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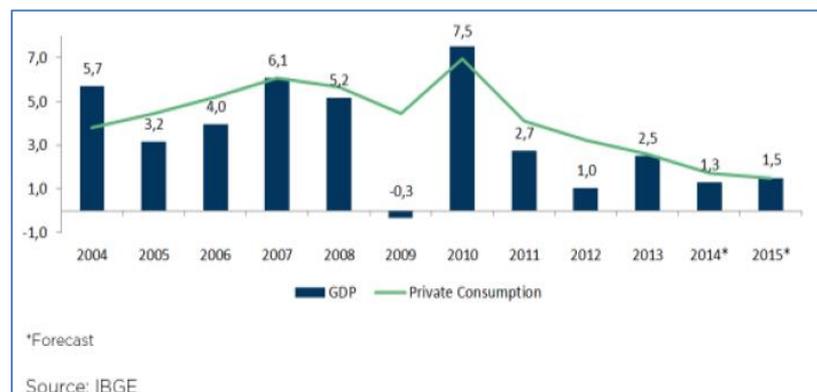
Downgraded to A4¹, Brazilian economy gears towards a year of adjustments in 2015

Brazil did not take advantage of the buoyant economy of the past to undertake the reforms needed to modernise its infrastructure and improve the country's business climate. In terms of market efficiency the country is weak, despite its potential in terms of market size. Local industry has been facing pressured margins, due to high transportation and energy costs and wages. Competing with imported products has been a major challenge for companies from many sectors.

Coface expects a considerable slowdown of GDP in 2014 (at +1.3% in 2014, down from +2.5% in 2013), due to household consumption growing at a slower pace, investments losing momentum and a weak trade balance. Coface considers 2015 to be a turning point, boosting GDP in the medium term.

2014: commercial weakness during the next months

After a marginal increase of 0.9% in 2012, Brazilian GDP registered a slightly better performance of 2.5% in 2013. Activity was mainly driven by a recovery of investment that increased by 6.3% YoY, following the drop of 4% observed in 2012. Despite this improvement, the level of investments in the country remains very low, representing only 18.4% of the GDP in 2013.



For many years the country's growth was driven by household consumption, which surpassed GDP on many occasions in the past decade. An emerging middle class and easier credit access contributed to this scenario, but the model seems to have reached its limits: interest

¹ The Coface country risk assessment measures the average risk of non-payment by companies in a country in the context of their short term commercial transactions. Sovereign debt is not included in this. In forming the assessment, Coface brings together the economic, political and financial outlooks for the country, Coface's payment experience and the business environment of the country. They are based on a scale with 7 levels: A1, A2, A3, A4, B, C, and D and can be combined with watch categories.

rates and inflationary pressures have increased, while salaries have been growing very slowly.

2014 will be marked by low activity and high inflation. Thanks to the World Cup and presidential elections, the business calendar will be shorter in Brazil this year. The World Cup will only benefit specific segments, such as tourism, restaurants and clothing. Moreover, many industries and services were obliged to halt activity on match days, as the country's transportation infrastructure was not sufficient to absorb the larger volume of users.

Entrepreneurs are expected to postpone investments during the second quarter of 2014 and it is not clear yet if investments will regain momentum in 2015. The next government will need to use restrictive measures to put inflation back on track.

"For 2014 we expect a weaker scenario in terms of GDP – at best, 1.3%. Brazil has already begun 2014 with a downgrade by rating agencies. In March 2014, Coface also downgraded Brazil from A3 to A4. The higher risk perception over the country is explained by the deterioration of official economic indicators, low investment, high inflation and activity that lacks momentum", says Patricia Krause, Economist for the Latin America region at Coface.

Industries will continue to face challenging times

- Chemical sector - will probably remain at high risk assessment, due to lack of competitiveness. Energy tariffs will rise and the dependence on imported natural gas is not expected to return in the medium term. Investments will remain low, due to business' lack of confidence and the increasing costs of investments (higher SELIC rate).
- Automotive sector – had a challenging start to the year. Increases in taxes, new security rules and Argentinian market restrictions seriously impacted the industry. Despite this deterioration, Coface considers the sector as a medium risk, due to its high bargaining power and its importance as a taxpayer. We expect the government to launch an incentive, in the short term, to mitigate the lower activity.
- Agro sector - is expected to confirm slight growth in 2014, due to stable prices and marginal increases in 2013/14 crops. The scenario is of "medium" risk, on the assumption that there are no unexpected weather events and higher credit supply. On the other hand, higher interest rates and poor port infrastructure could negatively affect profitability.
- Steel sector - as in many other parts of the world, will depend on the level of production in China. As Coface anticipates oversupply to continue in 2014, steel prices will not increase in the short term. That being said, steel producers' profitability will remain at a low level.
- Retail sector - is expected to grow above GDP, but not at such a high pace as previously. Lower gains in real wages and higher interest rates will also play a



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negative role in this segment. Some segments are expected to outperform in 2014, such as TVs, smartphones and tablets.

2015: a turning point?

The 2015 forecast still shows a low GDP rate and continued acceleration of inflation. Despite this, Coface forecasts a year of adjustments, with repressed administered prices returning to their equilibrium. This would negatively affect activity in the short term, but would increase investors' confidence, and boost GDP in the medium term.

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