

Brazil to Get a BB- for Global Bond Due 2037

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Fitch Ratings has assigned a prospective 'BB-' rating with a Positive Outlook to Brazil's soon-to-be-issued Global U.S. dollar bond due in 2037.

Brazil's sovereign ratings and Positive Outlook reflect the favorable trends in the country's balance of payments and external debt dynamics, as well as substantial progress in moderating inflationary pressures, holding out the prospect of lower real interest rates.

Fitch revised Brazil's Outlook to Positive from Stable on Oct. 11, 2005 in recognition of the fact that the turmoil in Brazilian politics that began in mid-2005 had not compromised the country's commitment to sound macro policy settings.

Exports were up 22.6% in 2005, totaling US\$ 118.3 billion, after rising 32% the year before, compared with a 17.1% increase in imports in 2005 to US\$ 73.5 billion, for a record US\$ 44.8 billion trade surplus.

The current account surplus is estimated at over US\$ 16 billion in 2005 (or 2% of GDP), Brazil's best current account performance in over 10 years.

Net external debt (NXD) to current external receipts (CXR), a key external solvency indicator monitored by Fitch, is expected to have fallen below 95% by year-end 2005, down from 128% in 2004 and a high of 308% in 1999.

Still, Brazil's ratio compares unfavorably with the 'BB' median of 45.1%, though Brazil's NXD-relative GDP compares favorably against peers.

Even so, Fitch warns that Brazil's public debt burden remains high and of short duration and remains a constraint on the country's sovereign ratings. This is in spite of the government's outperformance of its primary budget surplus targets in recent years.

Central to reducing the public debt and firmly anchoring public finances on a sustainable path is a reduction in real interest rates, which remain very high by international standards and impose large fiscal costs.

In Fitch's opinion, establishing a consistent track record on appropriate monetary policy actions to meet the central bank's stated inflation target, including in the run-up to the presidential elections, would further enhance the credibility of the macroeconomic policy framework.

This would support a sustained reduction in inflation expectations and real interest rates that would be beneficial both for growth and public finances. Likewise, central bank autonomy reform would underpin monetary policy credibility and therefore lower real rates.

Factors that could trigger an upgrade of Brazil's sovereign ratings include: continued strong export and balance of payments performance, even under less favorable market conditions; a fall in real interest rates underpinning sustained GDP growth rates of at least 3.5% per year; governability, reflected above all in fiscal restraint, maintained in spite of the corruption investigations and the 2006 elections; and finally, greater certainty about the continuity of macro policies in the incoming administration.

Fitch Ratings - www.fitchratings.com