



DNB

Brazil Economic and Politics Update – May 2018

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DNB Bank ASA representative in Brazil

Snapshot



Brazil facts

Population	Area	Agricultural land	Agricultural production	Freshwater reserves	FX reserves	Proven oil reserves	Car production
6 th	5 th	4 th	2 nd	1 st	8 th	15 th	9 th

Source: World Bank; CIA Factbook

Population (2017)

210 million (85% in urban areas)

GDP (2017)

USD 1.981 trillion (9th)

GDP composition

Services – 60%
Industry – 20%
Net taxes – 15%
Agriculture – 5%

Trade Balance (2017)

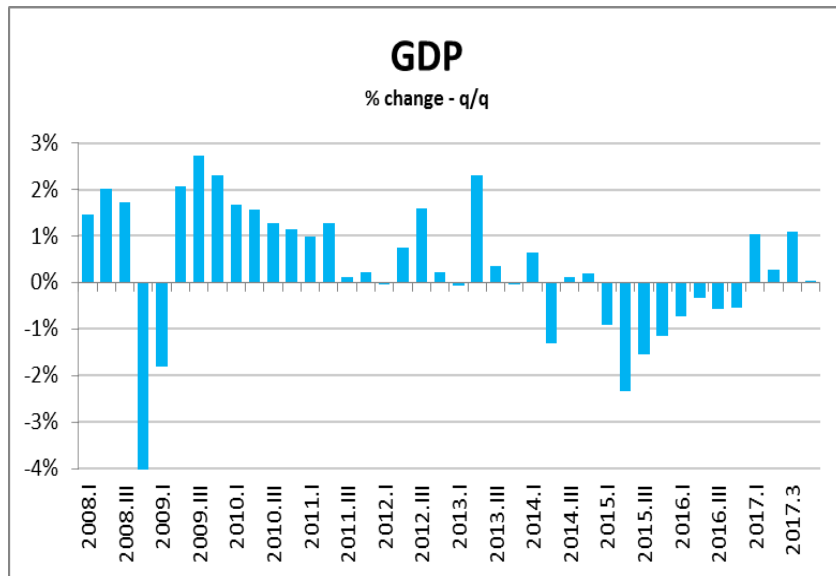
Exports: USD 217 billion
Imports: USD 150 billion

Credit ratings

Fitch: BB- (outlook stable)
Moody's: Ba2 (outlook stable)
S&P: BB- (outlook stable)



GDP

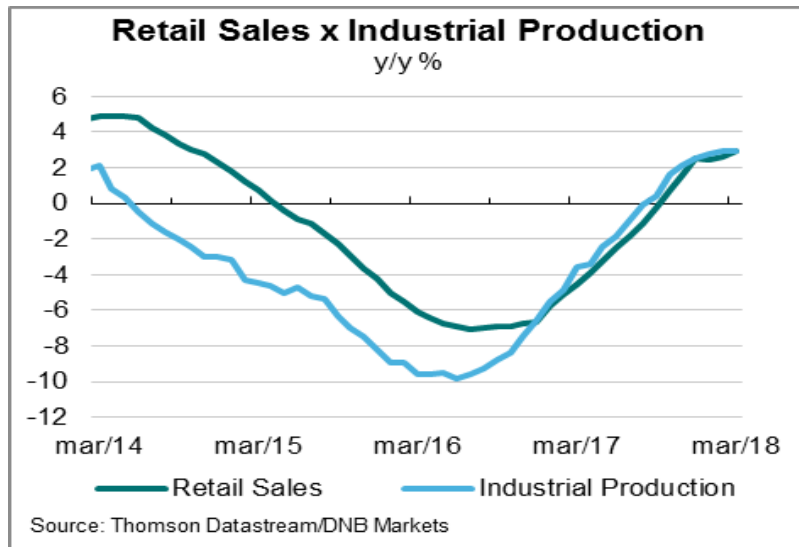


- GDP increased by 1% in 2017
- The GDP growth in 2017 was mainly driven by the strong output of the agricultural sector, which increased 13% compared to 2016
 - Record harvests of soy, which posted a 55% growth compared to 2016, had a very positive impact in the sector
- The service sector, responsible for around 60% of the supply side of the GDP, posted a positive number of 0.3%
 - The sector was benefited by the increase in family consumption funded by FGTS release
- On the other hand, the industry sector remained stable in 2017 after three consecutive decreases
 - Civil construction had a negative impact, shrinking 5%
- According to the Focus Report, the market expects the GDP to grow 2.51% in 2018

