

# Country Risk Analysis

## Brazil



Jan 2006

By: Sadegh Shirazi

Global Finance Chair



# Political Map



# Content

- **Overview**
- **Political analysis**
- **Economy analysis**
- **BOP analysis**
- **Risk analysis**
- **Strengths & Weaknesses**



# OVERVIEW

➔ **Location** - Eastern South America, bordering the Atlantic Ocean

➔ **Area** – 8,511,965 sq km

➔ **Land boundaries** - total: 14,691 km

border countries: Argentina 1,224 km, Bolivia 3,400 km, Colombia 1,643 km, French Guiana 673 km, Guyana 1,119 km, Paraguay 1,290 km, Peru 1,560 km, Suriname 597 km, Uruguay 985 km, Venezuela 2,200 km

➔ **Natural resources** - bauxite, gold, iron ore, manganese, nickel, phosphates, platinum, tin, uranium, petroleum, hydropower, timber.

➔ **Land use** - arable land: 6.96%  
permanent crops: 0.9%  
other: 92.15% (2001)



# OVERVIEW (cntd)

- **Irrigated land** - 26,560 sq km (1998 est.)
- **Natural hazards** - recurring droughts in northeast; floods and occasional frost in south .
- **Population** - 186,112,794 (July,2005 est.)
- **Age structure** -
  - 0-14 years: 26.1% (male 24,789,495/female 23,842,715)
  - 15-64 years: 67.9% (male 62,669,392/female 63,719,631)
  - 65 years and over: 6% (male 4,549,552/female 6,542,009) (2005 est.)



# OVERVIEW (cntd)

- **Population growth rate** - 1.06% (2005 est.)
- **Ethnic groups** - white 53.7%, mulatto (mixed white and black) 38.5%, black 6.2%, other (includes Japanese, Arab, Amerindian) 0.9%, unspecified 0.7% (2000 census).
- **Religions** - Roman Catholic (nominal) 73.6%, Protestant 15.4%, Spritualist 1.3%, Bantu/voodoo 0.3%, other 1.8%, unspecified 0.2%, none 7.4% (2000 census).
- **Languages** — Portuguese (official), Spanish, English, French.
- **Literacy** — 86.4% total population



# History of Brazil

Following three centuries under the rule of Portugal, Brazil became an independent nation in 1822. By far the largest and most populous country in South America, Brazil overcame more than half a century of military intervention in the governance of the country when in 1985 the military regime peacefully ceded power to civilian rulers. Brazil continues to pursue industrial and agricultural growth and development of its interior. Exploiting vast natural resources and a large labor pool, it is today South America's leading economic power and a regional leader. Highly unequal income distribution remains a pressing problem.





# Political Analysis

# Government and Political Figures

- Conventional Name: Federative Republic of Brazil
- Government type: federative republic
- Capital: Brasilia
- Constitution: 5 October 1988
- Legal system: based on Roman codes; has not accepted compulsory ICJ jurisdiction.



# Government and Political Figures(Cntd)

➡ **President:** Luiz Inacio LULA DA SILVA (since 1 January 2003),

➡ **Vice President:** Jose ALENCAR (since 1 January 2003),

note - the president is both the chief of state and head of government.

**cabinet:** appointed by the president.

➡ **elections:** president and vice president elected on the same ticket by popular vote for four-year terms; election last held 6 October 2002 (next to be held 1 October 2006, with a runoff on 29 October 2006 if necessary); runoff election held 27 October 2002



# Government and Political Figures(Cntd)

➡ **Legislative branch** - bicameral National Congress or Congresso Nacional consists of the Federal Senate or Senado Federal (81 seats; three members from each state and federal district elected according to the principle of majority to serve eight-year terms; one-third elected after a four-year period, two-thirds elected after the next four-year period) and the Chamber of Deputies or Camara dos Deputados (513 seats; members are elected by proportional representation to serve four-year terms)

➡ **Judicial branch:** Supreme Federal Tribunal (11 ministers are appointed for life by the president and confirmed by the Senate); Higher Tribunal of Justice; Regional Federal Tribunals (judges are appointed for life); note - though appointed "for life," judges, like all federal employees, have a mandatory retirement age of 70

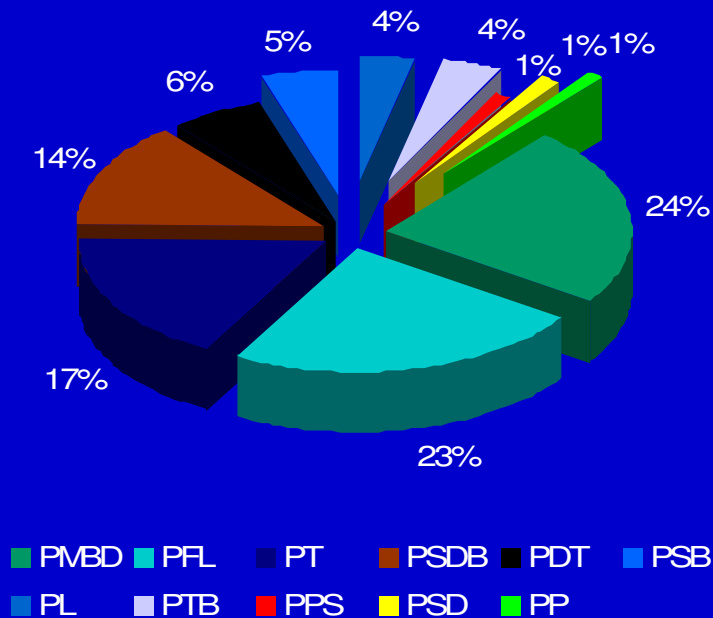


# The Election Result

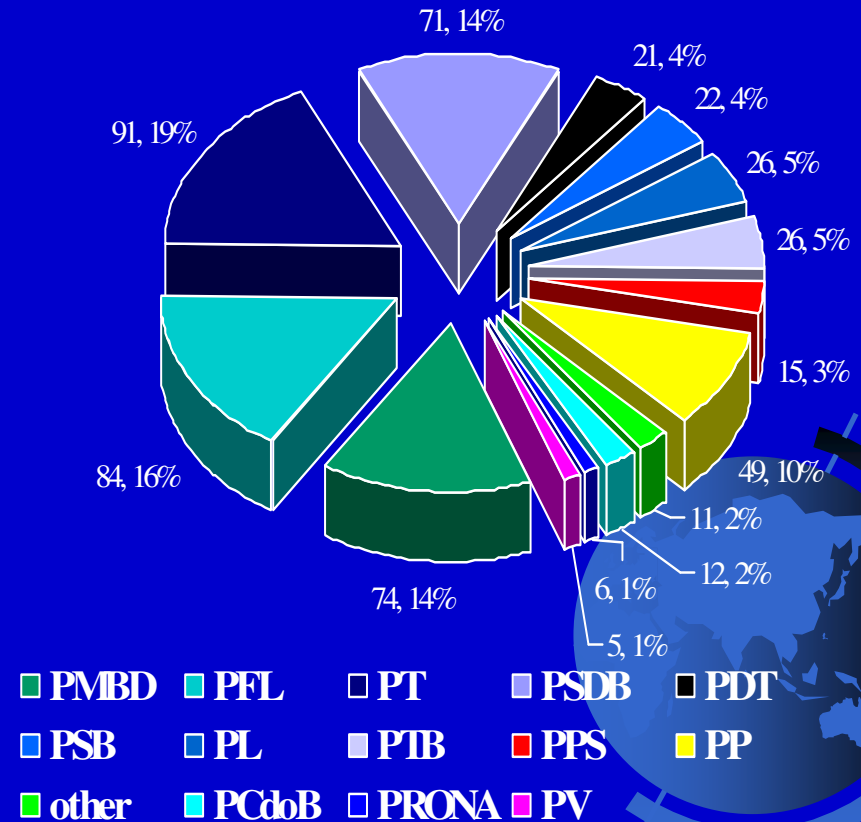
(25<sup>th</sup> May, 2003)

