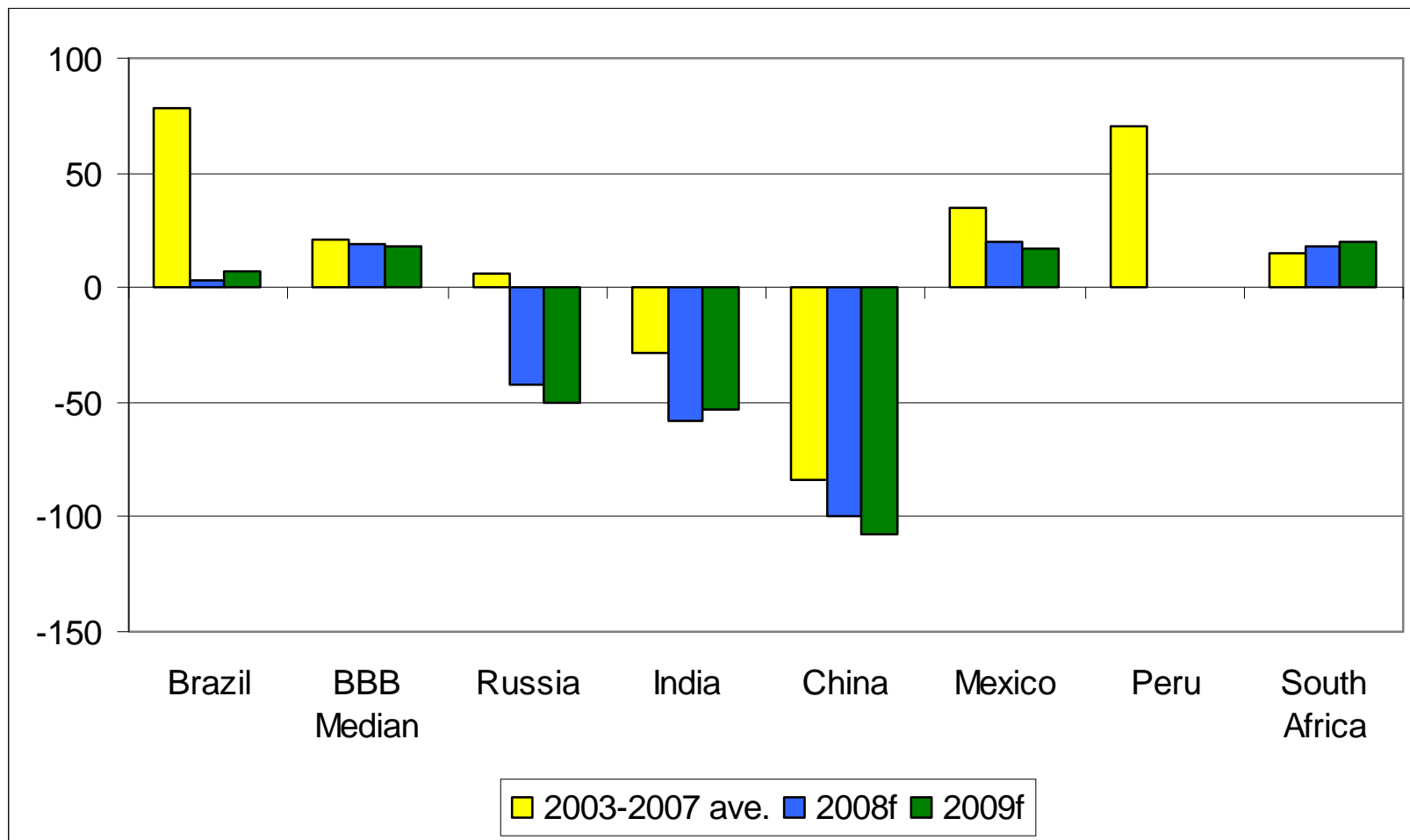
Net External Debt / CAR*, %

Dívida Externa Líquida / CAR* (%)



