

FEDERATIVE REPUBLIC OF BRAZIL
JANUARY 2008

CREDIT GUARANTEE COUNTRY PROFILE:

IES 02/ ATTACHMENT N

Country Rating	S/T Business Cycle Indicator	S/T Political Indicator	Debt Recovery
2B	↑	→	Debt recovery is better suited to the use of a good collection agent as opposed to the legal route.

Credit Guarantee Experience

We are open for cover in this market without any restriction. We have a large exposure to this market, which by and large has been favourable. This market has been claims free and as such exporters must always ensure they have adequately protected themselves against the risks of doing open account business.

Political Highlights

- ❑ President Luiz Inacio Lula da Silva secured a second four-year term in a landslide victory in October 2006. Seeing that Lula has successfully distanced himself from high profile corruption scandals over the past three years, The Economist expects his popularity to remain high boosted by a growing economy. The next presidential election is scheduled for October 2010.

Economic Trends

- ❑ Brazil's population is estimated at 190 million with an annual growth rate of about 1%.
- ❑ It has a diversified middle income economy, but with wide variations in development levels. Agriculture is a major sector and is key for growth and foreign exchange, accounting for about 8% of GDP (30% including agribusiness) and 40% of exports.
- ❑ The Brazilian economy is finally coming close to the dream of creating the 'broad mass consumer market' announced in 2002 as a campaign promise by President Lula da Silva, but many obstacles still lie ahead. Nearly two million formal sector jobs were created last year and Brazilians bought some 2.45 million new cars, trucks and buses, nearly 30% more than in 2006. Unemployment was estimated at 8.5% last November, the lowest rate since 2002, however full employment remains a distant goal.
- ❑ The South American country has a history of bouts of boom and bust cycles, but many believe that those trends have been eliminated through orthodox monetary policy embraced by Silva's administration after he took power in 2003. Central Bank president Henrique Meirelles said the cycle of growth Brazil is experiencing is strong and sustainable. The Economist foresees Brazil being in a better position to cope with a world slowdown supported by strong domestic demand, increased foreign direct investment, improved integration into world markets and reduced dependence on the US. However it remains concerned about the high government debt (estimated at 46% of GDP in 2006), unsustainable social security expenditure and lack of investment by the government to boost the country's economic potential.
- ❑ The economy expanded 3.8% in 2006 and about 4.7% in 2007. President Lula da Silva is trying to boost annual growth to 5% amid criticism that the nation's economy is expanding slower than the world's other major emerging economies; China, India and Russia. The World Bank forecasts the region's largest economy to grow 4.5% this year while the EIU forecasts annual growth to average 4.5% in 2008-12, sustained mainly by strong private consumption growth on the back of continuing real income gains and easier access to credit. The growth-acceleration programme (PAC) is also expected to spur infrastructure investment and lift GDP growth.
- ❑ Rapid growth and rising demand for consumer products is threatening to push up inflation which was around 4.3% at the end of 2007, compared to 3.1% the previous year. Financial market analysts and economists forecast inflation at 4.3% in 2008, below the central bank's target of 4.5%.
- ❑ Brazil's trade balance ended the year of 2007 with a surplus of \$40bn, 13.8% lower than the surplus for 2006. In 2007, exports grew 16.6% over 2006 reaching \$160.6bn, while imports grew by 32% totaling \$120.6bn. Experts pulled down their forecast for the 2008 foreign trade surplus to \$30.6bn. Brazil's real advanced 20% against the dollar in 2007, the biggest gain among the 16 most-actively traded currencies, buoyed by record exports and capital inflows into the stock and bond markets.

Key Indicators (forecasts)	2007	2008	2009	2010	2011	2012
Real GDP growth (%)	4.7	4.5	4.1	3.9	3.9	3.9
Consumer price inflation (average; %)	3.7	4.1	4.0	3.8	3.7	3.7
Current-account balance (% of GDP)	0.7	0.2	0.3	0.3	0.6	0.8
Exchange rate R:US\$ (average)	2.00	2.13	2.32	2.38	2.44	2.50

Source: Economist

- ❑ Improved investor perceptions of Brazil have resulted in a boost in FDI which doubled to reach a historic high of \$37.4bn in 2007 from \$18bn in 2006. The amount exceeded a forecast by the Brazilian Central Bank made towards the end 2007, which estimated investment of \$35bn for the year. Brazil is a major producer of agricultural and mineral commodities and the flow of investments in the country was largely directed to industries that used local raw materials in production. Much of the foreign investment now flowing into Brazil is coming from investors who expect the country's debt to receive an investment-grade rating from major firms such as S&P over the next couple of years.
- ❑ Brazil's construction industry is developing at full steam with new works being launched continually throughout the country. The sector presented growth of 4.6% in 2006 and forecasts point to a 7% growth this year. Foreign capital inflow rose from \$321m in 2006 to \$900m from January to July of 2007 alone. Brazil runs an 8 million habitation deficit and as a developing economy it has huge demand for infrastructure work. With the growth of the industry, forecasts over the next two years predict that foreign investors are going to apply approximately \$5bn a year in the Brazilian construction sector.