Next to be held in 2007

## Federal Senate (seats by party)



## Chamber of Deputies (seats by party)



note - many congressmen have changed party affiliation since the most recent election

# Political Analysis

- Brazil, Latin America's largest economy, is set to hold presidential and legislative elections in October 2006. Until June, most analysts expected Luiz Inacio "Lula" da Silva to easily win re-election. Lula has been president since 2003 and has won widespread praise for his market-friendly policies despite his leftist past.
- However, the corruption scandal that hit the ruling Workers Party (PT) weakened Lula and his government and it's unclear whether or not he plans to run again and if so whether he will win. The scandal has even generating calls for Lula to be impeached.
- Nevertheless, Lula remains surprisingly popular despite the scandal.



# Political Analysis

- A Datafolha/Folha de Sao Paulo poll in October found that Lula would win more votes than his leading contender, Sao Paulo mayor and former health minister Jose Serra. The poll showed that Lula would get 30 percent of the vote, while Serra would get 27 percent, while other candidates got 10 percent or less. However, if there were a runoff with only Lula and Serra, Lula would get 41 percent, less than Serra at 45 percent, the same poll shows.
- If Lula decides to not run for re-election, a likely candidate from his own party would be finance minister Antonio Palocci, who is also popular among local and foreign investors.
- Either way, a pro-business candidate should win the election, whether it be Lula, Serra or Palocci. Combined with the impressive economic growth and fiscal stability in Brazil so far, investors are likely to maintain or boost their stake in Brazil even leading up to the elections - unlike the situation last time, when the fear of a Lula victory nearly paralyzed local and foreign investments in Brazil.





# Economy Analysis

# Economic overview

- Possessing large and well-developed agricultural, mining, manufacturing, and service sectors, Brazil's economy outweighs that of all other South American countries and is expanding its presence in world markets.
- From 2001-03 real wages fell and Brazil's economy grew, on average, only 2.2% per year, as the country absorbed a series of domestic and international economic shocks. That Brazil absorbed these shocks without financial collapse is a tribute to the resiliency of the Brazilian economy and the economic program put in place by former President CARDOSO and strengthened by President LULA DA SILVA. In 2004, Brazil enjoyed more robust growth that yielded increases in employment and real wages. The three pillars of the economic program are a floating exchange rate, an inflation-targeting regime, and tight fiscal policy, all reinforced by a series of IMF programs.
- The currency depreciated sharply in 2001 and 2002, which contributed to a dramatic current account adjustment



# Economic overview(ctnd)

☞ In 2003 and 2004, Brazil ran record trade surpluses and recorded its first current account surpluses since 1992. Productivity gains - particularly in agriculture - also contributed to the surge in exports, and Brazil in 2004 surpassed the previous year's record export level and again posted a current account surplus. While economic management has been good, there remain important economic vulnerabilities. The most significant are debt-related: the government's largely domestic debt increased steadily from 1994 to 2003 - straining government finances - before falling as a percentage of GDP in 2004, while Brazil's foreign debt (a mix of private and public debt) is large in relation to Brazil's small (but growing) export base. Another challenge is maintaining economic growth over a period of time to generate employment and make the government debt burden more manageable.



# Macroeconomic adjustment in 2005

- ☞ Primary budget **surplus** reached a record 4,84% in 2005, above the country's and the IMF's targets, equivalent to US\$39 billion. However, taking into account US\$64 billion of interest payments, the overall budget is in **deficit** to 3,29% of GDP, compared with 2,67% in 2004.

