

Brazil's Global Bonds Get a BB- from Fitch

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Fitch Ratings, the international rating agency, has today assigned a 'BB-' rating to the global bonds to be issued in exchange for some US\$ 5.6 billion in C-bonds. The outlook on the rating is stable.

As part of a liability management operation, the Brazilian treasury announced this week the issuance of the new global bonds in exchange for the C-bonds which were issued as part of the restructuring of Brazilian sovereign debt during the 1980s debt crisis.

The new bonds have a longer duration than the C-bonds, improving the overall debt profile of the treasury.

Brazil's sovereign ratings, which were affirmed last week, reflect a balance between the favorable trends in Brazil's external finances and the risk that political gridlock could hamper improvements in public debt dynamics and constrain economic growth.

Officials of the PT (Workers Party) party have been accused of bribing congressman for key votes, and coalition members accused of improper use of funds in the postal and reinsurance authorities.

The Lula government has acted to contain the negative fallout by dismissing some officials allegedly involved. Corruption investigations could prevent the passage of reforms and stymie the budgetary process, though Fitch does not expect any major fiscal or monetary policy slippage as a result.

A downside political scenario cannot be ruled out, however, in which key economic policy officials are implicated and forced to resign and some policy slippage ensues.

Difficulty getting important government positions confirmed by the Senate is possible, for example, in the event of the resignation of a central bank board member. Uncertainty about the outcome of the October 2006 national elections has increased as well.

Brazilian balance of payments performance continues to be favorable, with annual export growth over the last 2 1/2 years averaging 26%.

However, certain commodity prices (for steel and agricultural goods) have moved lower, global growth is softening, and the Brazilian Real has strengthened, resulting in signs of slower Brazilian export growth.

Export growth and a paydown of external obligations have driven improving performance on one of Fitch's key external solvency indicators.

Net external debt (NXD) to current external receipts (CXR) is expected to fall to just over 100% by year-end 2005 and to 90% next year from 233% in 2002, though this still lies well above the forecast 2005 'BB' median of 43% for this indicator.

On public finances, last year the Lula government outperformed its original primary budget surplus target of 4.25% of GDP, achieving 4.6% on strong tax revenue growth.

Nevertheless, given how robust 2004 GDP growth was (4.9%) and how high 2004 general government (GG) debt was (75% of GDP), perhaps more of the windfall could have been saved.

GG debt to GDP compares unfavorably to the 'BB' median of 51%, but relative to GG revenues, at 200%, GG debt is lower than the 'BB' median of 235%. Furthermore, Brazil's government has nearly 10% of GDP in liquid deposits at the central bank.

Fitch Ratings - www.fitchratings.com