Fitch Upgrades Brazil's IDRs to 'BB+'

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Fitch Ratings today upgraded Brazil's long-term foreign and local currency sovereign Issuer Default Ratings (IDR) to 'BB+' from 'BB' and the Country Ceiling to 'BBB-' from 'BB+'. In addition, Fitch affirmed Brazil's Short-term IDR at 'B'. The Rating Outlook is Stable. The upgrade reflects the significant improvement in Brazil's external balance sheet underpinned by prudent macroeconomic policies and a rise in domestic savings. 'The accumulation of international reserves - US$36 billion since the beginning of the year alone - underscores the continuing strengthening of Brazil's external balance sheet and resilience to external shocks', said Shelly Shetty, Senior Director in Fitch's Sovereign Group. On the back of a healthy current account surplus, and continued robust foreign capital inflows, international reserves are currently at a record high of US$122 billion and projected by Fitch to exceed USD130 billion by the end of the year, equivalent to 150% of short-term and liquid foreign debt liabilities. While the accumulation of international reserves in part reflects potentially volatile inflows attracted by Brazil's high real interest rates, it is also underpinned by continuing trade and current account surpluses and foreign direct investment. It also provides insurance against a less favorable global economic and financial environment, albeit at a cost given the large interest rate differential on Real and U.S.-dollar assets. The increase in international reserves and the government's active liability management operations have resulted in a sustained reduction in Brazil's key external solvency ratios as well. Brazil's net external debt (percent current external receipts, or CXR) is expected to reach 34% in 2007, which is consistent with the 'BB' median and modestly above the 'BBB' median of 23%. More impressively, Fitch estimates that net public sector external debt could reach -20% of CXR by end-2007, making Brazil one of the few net public external creditors in the 'BB' category. Macroeconomic stability remains well anchored, underpinned by low inflation, a strengthening exchange rate, and fiscal policies consistent with stable government debt burden. The recent upward revision in Brazil's GDP figures lowered the general government debt to 67% of GDP in 2006, from the previous 75%. The lower initial government debt burden combined with potentially higher growth has modestly improved Brazil's debt dynamics, with Fitch expecting the general government debt to fall to 64.5% of GDP by 2010, down from 67% in 2006. The rise in domestic savings since 2002 provides additional comfort that Brazil's still high public debt burden is sustainable and can be largely financed domestically. Nonetheless, Brazil's sovereign ratings remain constrained by its heavy government debt burden and the substantial market risk from its relatively short duration. Brazil's debt burden remains heavy compared with the 'BB' and 'BBB' medians of 40% and 34%, respectively. Moreover, the government has made only slow progress in lengthening the maturity of its domestic debt, which implies that its financing needs (maturing debt plus the budget deficit) remain well above 20% of GDP, one of the highest levels in its peer group. 'Further improvements in Brazil's sovereign creditworthiness would require greater confidence that public debt was on a sustained decline over the medium term. With real interest still in high single-digits and economic growth averaging just 3% over the last five years, public debt dynamics remain vulnerable to adverse shocks' according to Shetty. Impediments to a low investment rate (estimated at 17% of GDP) need to be removed in order to boost productivity and potential growth. A high tax burden, high real interest rates, infrastructure constraints, and a relatively low public investment level explain Brazil's low growth performance. Sustained macroeconomic stability and greater evidence of the resilience of the country's policy framework to external shocks, a faster reduction in the government's debt burden including an improvement of the domestic debt composition, and further strengthening of the country's external solvency and liquidity ratios would enhance Brazil's prospects of reaching investment grade in the future. Further structural reforms, such as central bank autonomy and fiscal reforms, notably addressing the continuing deficit in the social security system, would enhance Brazil's capacity to absorb shocks and sustain a higher rate of economic growth, though the prospect for such reforms appears modest at best. 'A weakening of the commitment to prudent fiscal policies and of the central bank's de facto operational autonomy would bring downward pressure on Brazil's sovereign ratings' warned Shetty. Contact: Shelly Shetty +1-212-908-0324, Erich Arispe +1-212-908-9165, New York; or David Riley +44-207-417-6338, London. Media Relations: Christopher Kimble, New York, Tel: +1 212-908-0226. Fitch's rating definitions and the terms of use of such ratings are available on the agency's public site, 'www.fitchratings.com'. Published ratings, criteria and methodologies are available from this site, at all times. 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