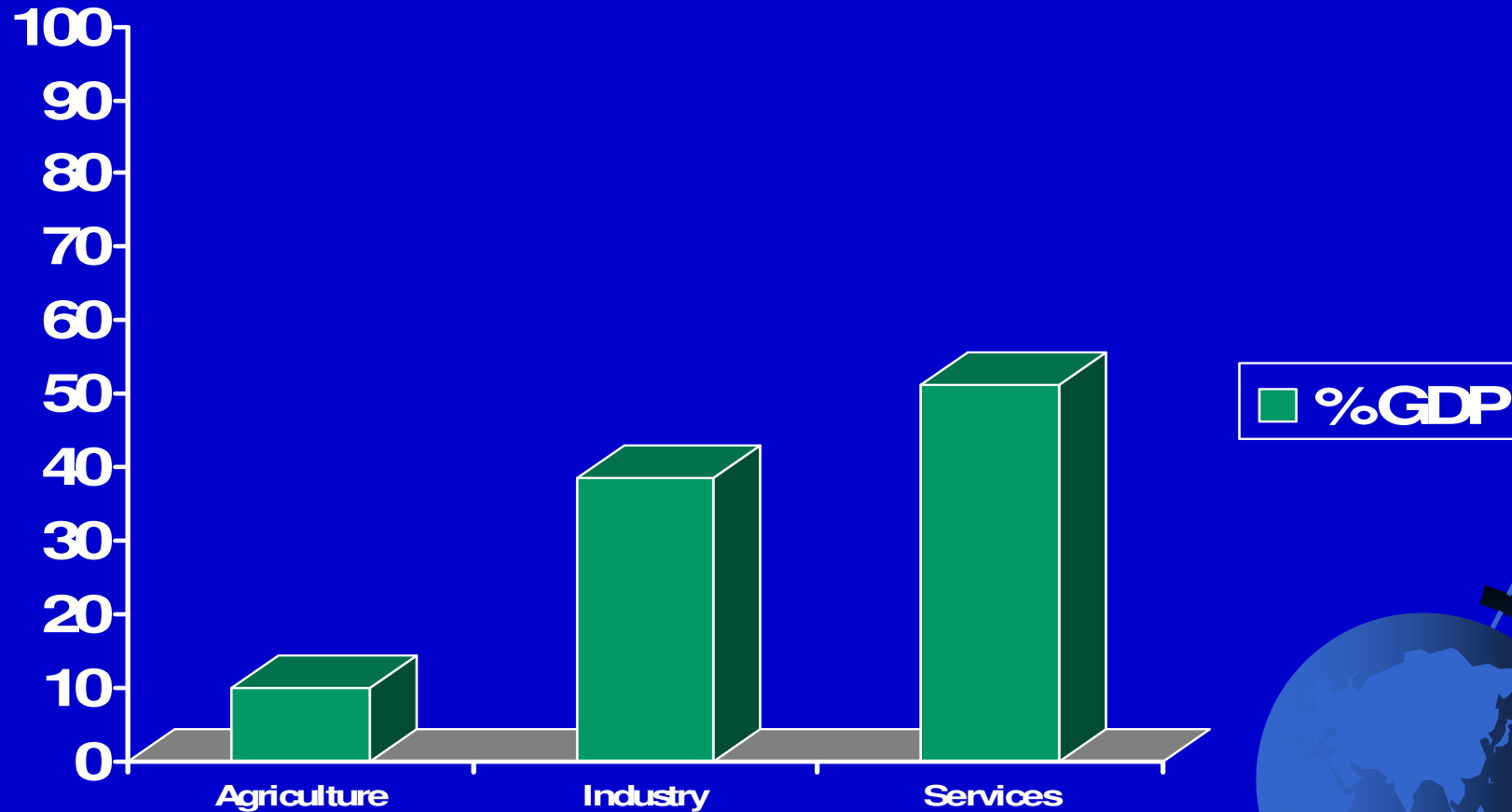


# Macro-economy analysis

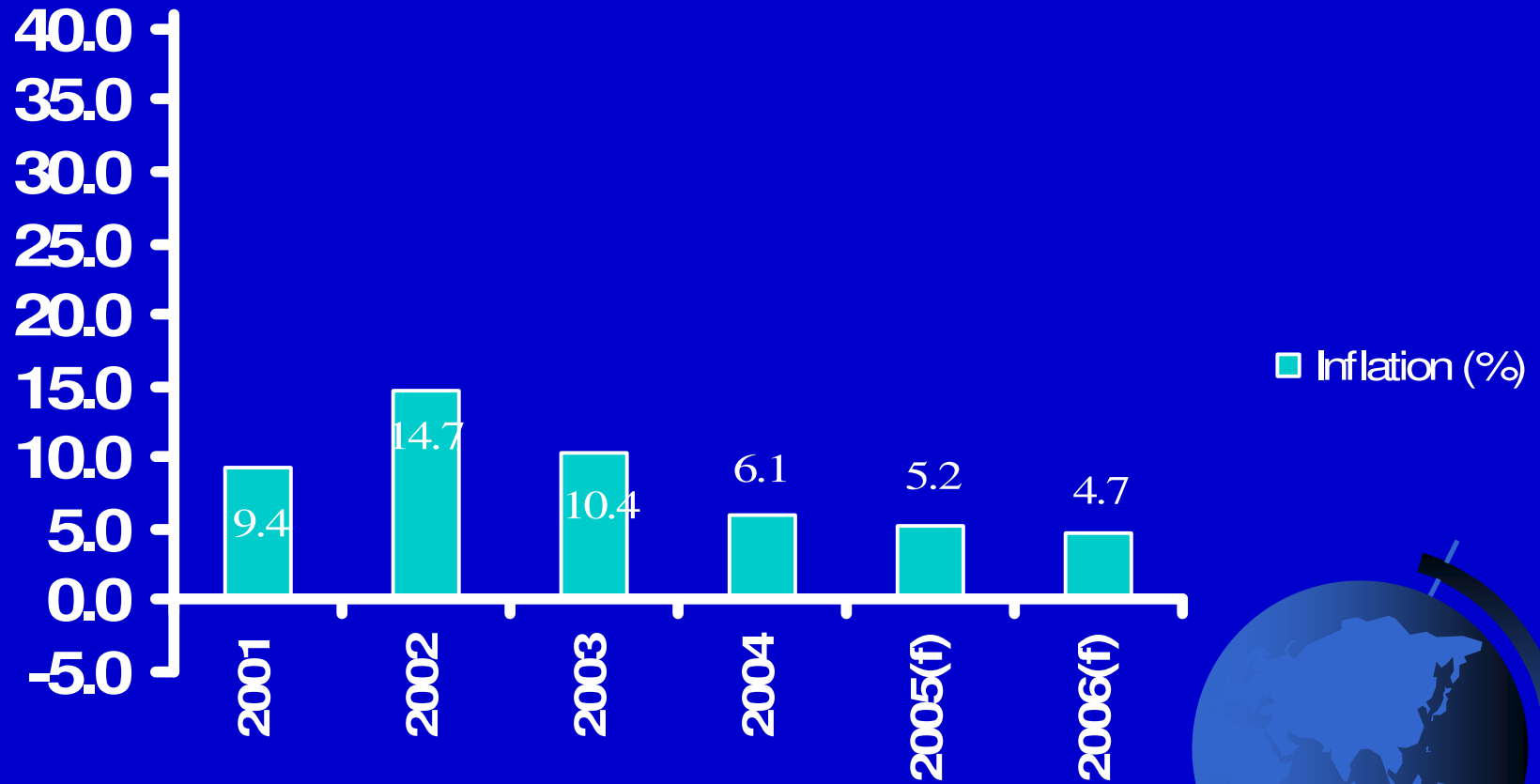
- ☞ **Currency unit – Brazilian Real (US\$ 1=BRL 2.331)**
  
- ☞ **SDR exchange rate for Brazilian Real (16 Jan, 2006 ):**  
**SDR/Unit = 0.30    Unit/SDR = 3.296230**
  
- ☞ **Major Trading Partners:**
  - ◆ **Imports: US 18.3%, Argentina 8.9%, Germany 8.1%, China 5.9%,  
Nigeria 5.6%, Japan 4.6% (2004)**
  - ◆ **Exports: US 20.8%, Argentina 7.5%, Netherlands 6.1%, China 5.6%,  
Germany 4.1%, Mexico 4% (2004)**
  
