Woodrow Wilson International Center for Scholars
Brazil Institute

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BRAZIL INSTITUTE DISCUSSION BRIEF

BRAZIL'S EMERGING ECONOMIC POWER: NOW INVESTMENT-GRADE AND WHY IT MATTERS

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EXECUTIVE SUMMARY

On April 30, 2008, Standard & Poor's became the first ratings agency to raise Brazil's foreign debt to investment-grade status—Fitch Ratings, the second of the world's largest three ratings agency, followed suit a few days later. These unprecedented decisions, coupled with the discovery of massive new oil and gas reserves, boosts Brazil's prospects for continued, long-term economic and political stability. To explore the implications of Brazil's investment grade status the Brazil Institute hosted a luncheon at the Rayburn House Office Building in Washington, D.C. on June 20th, in partnership with the Wilson Center on the Hill program, a nonpartisan forum that focuses on current issues related to international trade and security, sustainable development, and globalization. The focus of the event was to discuss Brazil's economic position in the context of the investment-grade ratings decisions, as well as the country's economic emergence and the challenges that it faces going forward. The discussion featured Lisa Schineller, Director of Sovereign Ratings at Standard & Poor's, and speakers Nancy Lee, Visiting Fellow at the Center for Global Development, and Otaviano Canuto, Vice President for Countries at the Inter-American Development Bank.

Lisa Schineller

Schineller described the Standard & Poor's rating as a "globally comparable, forward-looking estimate of default probability," or an "assessment of the government's ability and willingness to service its debt on time, in full." She clarified that it is not a country risk rating or country investment ranking, nor is it a "recommendation to buy or sell a security, or a prediction of a security." Nevertheless, Schineller explained, the decision to upgrade the sovereign foreign debt rating does reflect upon the political and economic status of Brazil as the decision to place the rating above the threshold for investment-grade "depends on the government's policy stance and commitment, and upon the performance of various economic indicators."

The principal positive indicators that Standard & Poor's found in Brazil include a consistent macroeconomic framework and track record of policy continuity (in particular the commitment to fight inflation) through political transitions, net external debt less than 10 percent of current account receipts, a profile of government debt beginning to line-up with investment-grade credits, the growth of Brazil's middle class (signifying a growing strength in the economy and a surge in domestic demand), and the broadening base of economic growth drivers (which has attracted larger amounts of foreign direct investment). Despite these positive trends, Brazil still faces important challenges. Constraints include large government debt (around 40 percent of GDP) and interest burdens; budgetary inflexibility amid high current spending; and structural impediments that limit investment and growth compared with other emerging market economies. For this reason, Canuto emphasized that receiving investment-grade status is only an intermediate step in Brazil's continued development and economic emergence, reminding that Brazil's new rating, BBB-, is the lowest investment-grade ranking. Nonetheless, he added, it is a clear reflection of sound economic policies and the maturation of Brazil's institutions.

"THE INVESTMENT-GRADE RATING IS A CLEAR REFLECTION OF SOUND ECONOMIC POLICIES AND THE MATURATION OF BRAZIL'S INSTITUTIONS."

Nancy Lee

Lee noted that a more open Brazilian economy as well as innovative and successful poverty-reduction programs (such as Bolsa Familia, a conditional cash-transfer initiative) have been critical to the country's recent economic growth. It remains to be seen, however, how a proposal announced by Finance Minister Guido Mantega to create a sovereign wealth fund will affect the economy. Lee said it could either serve as a welcomed stabilizing mechanism that promotes fiscal savings or as a tool to intervene in foreign exchange market.

In the context of continuing challenges for Brazil, she argued that Brazil's commitment to fight inflation, expand credit access to the growing middle class, and strengthen regional integration, and the regional investment climate will determine the path that Brazil's emergence will follow. Schineller concurred, stating that the underlying assumption in the investment-grade rating is that pragmatism will continue to drive the policy decisions and actions of Brazil's government and financial sectors as they show their determination to improve the overall investment climate in Brazil.

Otaviano Canuto

BRAZIL INSTITUTE

Created in June 2006 as part of the Wilson Center's Latin American Program, the BRAZIL INSTITUTE strives to foster informed dialogue on key issues important to Brazilians and to the Brazilian-U.S. relationship. We work to promote detailed analysis of Brazil's public policy and advance Washington's understanding of contemporary Brazilian developments, mindful of the long history that binds the two most populous democracies in the Americas.

The Institute honors this history and attempts to further bilateral cooperation by promoting informed dialogue between these two diverse and vibrant multiracial societies. Our activities include: convening policy forums to stimulate nonpartisan reflection and debate on critical issues related to Brazil; promoting, sponsoring, and disseminating research; participating in the broader effort to inform Americans about Brazil through lectures and interviews given by its director; appointing leading Brazilian and Brazilianist academics, journalists, and policy makers as Wilson Center Public Policy Scholars; and maintaining a comprehensive website devoted to news, analysis, research, and reference materials on Brazil.

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