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Brazil: no quick fix for the crisis

Brazil, downgraded to B (significant risk of businesses defaulting) by Coface in September, has been facing a scenario of economic juggling. The Central Bank's increase in interest rates, to control inflation, has compromised GDP. Lower activity is reducing tax revenues and threatening fiscal adjustment. In addition, the government needs Congress's backing in order to reach its primary surplus targets – but this support is lacking. Political uncertainties are weighing heavily on the country's economic performance.

From boom to bust

It was already understood that 2015 would be a year of adjustments, particularly with regards to inflation and public accounts. Inflation ended 2014 at 6.4 %, close to the target ceiling of 6.5 %. The reality, however, was worse than the predictions, with even higher pressure on prices and difficulties caused by artificially-low fixed prices. Inflation reached 9.49 % in the 12 months accumulated to September 2015, mainly driven by a high of 16.3 % in fixed prices and the strong depreciation in exchange rates.

GDP shrunk by 2.6 %, YoY, in the second quarter of 2015. On the demand side, activity has been mainly impacted by the free fall in investments (- 7.9 % for 1H2015, YoY) and by declining consumption, due to increasing inflation and unemployment (8.6 % for the quarter ended July of 2015, against 6.9 % in July 2014).

The second part of the panorama reveals the effects of the recession, on a sectorial basis. Three industries have been severely affected and downgraded from high risk to very high risk:

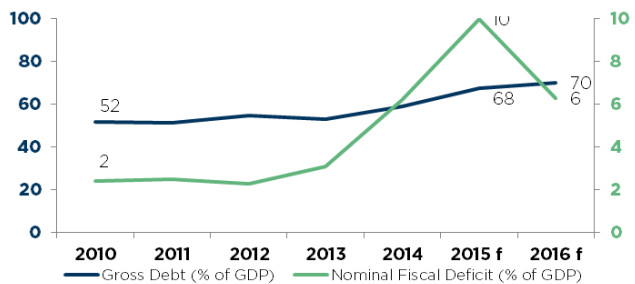
- **Automotive** – Between January and August 2015, production fell by 20.1%, sales by 22.7% and exports by 10.8% (compared with the same period in 2014).
- **Steel Industry** – In 2015, the industry's vulnerability to weak external fundamentals was exacerbated by a sharp deterioration in domestic activity.
- **Construction** – The industry fell by 5.5% in the first half of 2015 (YoY). Capacity utilisation stood at only 58% in August 2015, the lowest level observed since the time series was initiated in 2012.

No positive outlook for the economy

The country's public accounts' figures have rapidly deteriorated. When the incumbent president took up her first mandate in January 2011, gross public debt stood at 52 % of GDP.

As at August 2015, the same indicator had reached 65.3 % of GDP.

Fiscal Deficit vs Public Debt



Sources: Central Bank

Over the years, Brazil's government has loosened its commitment to primary surplus by establishing lower targets - and through creative accounting. In 2014 it delivered a primary deficit of 0.6 % of GDP, breaking the Fiscal Responsibility Law that was established in 2000. At the beginning of October 2015, the Federal Court of Accounts (TCU) unanimously recommended the rejection of the government's figures for 2014. This was the first time since 1937 that the TCU has sent Congress an opinion favouring the rejection of government accounts.

Fiscal adjustment is being threatened by lower activity, weak support from Congress and delays by companies in paying taxes. In the 12 months accumulated to August 2015, fiscal deficit stood at 0.8 % of GDP.

MEDIA CONTACTS:

Verena SCHWARZ T. +43 (0)1 515 54-540 verena.schwarz@coface.com

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