- ☞ **GDP - Purchasing Power Parity \$1.492 trillion (2004 est.)**



# GDP - composition by sector

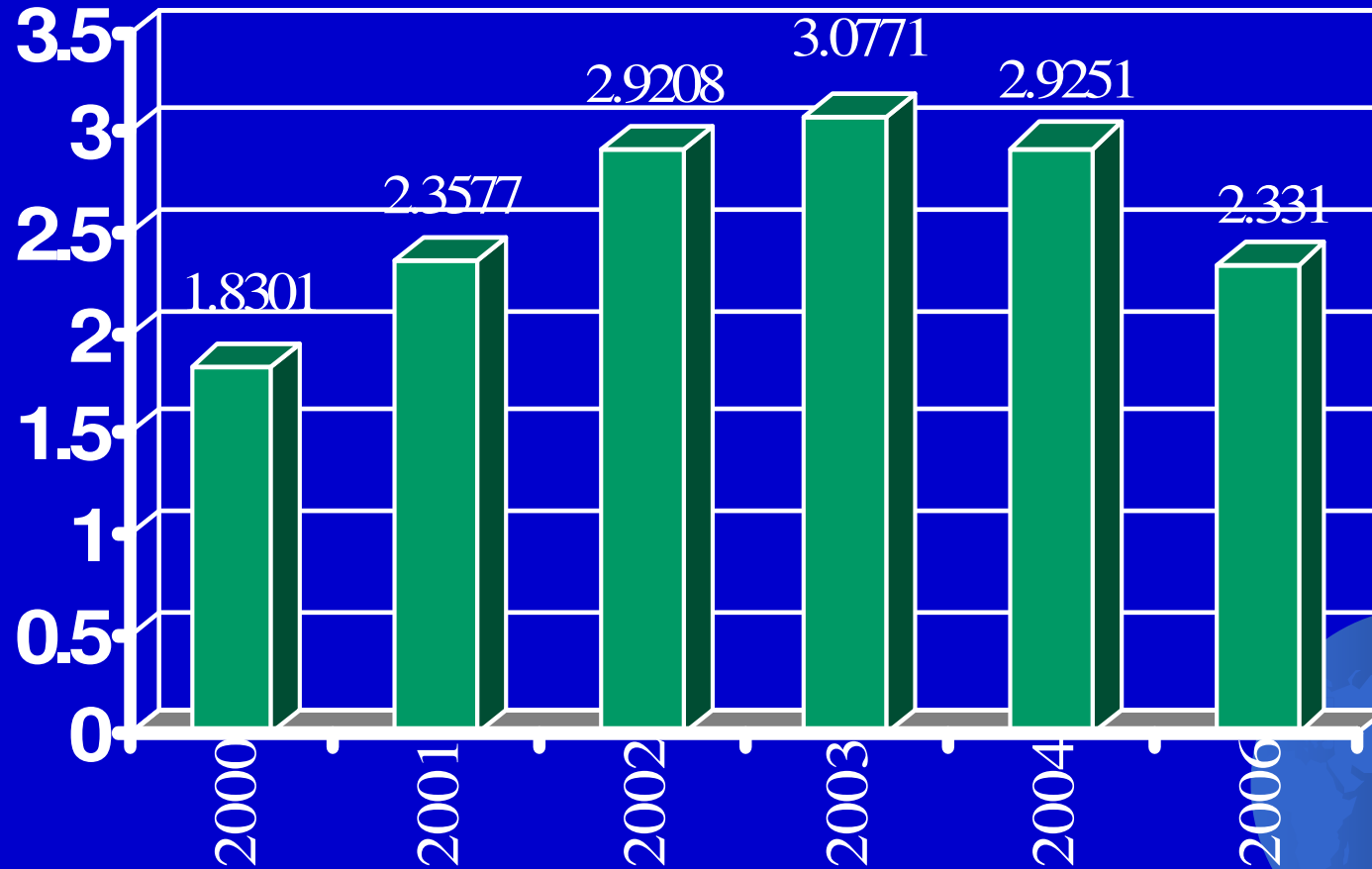