- ❑ Brazil's political and economic landscape is set for major changes following the discovery of oil last year. Brazil's Tupi oil field, estimated to contain as much as 8 billion barrels of light crude and natural gas, could quite possibly have an even bigger deposit right next to it. Another huge natural gas reserve was discovered at the beginning of this year off the coast of Rio de Janeiro. Brazil has welcomed the discovery as its robust industrial sector uses natural gas for power generation and the fuel is also used by millions of drivers. In the next five years it is conceivable that Brazil could move ahead of Mexico and Canada in total oil reserves, becoming second only to Venezuela and the US in the energy pecking order of the Americas.
- ❑ The Brazilian Energy Minister denied reports that a short supply of natural gas from Bolivia and a lack of rain might force Brazil, which relies heavily on hydroelectric power, to ration energy later this year. Rainfall at the beginning of January was 55% lower than usual prompting officials to switch on all thermoelectric power plants to reduce the strain on hydroelectric dams that generate more than 80% of its electricity energy. Petrobras, Brazil's state oil company, does not have enough natural gas to fuel thermoelectric plants, mainly because of rising domestic demand and supply hurdles in Bolivia which provides 50% of Brazil's gas. With electricity demand growing at about 6% per year, some energy experts have been warning of potential energy shortages beginning 2009. Energy prices in the non-regulated market shot up recently to \$269/ MW, 18 times higher than in January 2007.
- ❑ The government faces the immediate challenge of adjusting its 2008 budget due to the loss of the Provisional Contribution of Financial Movements (CPMF) – cheque tax, which the Senate decided not to renew for the next four years. This represents a loss of \$22bn to the government coffers. Lula has promised to compensate for the lost income by means of spending cuts, which would affect public investment in infrastructure and therefore economic growth. Lula says the country's banks can afford to pay more taxes on earnings in light of their profitability in recent years and the government has announced various and increased taxes on banks' lending and profits.
- ❑ Coffee output in Brazil, the world's biggest producer and exporter of the commodity, will fall short of demand this year, driving up prices. Domestic and overseas demand for Brazilian coffee will likely reach 46 million bags in 2008, exceeding an estimated output of 41.2-44.1 million bags. The shortfall will further deplete Brazil's non-government stockpiles, which have fallen by about half to 7.77 million bags now compared with a year earlier.

Trade Developments

- ❑ Main exports: transport equipment and parts (14.6%), metallurgical products, soy beans, meals and oils (7.6%), chemical products.
- ❑ Main imports: machinery and electrical equipment (25.8%), oil and derivatives (16.6%), chemical products (15.8%), transport equipment and parts (11.3%).
- ❑ Leading markets in 2006: US (17.9%), Argentina (8.5%), China (6.1%) and Germany (4.1%).
- ❑ Leading suppliers in 2006: US (16.3%), Argentina (8.8%), China (8.7%) and Netherlands (0.9%).
- ❑ SA's exports to Brazil amounted to R2.8bn in 2006 and R3bn in the year-to-October 2007. SA's imports from Brazil amounted to R9.4bn in 2006 and R9.9bn in the year-to-October 2007. Major South African exports to Brazil include precious and semi precious stones and metals, anthracite and coal, iron and steel, miscellaneous chemical products, organic chemicals, aluminium, nickel, synthetic fibres, machinery and mechanical appliances, paper and paper board. Brazil also remains a major tourist market for South Africa.
- ❑ At the second IBSA summit, held in South Africa last October, leaders signed pledges to accelerate cooperation and to double trilateral trade to \$15bn by 2010. Member states signed seven agreements and resolved to push for a free trade area. The seven agreements signed during the summit envisage cooperation among the three nations in the areas of public administration and governance, tax administration, arts and culture cooperation, higher education, wind resources, health and medicines and social development. Most observers note that the collaboration is only at the beginning, and that the ties of each country with the Global North are still much stronger than their trilateral ties.
- ❑ According to Brazil's state news agency, the country's biofuel sector will open its own 'ethanol embassy' in Brussels as a way to promote the highly efficient fuel. The Sugarcane Industry Union (UNICA) will open an office in the capital of the EU and will select a series of ambassadors to present the case of importing Brazilian ethanol into the Union. It will also work as a hub to ensure exporters can enter the market more easily.
- ❑ On December 18 2007, Mercosur and Israel signed a Free Trade Agreement (FTA) in Uruguay, completing the negotiating process begun in 2005. The agreement with Israel is the first Mercosur Free Trade Agreement with a trade partner outside the region and is part of Mercosur's commitment to broaden its understandings with partners in the Middle East.