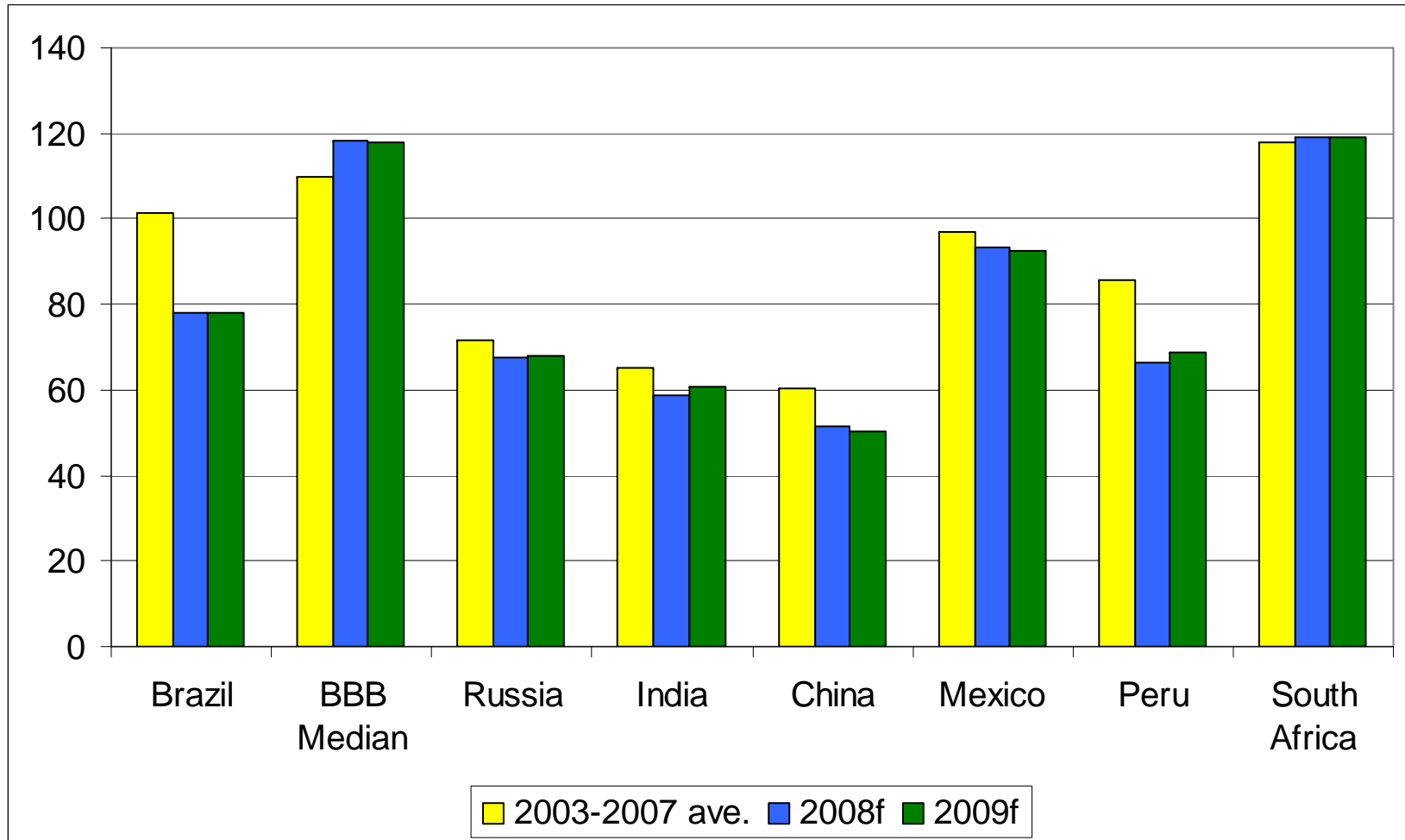
*CAR – Current Account Receipts

Net External Debt / CAR*, %



*CAR – Current Account Receipts

Gross External Financing Needs / CAR* + International Reserves

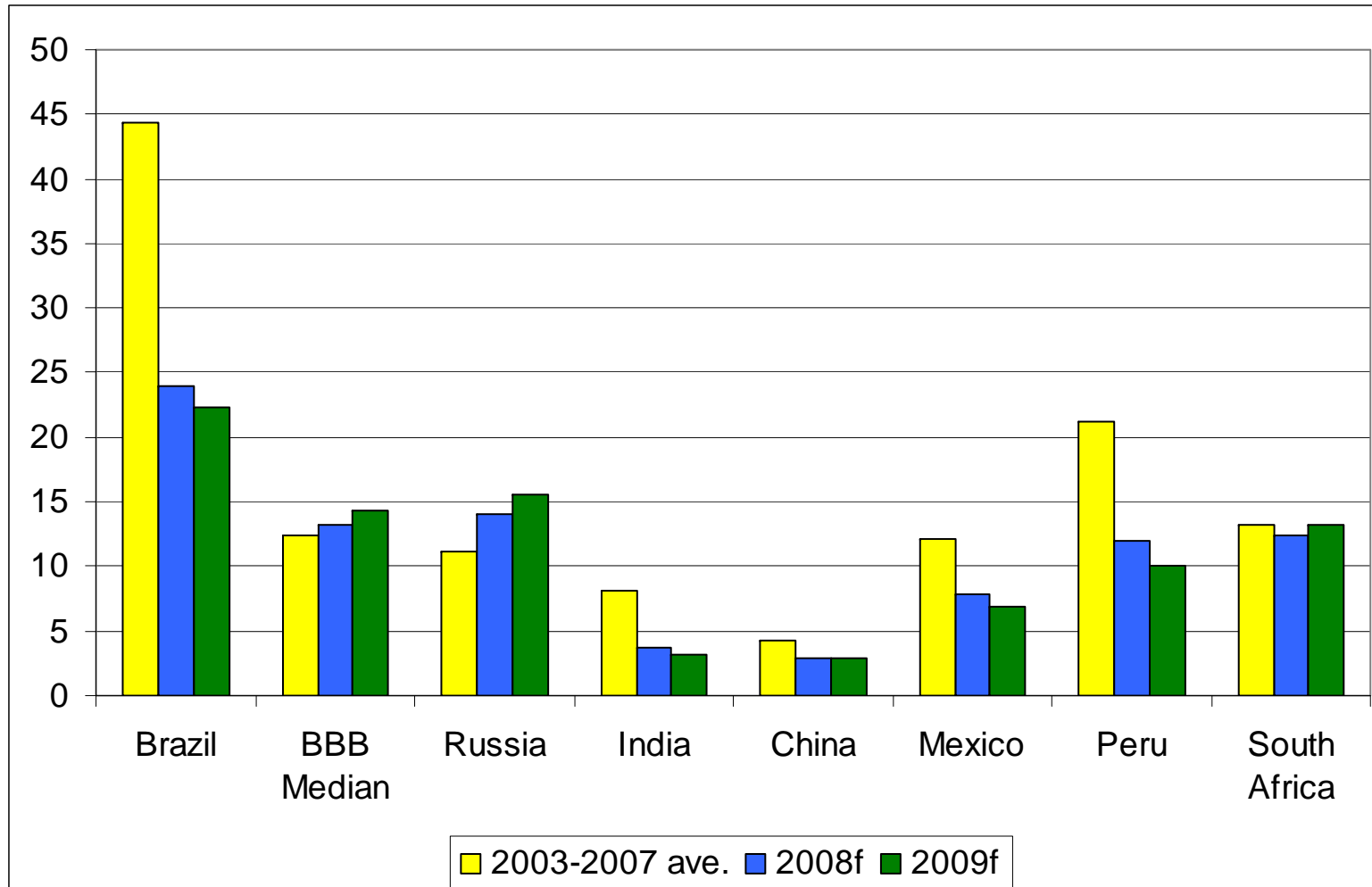


*CAR – Current Account Receipts

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External Debt Service (exc. Short-term) / CAR*, %



*CAR – Current Account Receipts

Brazil: Selected Economic Indicators

	2008f	2007	2006	2005	2004
Real GDP (% change)	4.5	5.4	3.8	3.2	5.7
Real GDP per capita (% change)	3.0	3.8	2.3	1.8	4.2
General Govt. Fiscal Balance / GDP (%)	-3.3	-2.8	-3.9	-3.7	-3.1
General Govt. Primary Balance / GDP (%)	3.2	3.5	3.1	3.6	3.6
Social Security Balance / GDP (%)	-3.0	-3.4	-3.6	-3.7	-3.9
Gross General Govt. Debt / GDP (%)	58.4	61.1	58.5	58.0	61.5
Net General Govt. Debt /GDP (%)	46.2	46.9	45.1	44.0	48.6
Interest Payments / General Govt. Revenue (%)	16.8	16.7	18.8	19.8	19.1
Current Account Balance (US\$ billion)	-19.8	1.4	13.3	14.2	11.8
Trade Balance (US\$ billion)	19.5	40.0	46.1	44.7	33.7
Gross External Fin. Needs/Reserves + CAR	80.0	88.9	97.9	103.9	98.0
Net External Debt / CAR	2.9	4.5	42.2	66.7	112.6
Net Public Sector External Debt /CAR	-41.7	-36.3	1.3	24.8	54.1
Net Banking Sector External Debt/CAR	17.2	16.3	10.2	9.6	15.4
Net Non-Bank External Debt/CAR	16.6	13.0	17.5	18.1	25.7