# Inflation

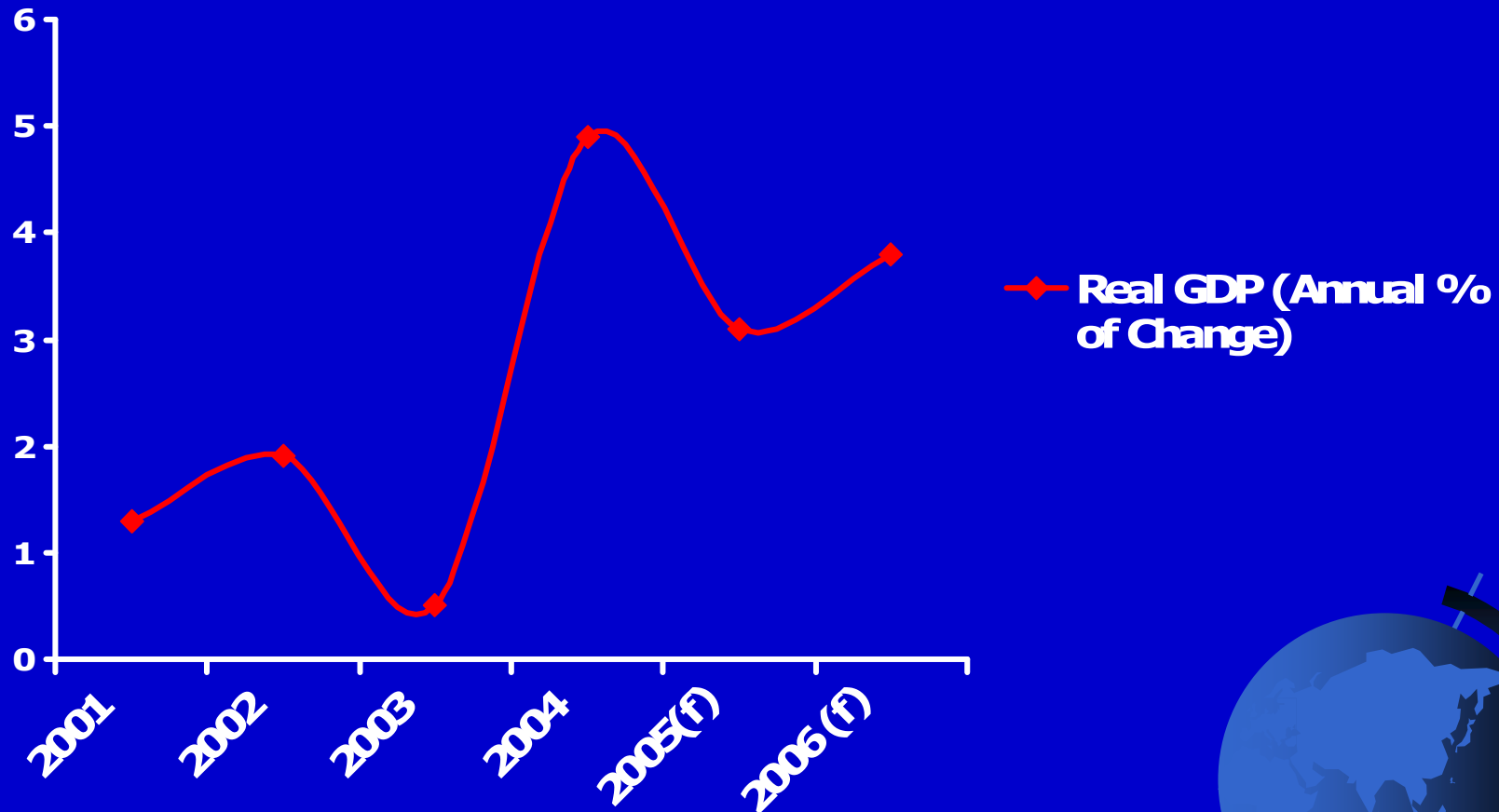


Source: COFACE

# Real Exchange Rate (Real per US\$)



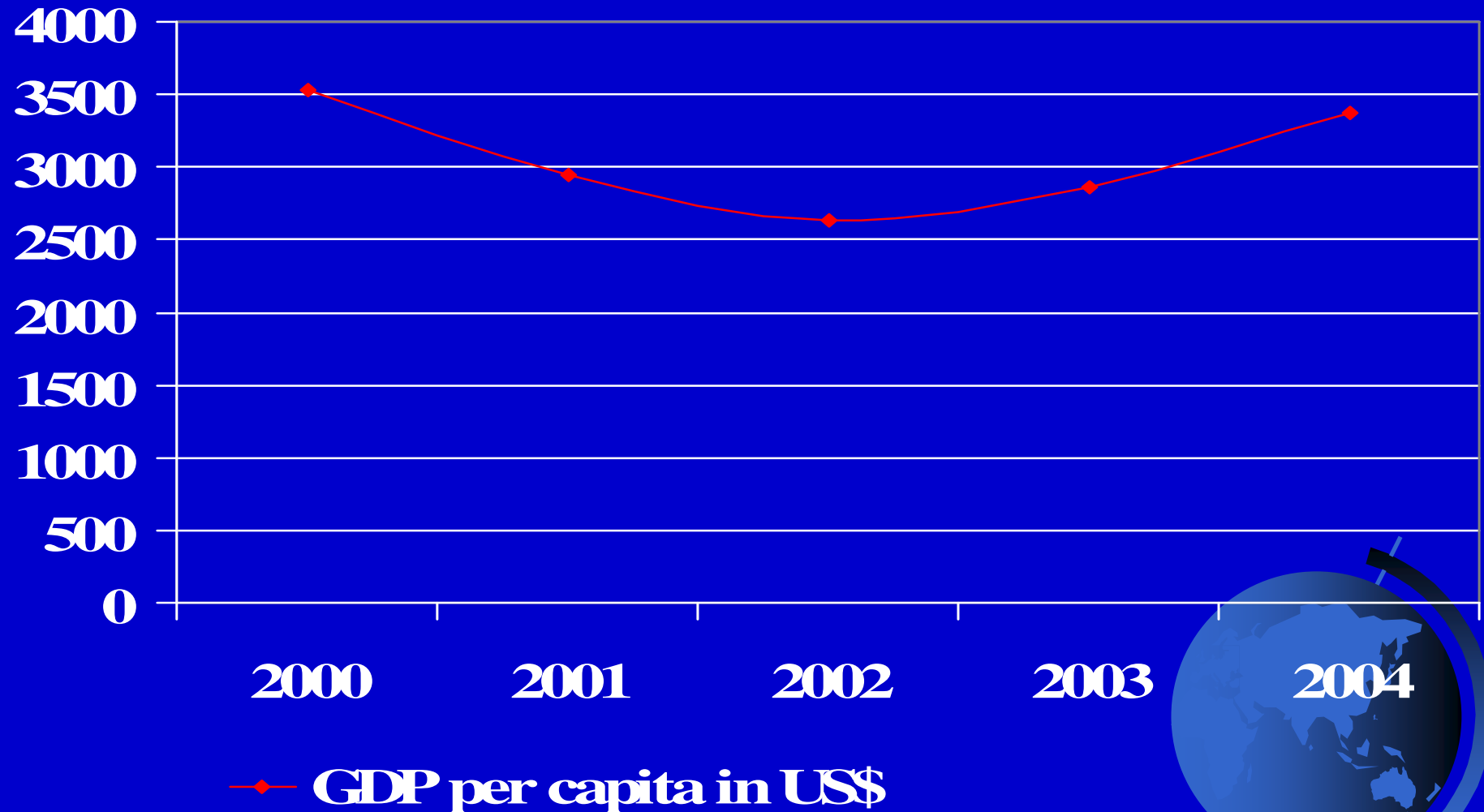
# Real GDP (percentage changes)



