

Fitch Affirms Brazil's IDRs at 'BBB'; Outlook Stable

Written by Australian Business

NEW YORK--([BUSINESS WIRE](#))--Fitch Ratings has affirmed Brazil's long-term foreign and local currency Issuer Default Ratings (IDRs) at 'BBB'. Fitch has also affirmed the issue ratings on Brazil's senior unsecured foreign and local currency bonds at 'BBB'. The Rating Outlooks on the long-term IDRs are Stable. Fitch has affirmed the Country Ceiling at 'BBB+' and the short-term foreign currency IDR at 'F2'.

KEY RATING DRIVERS

Brazil's IDRs reflect the following key factors:

Brazil's ratings reflect its economic diversity, relatively developed institutions, a strong shock-absorption capacity underpinned by a robust external liquidity position, its status as the fifth strongest net sovereign external creditor in the 'BBB' category, and an adequately-capitalized banking system. These factors are counterbalanced by structural weaknesses in the country's public finances, relatively high government indebtedness, low savings and investment rates and limited progress in improving competitiveness and fiscal flexibility.

Brazil's economic under-performance continues while inflation is hovering around the upper limit of the tolerance interval around the inflation target. Five-year growth average has slipped to 2.7%, which is lower than the 3.2% for the 'BBB' median. Fitch projects average growth to remain around 2% during 2014-16. Brazil's tepid growth responds to restrained domestic confidence as well as other cyclical and structural factors.

Over the past year, Brazil has made some policy adjustments intended to restore confidence including monetary tightening of 375bps since April 2013, greater flexibility of the exchange rate, and measures to promote private investment in the infrastructure sector. Yet, confidence remains subdued, suggesting the need for further adjustments. Concerns over lagging administrative price adjustments, reduced fiscal credibility and the lack of a comprehensive reform agenda may have to be addressed to improve confidence. While the election cycle is likely to delay these adjustments, Fitch believes that some progress is likely after the elections.

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Brazil's fiscal accounts have deteriorated, as reflected by lower primary surpluses. The government has relied on non-recurrent revenues to prevent a faster deterioration and this is likely to be the case in 2014 as well. This highlights the need for the government to control spending, especially in the context of moderate economic growth which will likely constrain a robust recovery in fiscal revenues. Fitch forecasts that the general government deficit could reach over 4% of GDP this year.

Brazil's general government debt declined to 56.7% of GDP in 2013 but remains heavier than the 40% for the 'BBB' median. Fitch is currently forecasting the debt burden to increase slightly in 2014 before stabilizing at below 60% of GDP thereafter provided that there is some fiscal tightening next year and Treasury loans to BNDES (the Brazilian development bank) remain on a downward trajectory. Brazil has continued to improve its debt composition in recent years and retains favorable market access, which reduces interest rate, currency and refinancing risks.

Brazil's current account deficit reached 3.6% of GDP in 2013 and Fitch expects it to remain at a similar level in 2014 before narrowing slightly during the forecast period. However, Fitch believes that the relative resilience of foreign direct investment flows, good access of private and public sectors to external borrowing and a strong reserves position continue to support Brazil's external flexibility.

Brazil will hold general elections in October 2014. Polls suggest that the chances of a second round have increased. Fitch believes that the next administration will confront the challenge of making policy adjustments to reduce inflation and place public finances on a stronger footing. Irrespective of the outcome, Fitch expects some policy tightening next year although the pace and degree of the adjustment and reform momentum could depend on the ultimate winner and the size of the governing coalition.

RATING SENSITIVITIES

The Stable Outlook reflects Fitch's assessment that upside and downside risks to the rating are currently balanced. Fitch's sensitivity analysis does not currently anticipate developments with a high likelihood of leading to a rating change.

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The main factors that individually, or collectively, could trigger a negative rating action include:

--Erosion of the policy framework leading to increased macroeconomic and financial vulnerabilities;

--Sustained economic under-performance and fiscal deterioration that undermines government debt dynamics;

--A severe deterioration in Brazil's international reserves position and/or government debt composition.

The main factors that individually, or collectively, could trigger a positive rating action include:

--Higher investment rates and growth trajectory;

--Fiscal consolidation that supports government debt reduction.

KEY ASSUMPTIONS

The ratings and Outlooks are sensitive to a number of assumptions:

--Fitch expects the Brazilian elections in October to be smooth, overall governability to remain intact despite periodic protests in certain cities and no material changes to the overall macroeconomic policy framework following the elections.

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--Fitch does not include any potential electricity rationing scenario in its baseline economic projections.

--Fitch assumes that Brazil maintains international and domestic market access even if there is return of higher international financial volatility.

--Fitch assumes that China avoids a hard landing although its growth decelerates to 7.3% in 2014 and 7% in 2015 from an average of 8.2% during 2011-13. Under this scenario, Fitch expects commodity prices to soften but remain at relatively high levels.

Additional information is available on www.fitchratings.com

Applicable Criteria and Related Research:

--'Sovereign Rating Criteria' dated Aug. 13, 2012;

--'Country Ceilings' dated Aug. 9, 2013.

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Sovereign Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685737

Country Ceilings

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=715618

Additional Disclosure

Solicitation Status

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