Fitch Upgrades Brazil's Ratings to 'BBB'

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Fitch Ratings-New York-04 April 2011: Fitch Ratings has taken the following rating actions on the Issuer Default Ratings (IDRs) and Country Ceiling for Brazil: --Foreign currency IDR upgraded to 'BBB' from 'BBB-'; --Local currency IDR upgraded to 'BBB' from 'BBB-'; --Country ceiling upgraded to 'BBB+' from 'BBB'; --Short-term IDR upgraded to 'F2' from 'F3'. The Rating Outlook is revised to Stable from Positive. The upgrade reflects Fitch's assessment that the sustainable potential growth rate of the Brazilian economy has increased to 4%-5%, supporting the medium-term fiscal outlook and the continued strengthening of its external liquidity position, which increases the country's shock-absorption capacity. The transition of power to the Rousseff administration has been smooth and the consensus on responsible macroeconomic policies remains well-anchored. Moreover, the Rousseff administration has displayed signs of greater fiscal restraint, which coupled with healthy growth prospects should allow for a fall in Brazil's heavy general government debt burden. The Brazilian economy expanded at historically high rates last year with GDP growth reaching 7.5%. Fitch's base case assumes that the tightening of macroeconomic policies that is currently underway should allow for a soft-landing of the Brazilian economy with growth reaching approximately 4% in 2011. 'Brazil's medium-term growth trajectory is likely to remain relatively robust due to its domestic demand dynamics, which are underpinned by the country's economic diversity, a large and growing middle class and a positive investment cycle,' said Shelly Shetty, Senior Director and head of Latin America Sovereign ratings. Brazil's five-year GDP growth reached 4.4%, which is above the 'BBB' median and its per capita income at market exchange rate is above the 'BBB' median. Brazil's external liquidity position has strengthened further since the global credit crisis, with international reserves at over USD300 billion currently. Brazil remains one of the strongest net sovereign external creditors in the 'BBB' category. Fitch notes that while Brazil's current account deficits are likely to remain more elevated than in the recent past, the deterioration in net external debt indicators could be contained by the expected robust foreign direct investment flows. The new government's announcement of spending cuts in 2011 and a modest increase in the minimum wage as well as a steady reduction in the Treasury's loans to the BNDES (a national development bank) are supportive of a gradual improvement in the overall fiscal stance. Fitch also notes that the Treasury's pro-active liability management has led to further improvements in the domestic debt structure. Moreover, the Treasury has already secured considerable resources for external debt amortizations in the coming years, which reduces the country's vulnerability to volatility in international capital markets. 'Brazil's near-term macroeconomic challenges include fighting inflation and bringing it back to the mid-point of the target range and moderating the pace of credit growth,' added Shetty. A more rapid tightening of fiscal policy would improve the overall fiscal-monetary policy mix and relieve currency appreciation and upward pressure on interest rates, while further action may be required to slow the pace of private credit growth to a more sustainable level. Potential policy slippage and a 'hard landing' remain as risks for Brazil, though they are expected to be contained and to moderate as the economy gradually rebalances and credit expansion slows. Fitch believes that despite the Rousseff administration gaining strength in Congress, progress on economic reforms is likely to be incremental and gradual in nature. Tax and social security reforms are still important to improve the structure of public finances. Higher savings rate and further progress on microeconomic reforms to improve business climate and develop infrastructure would ease constraints on achieving a higher growth trajectory. While measures announced to attract long-term capital in Brazil's credit markets are positive and indicate a more pragmatic stance towards private investment, the development of such markets will take time. Going forward, a sustained improvement in Brazil's fiscal and external balance sheets, further improvements in economic growth dynamics and a continued consolidation of macroeconomic stability will be viewed positively. Economic reforms that improve Brazil's competitiveness and address structural weaknesses of public finances would be credit-positive. On the other hand, a sharp rise in public debt burden or the crystallization of significant contingent liabilities from the financial sector could also undermine creditworthiness. Contact: Primary Analyst Shelly Shetty Senior Director +1-212-908-0324 Fitch Inc. One State Street Plaza New York, NY 10004 Secondary Analyst Erich Arispe Director +1-212-908-9165 Committee Chairperson David Riley Group Managing Director +44-203-503-1175 Media Relations: Cindy Stoller, New York, Tel: +1 212 908 0526, Email: cindy.stoller@fitchratings.com. Additional information is available at 'www.fitchratings.com' ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTP://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. 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