Source: COFACE



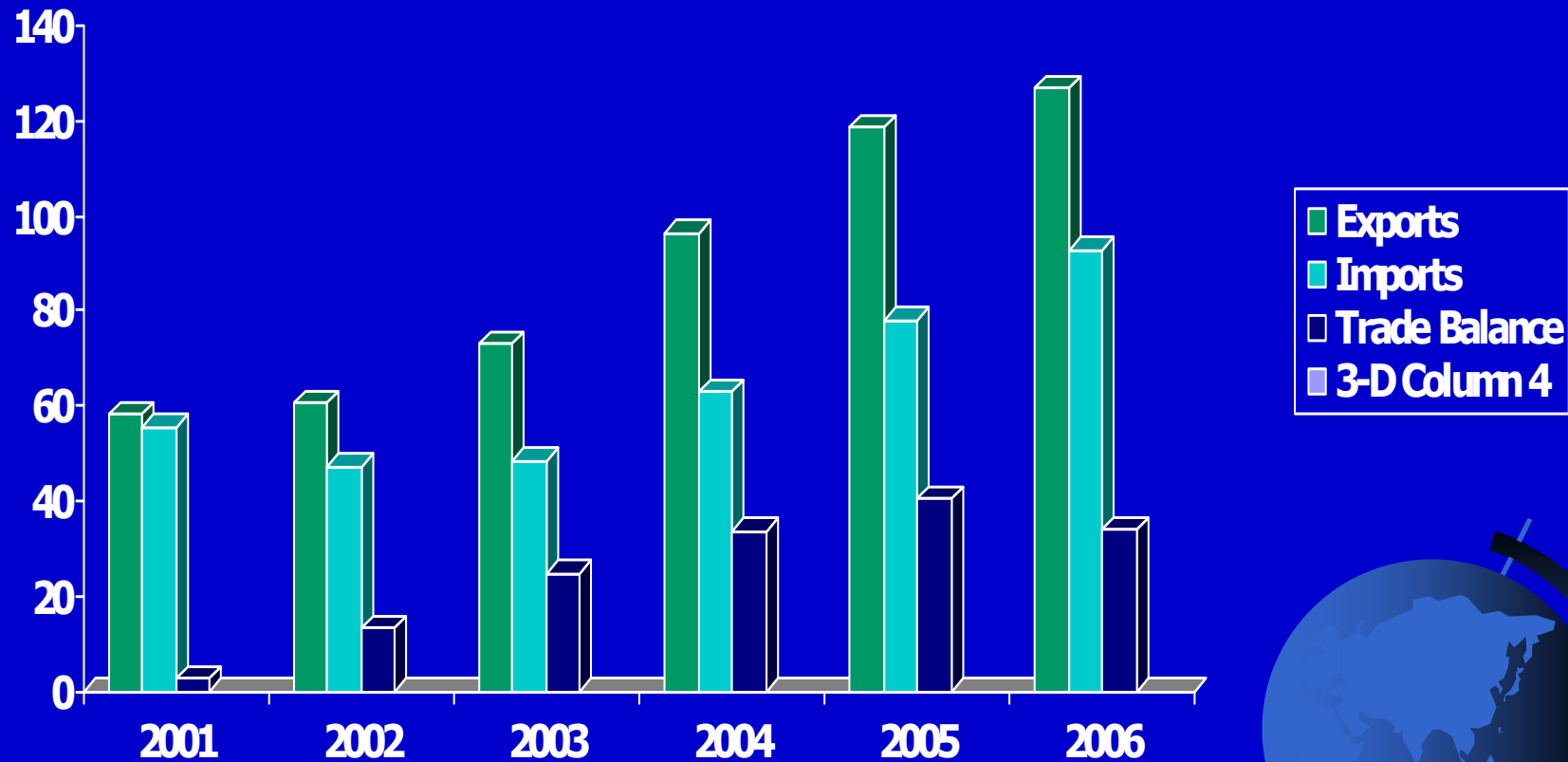
# GDP – Per Capita



Source: IMF, Latin business chronicle

# Foreign Trade in U.S. Dollars

Value : U. S. \$ billion



Source: Coface



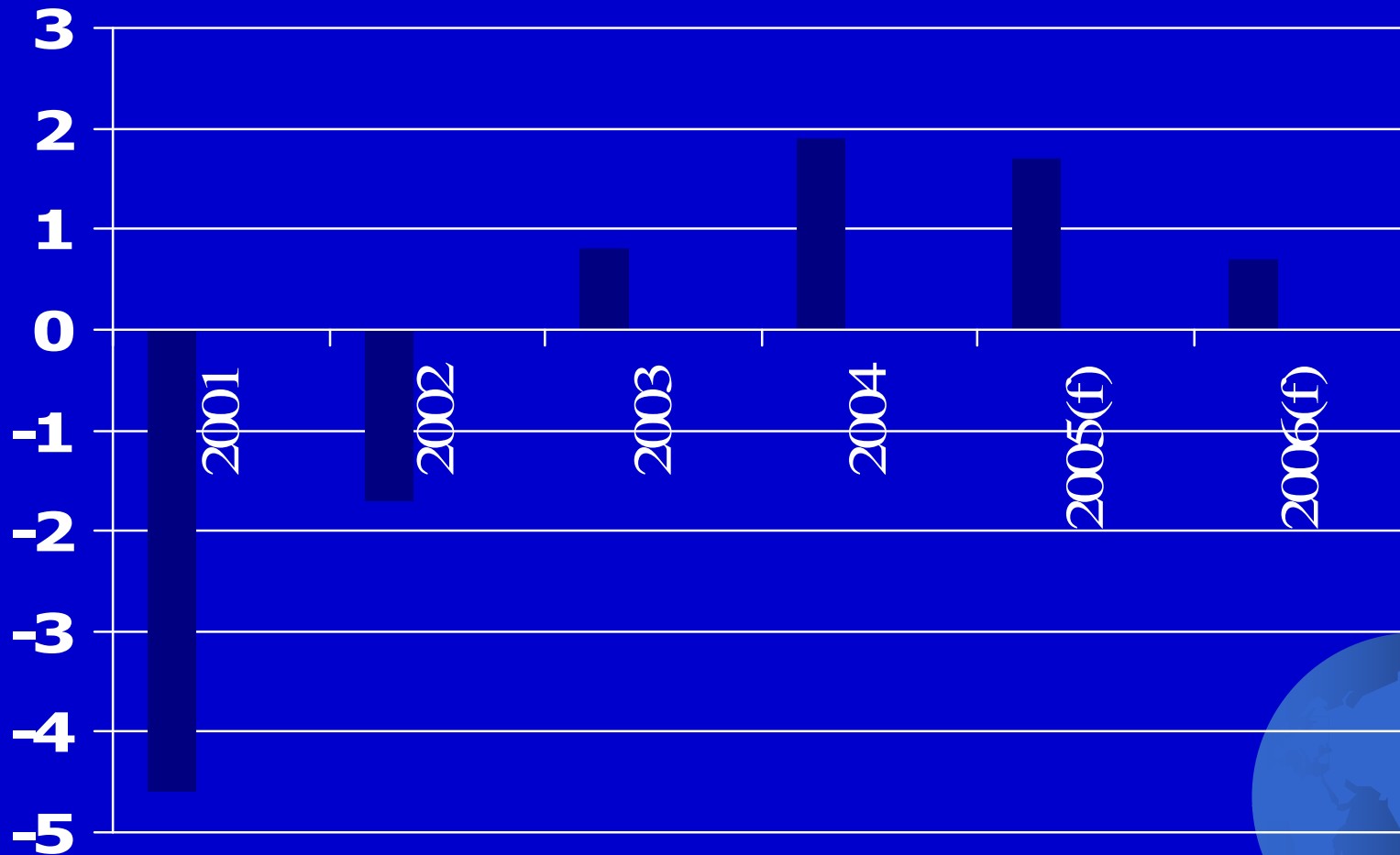


# BOP Analysis

- Liquidity ratio
- Solvency ratio

# Liquidity Ratio

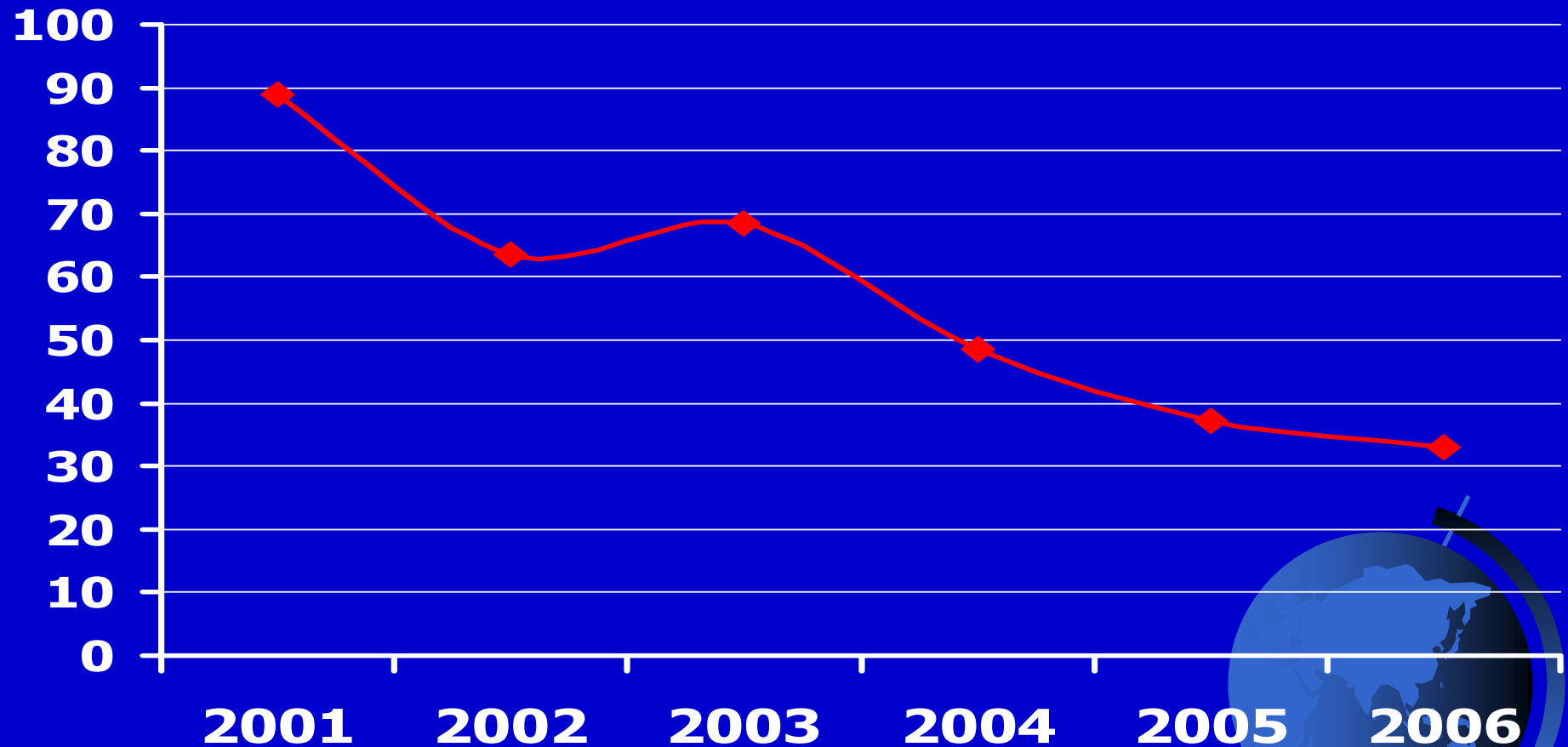
## Current Account / GDP (%)



