Fitch Revises Brazil

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Fitch Ratings-New York-October 11, 2005: Fitch Ratings has revised the Outlook on Brazil's 'BB-' sovereign ratings (long-term foreign currency and long-term local currency) to Positive from Stable. This reflects the country's favorable trends in the 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 and underpinning future growth prospects. In addition, the Outlook revision is supported by the fact that the recent turmoil in Brazilian politics has not compromised the country's commitment to sound macro policy settings. 'The improvement in Brazil's external solvency indicators has been impressive and is expected to continue. And, in spite of a strong currency, Brazilian exports continue to expand at a nice pace,' said Roger Scher, head of Latin American Sovereign Ratings at Fitch. Exports were up 23.4% in the year to September to US$86.7 billion, compared with a 19.6% increase in imports to US$54 billion, for a US$32.7 billion nine-month trade surplus, or US$41 billion over the last 12 months. Fitch has raised its forecasted trade surplus for year-end 2005 to US$40 billion from US$33.3 billion in July 2005, when the agency issued a report on the Brazilian sovereign. The current account surplus is forecast at US$11.5 billion (or 1.4% of GDP) this year. Net external debt (NXD) to current external receipts (CXR), a key external solvency indicator monitored by Fitch, should fall below 100% this year from 128% last year and a high of 308% in 1999. Still, Brazil's ratio compares unfavorably to the 'BB' median of 56.1%, though Brazil's NXD relative GDP compares favorably against peers. Even so, Fitch warns that despite the government's adherence to its primary budget surplus targets, the public debt burden remains high and of short duration and remains a constraint on Brazil's sovereign ratings. 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. 'GDP growth should be higher next year than originally expected,' said Scher, 'due to lower real interest rates'. Fitch revised its 2006 GDP growth forecast to 3.5% from 3.2%. Finally, while the corruption scandals that have rocked Brazilian politics since June of this year are far from resolved, there have been signs of late that Brazil's political leaders are not willing to compromise sound macro policy settings and economic performance as a result of pre-election power struggles. The Lula administration passed the LDO multi-year budget guidelines law in August, albeit two months later than is customary, with the budgetary spending and tax ceilings intact. Moreover, President Lula vetoed amendments to the LDO that would constitute policy slippage. Congress will ultimately vote on whether to uphold or override his vetoes. While the president may have difficulty putting through a 2006 budget this year, signs of his ability to govern have emerged, in spite of the corruption allegations. Such signs include the recent victory of his allies in the election for the leadership of the Chamber of Deputies. 'Fitch will closely watch whether President Lula can uphold his vetoes and pass a sound budget,' said Scher, 'or whether there will be fiscal policy slippage as a result of the current political crisis.' Factors that could trigger an upgrade of Brazil's sovereign ratings include: exports and the balance of payments continuing to weather a strong Real, slower global growth and the possibility of increased risk aversion in the international capital markets; a fall in real interest rates underpinning sustained GDP growth rates of at least 3.5% per year; governability maintained in spite of the corruption investigations and the 2006 elections (underscored in the near term by passage of the Lula LDO vetoes and the 2006 budget), as well as continued fiscal restraint; and finally, greater certainty about the continuity of macro policies in the incoming administration. Contact: Roger M. Scher +1-212-908-0240 or Morgan Harting

+1-212-908-0820, New York. 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. Fitch's code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance and other relevant policies and procedures are also available from the 'Code of Conduct' section of this site. Media Relations: Chris Kimble +1-212-908-0226, New York