f-forecast. CAR- current account receipts.

Global & Regional Context

United States

- **Recession is S&P's base case, but now the low point in early 2009**
- **Fairly shallow given fiscal stimulus package and interest rate cuts**
- **But, oil prices weigh on consumer**
- **May not have two consecutive negative quarters of growth**

- **Growth slows from 2.2% in 2007 to 1.3% 2008, and remains at 1.3% in 2009**

- **Under a deep recession scenario, growth -0.3% in 2008 and -0.4% in 2009**

Europe

- **Slowdown underway, but avoid recession**
- **Growth in Euro-zone from 2.7% in 2007 to 1.7% in 2008, and 1.8% in 2009**
- **In the UK, real GDP growth from 3.1% in 2007 to 1.5% in 2008, and 1.9% in 2009**

Global Context

- **U.S. accounts for 20% of world-GDP, but emerging markets led by China and India account for over 2/3 of the world's growth rate in recent years**
- **In China, real GDP growth slows from 11.4% in 2007, to around 10% in 2008 and 9.5% in 2009**
- **In India, real GDP growth of 9.4% in 2007 also slows toward 8.5% in 2008 and in 2009**
- ***Implication: support for soft and hard commodity prices***

Latin American Outlook

- **Region is much better placed to withstand a U.S. recession and global slowdown**
 - Lower external and fiscal indebtedness
 - Floating exchange rate regimes
 - Increased reliance on local market for government (& corporate) funding
- **But, government policy reaction remains a key factor**
- **Various risks to current and capital account balances**
 - Remittances
 - FDI, portfolio flows

Regional Indicators

Selected Indicators	2004	2005	2006	2007e	2008-f	2009-f
Current account balance	20.17	37.11	50.67	25.52	8.45	-10.5
Trade balance	64.8	90.4	107.8	81.3	72.1	52.1
External debt / CAR, %	184.3	142.9	122.7	114.6	109.5	104.4
Net external debt / CAR, %	103.9	69.3	50.2	35.2	32.5	29.5
Public sector external debt / CAR, %	108.0	79.7	66.0	62.0	58.8	56.3
Net public sector ext. debt / CAR, %	60.3	34.0	20.9	8.9	6.8	4.3
General government balance / GDP, %	-1.3	-0.9	-0.1	0.1	-0.6	-0.8
General government primary balance / GDP, %	1.7	2.0	2.6	2.7	1.8	1.4
General government debt / GDP, %	51.1	44.7	39.7	35.9	33.4	31.7
Net general government debt / GDP, %	42.7	35.0	30.1	26.4	24.8	23.4

e-estimate; f-forecast

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Latin American Outlook

- **Real GDP growth 4.5% in 2008 and 4% in 2009 from 5.6% in 2007**
- **Inflation pressures remain a policy challenge given global food and energy prices and ...**
- **Domestic demand, a main driver for growth in a number of countries**
- **Trade and current account balances worsen somewhat, but commodity prices provide an important support**
- **Some fiscal loosening, but debt levels contained**

Growth and Inflation Outlook

<i>percent change</i>	2004	2005	2006	2007e	2008-f	2009-f
Real GDP (weighted average)	6.2	4.7	5.3	5.6	4.5	4.0
Domestic demand (weighted average)	7.0	6.6	7.5	7.7	6.4	5.4
Consumer prices (annual average)	6.2	6.1	5.7	6.5	6.3	5.6

e-estimate; f-forecast

The logo for Standard & Poor's, featuring the word "STANDARD" in a large, bold, black serif font, followed by "& POOR'S" in the same font. The text is centered and flanked by two horizontal red lines, one above "STANDARD" and one below "& POOR'S".

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