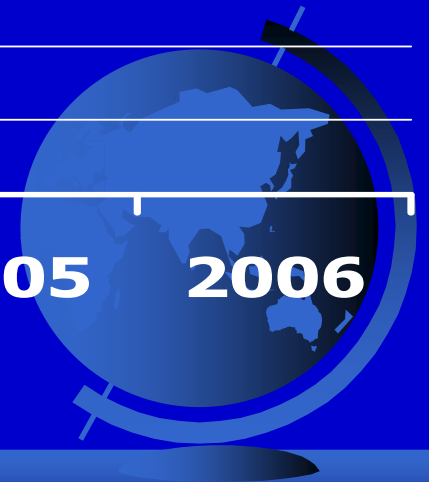
Source: COFACE



# Liquidity Ratio Debt Service Ratio

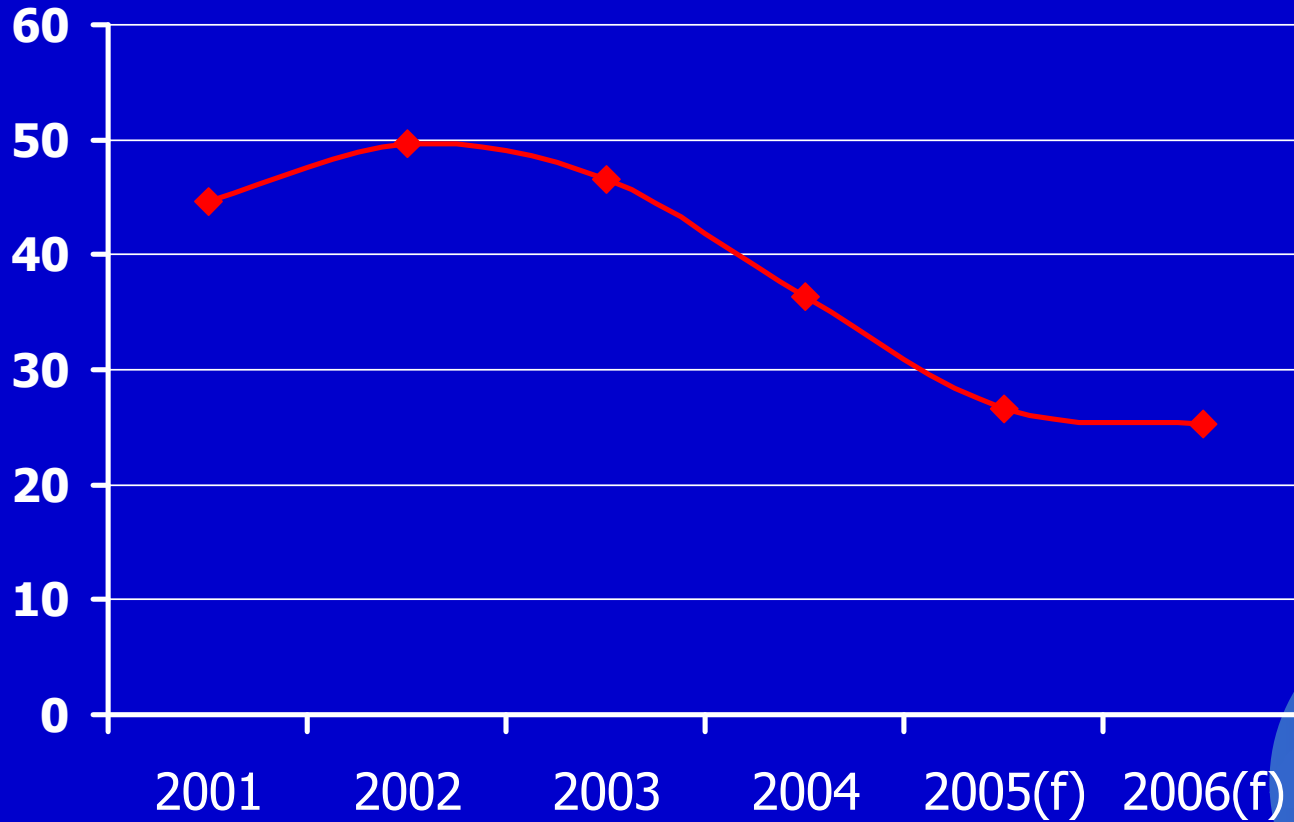


Source:COFACE



# Solvency Ratio

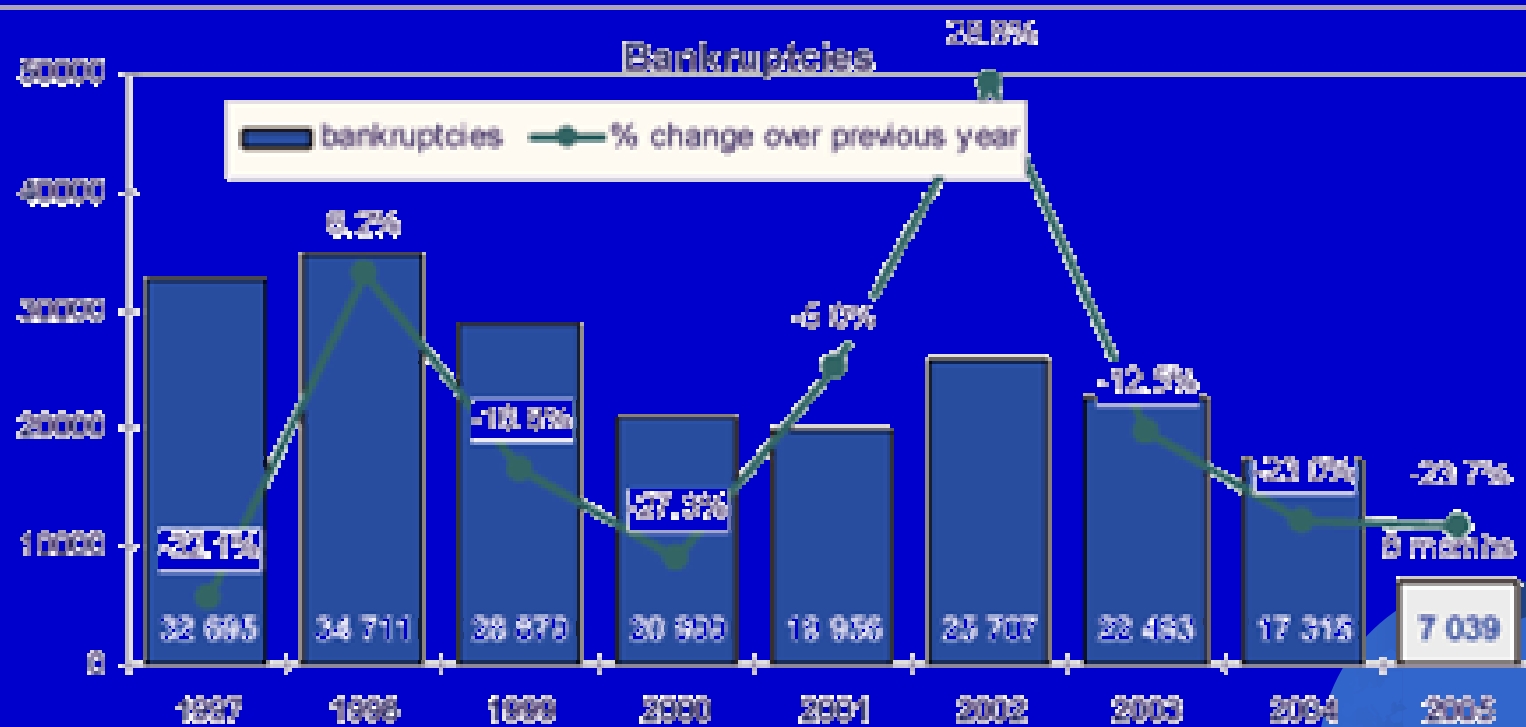
## Debt / GDP Ratio



Source:COFACE



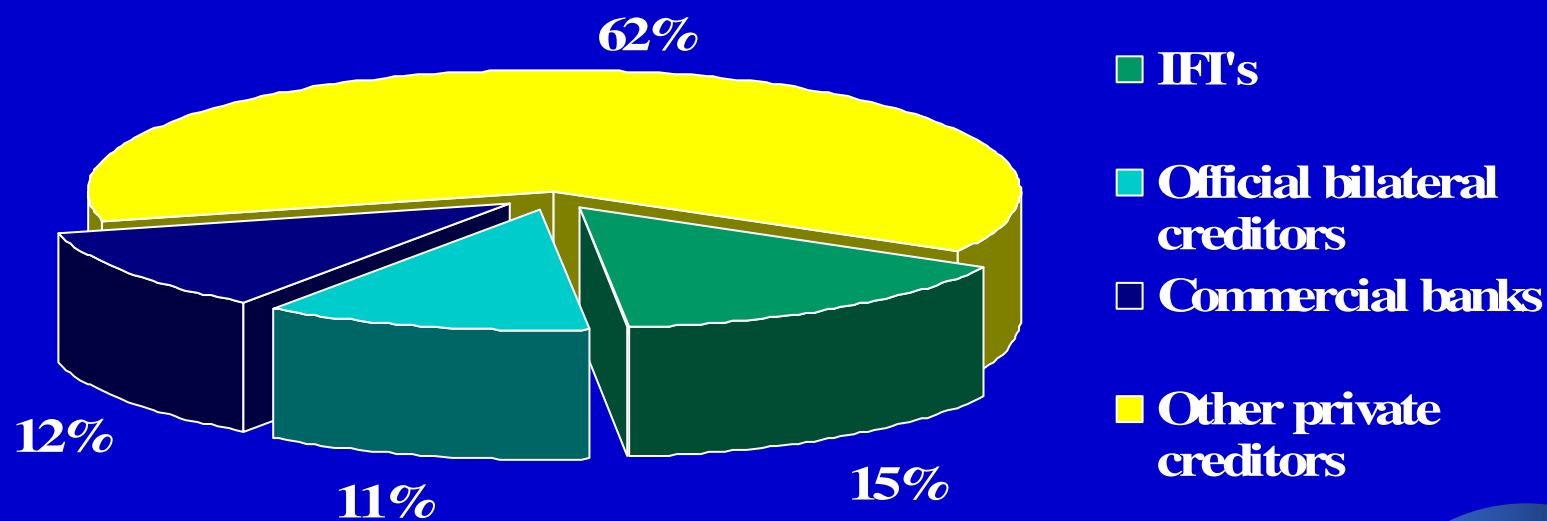
# Insolvency Trends



Source: COFACE

Source: COFACE

# Composition of Debt-Sept 2005



Source: IIF





# Risk Analysis

# COUNTRY RATING

**Rating : B**

**rating watchlisted with positive implications  
since December 2004**

**« An unsteady political and economic  
environment is likely to affect further an  
already poor payment record ».**

**Source: Coface**



# Index of payments arrears 1997-2005 (Coface)



# Country Credit Rating

Rank		Country	Rate	Six month change	One-year change
March 2005	Sept 2005				
137	115	Argentina	26.4	6.3	4.2
83	85	Uruguay	37.8	0.4	4.3
67	66	Brazil	48.2	1.5	5.6
32	30	Chile	71.6	1.6	4.1

Source: Institutional Investor



# Corruption Perceptions Index 2005

Country	Rank	2005 CPI score
Argentina	97	2.8
Brazil	62	3.7
Uruguay	32	5.9
Chile	21	7.3

Source: Transparency International



# Human Development Index (HDI)

Country	Rank
Argentina	34
Brazil	72
Chile	43
Uruguay	46



# Risk assessment

- After three catch-up years, an economic slowdown should develop in 2006 due notably to sagging domestic consumption and insufficient investment.
- The public sector financial situation has remained precarious despite the generation of comfortable primary surpluses and the favourable treatment obtained by Argentina following the restructuring of its bond debt in June 2005. Although that operation also allowed Argentina to sharply reduce its foreign debt, it still has very high debt ratios and substantial financing needs.
- Although foreign exchange reserves nonetheless rose due to substantial trade surpluses and capital repatriation, that trend should wane. Meanwhile, the banking sector is still shaky despite modest improvement.
- The run-up to presidential elections in 2007 will hardly be conducive to progress on structural reforms, particularly concerning the business environment, financial system, and price adjustments for privatised public services.