	2015	2016	2017	2018P
GDP (% of growth)	-3.85	-3.60	1.00	2.51

Source: Focus Report (Central Bank of Brazil)

Industrial Production and Retail Sales

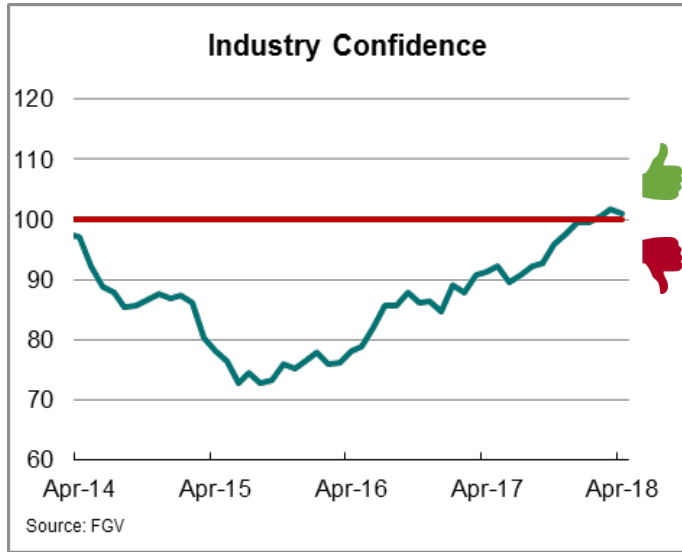


- After three consecutive years posting negative figures, the industrial production finally posted an increase of 2.5% in 2017
 - The main sectors responsible for this growth were the vehicles (17.6%), electronics (19.6%) and the metallurgical (4.7%) sectors
- Year to date (March), the accumulated industrial production reached 3.1% boosted by the mining sector and vehicles manufacturing
- In the same path as the industrial output, retail sales grew by 2% in 2017, first positive figure in two years and the highest growth since 2014
 - The products which posted the best figures were household appliances and building materials
- So far this year, the retail sales have reached an accumulated growth of 3.8%

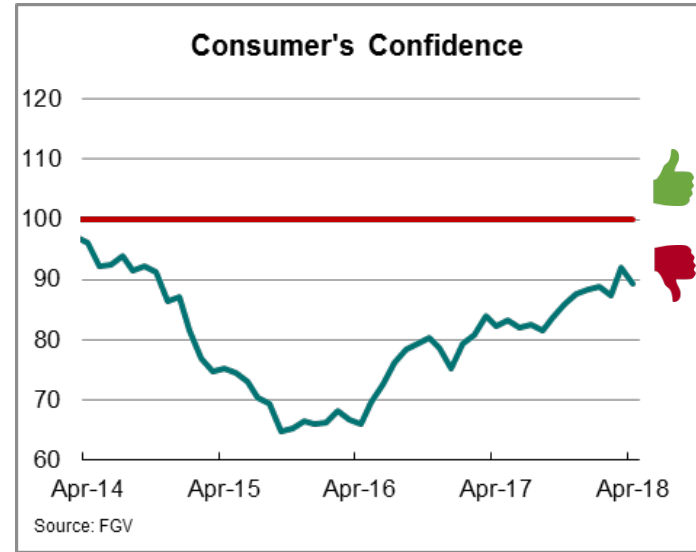
	2015	2016	2017	2018P
Industrial production (% of growth)	-3.24	-6.65	2.50	3.80

Source: Focus Report (Central Bank of Brazil)