- In that context, business-to-business credit has been gradually resuming and the financial health of export-oriented companies has been better than that of companies focusing on the domestic market. Subsidiaries of foreign companies have been more cautious, however, due notably to uncertainties concerning the legal and judicial framework.ms.



# Overall Risk Assessment

## Strengths

- Brazil boasts abundant natural resources with a relatively diversified economy.
- Fiscal and monetary policy has been prudent and pragmatic.
- Domestic market potential and low labour costs have continued to attract foreign investors.
- The current level of real permits Brazilian companies to be competitive.
- The country enjoys international financial community backing.

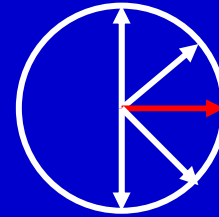
## Weaknesses

- The public debt burden is very heavy with maturities too short.
- The external debt level is unsustainable over the long haul.
- External financing needs are too great in comparison to currency earnings due to the debt amortisation burden.
- The low level of savings — which government financing needs essentially gobble up — has been impeding private company investment.
- The new president has little room for maneuvers, squeezed by his electors' aspirations for change, the need to reach compromises with coalition partners, and by economic restraints.

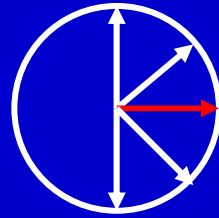


# Overall Risk Assessment

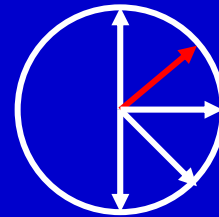
Social & Political stability



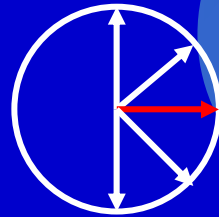
Economic growth prospects



Domestic financial stability

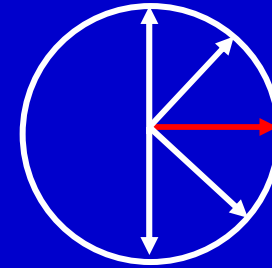


External competitiveness

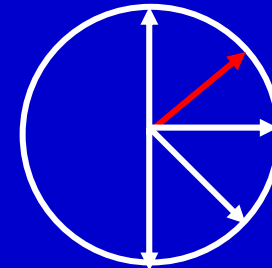


# Overall Risk Assessment

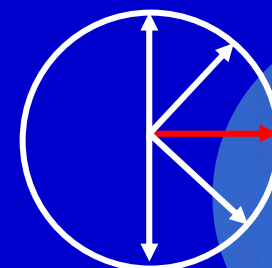
Balance of payments sustainability



Debt servicing capacity



Overall MT perspectives



# Sources

- ☞ **Central Intelligence Agency (CIA)**
- ☞ **Cofacerating**
- ☞ **Country Watch**
- ☞ **World Bank**
- ☞ **The Institute of International Finance (IIF)**
- ☞ **International Monetary Fund (IMF)**
- ☞ **Latin Business Chronicle**
- ☞ **UNDP**
- ☞ **Rating & Investment Information**
- ☞ **Standard & Poor's**
- ☞ **Transparency International**
- ☞ **Kurtzman Group**
- ☞ **Institutional Investors**