Consumer's and Industry's Confidence

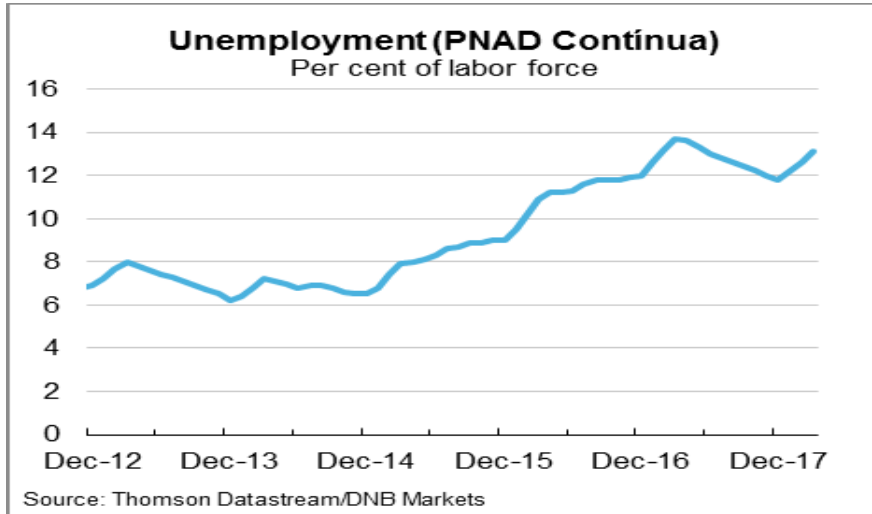


- The industry's confidence has been recovering after decreasing drastically during the last years



- Consumer's confidence reached low levels during the 2015 crisis, but posted a small recovery throughout 2016-17
- Nevertheless, political and economic uncertainties have been undermining a stronger recovery

Labor market



- Despite small reductions in unemployment during the last year, it has increased in recent months
- The unemployment rate was 13.1% (13.7 million) in the moving quarter January-February-March
- The average worker's real income is at BRL 2,169 per month (≈USD 600)

- Despite the increase in the unemployment rate, the Minister of Labor highlighted that during the first quarter of the year were created over 200,000 formal jobs, which shows a positive trend for job creation
- In order to strengthen the labor market, Congress approved new labor legislation in October 2017
- The main points were:
 - Increase in the time contract for temporary workers
 - Direct negotiations between employee and employer for specific features
 - Intermittent work
 - End of the obligatory union contribution

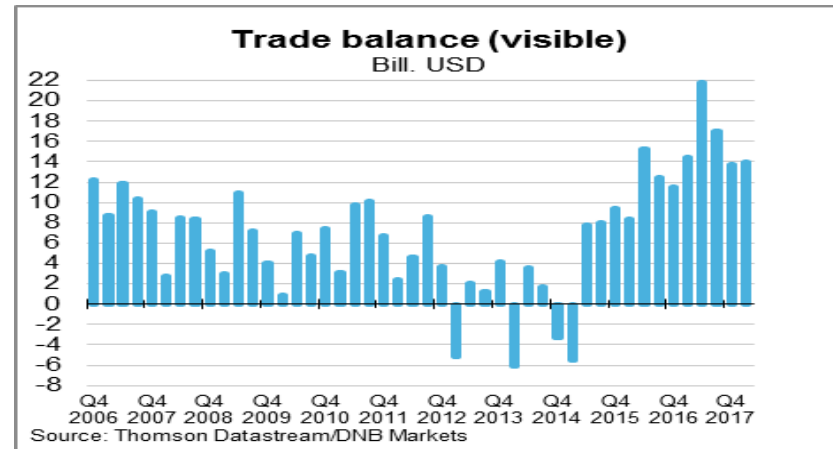
Exchange rates and trade balance



- The BRL–USD was relatively stable in 2017
- The BRL has depreciated relatively to the USD in 2018

	2015	2016	2017	2018P
Exchange rate (BRL per USD)	3.90	3.26	3.31	3.40

Source: Focus Report (Central Bank of Brazil)



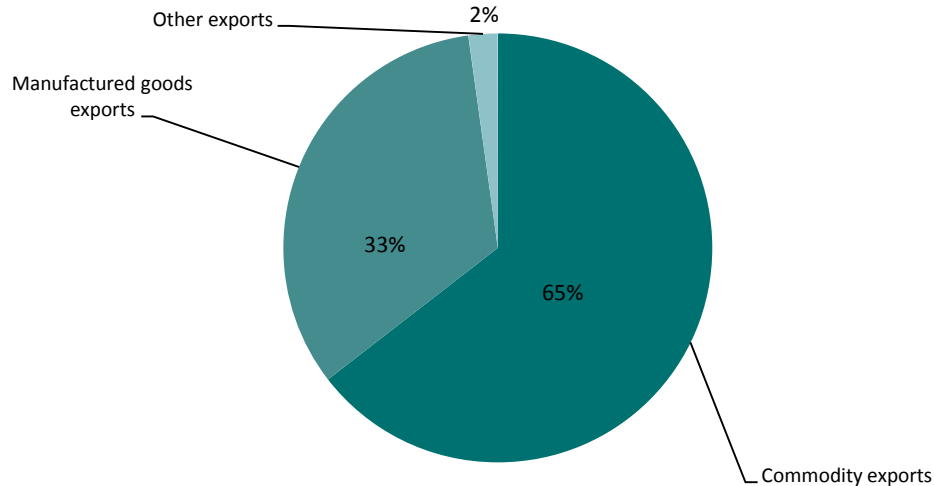
- In 2017, the trade balance posted a surplus of USD 67 billion
- This result was mainly impacted by an increase in exports

	2015	2016	2017	2018P
Trade Balance (USD bn)	19.67	47.72	67.07	55.60

Source: Focus Report (Central Bank of Brazil)

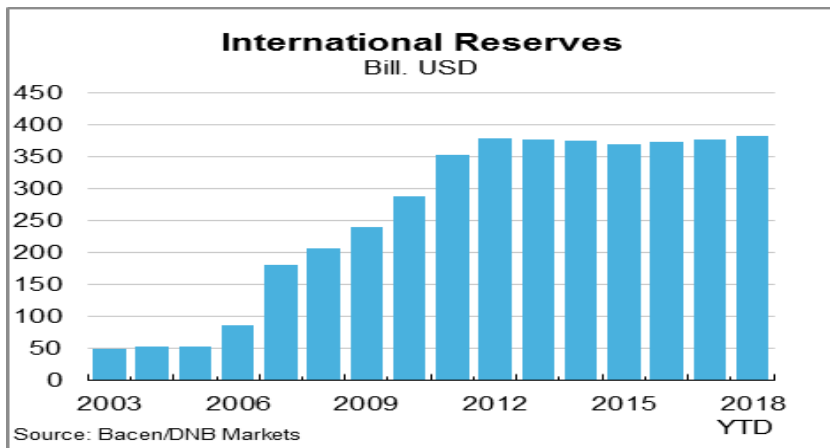
Exchange rates and trade balance

**Exports by product group
(% of total product exports)**



- The main commodity exports are agricultural products and ores & metals, representing 54% and 26% respectively
- On the manufactured goods, machinery and transport equipment are responsible for 44% of the total
- Main exports destinations are:
 1. Eastern, Southern and South-Eastern Asia with 30% of the total exports
 2. Latin America with 21% of the total exports
 3. European union with a total of 19% of the exports
 4. United States with 12% of the total exports

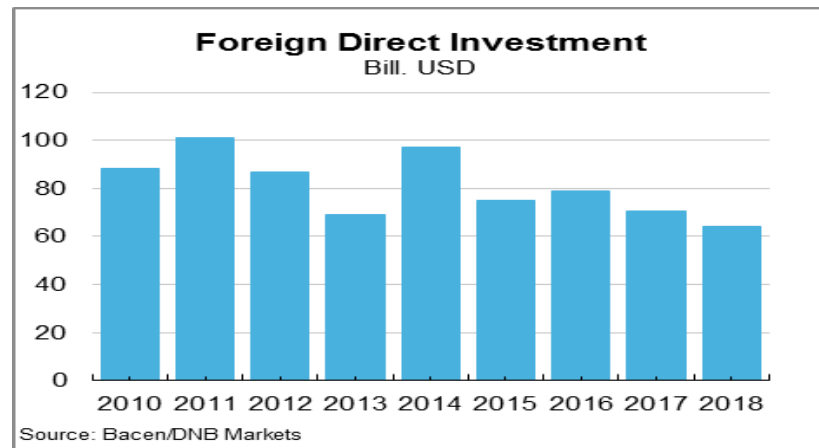
Foreign accounts



- The international reserves have been stable during the last years
- External debt (including public and private sectors) has been decreasing and now is at USD 310 bn

	2014	2015	2016	2017
International Reserves (USD bn)	374.1	368.7	372.2	381.7

Source: Focus Report (Central Bank of Brazil)

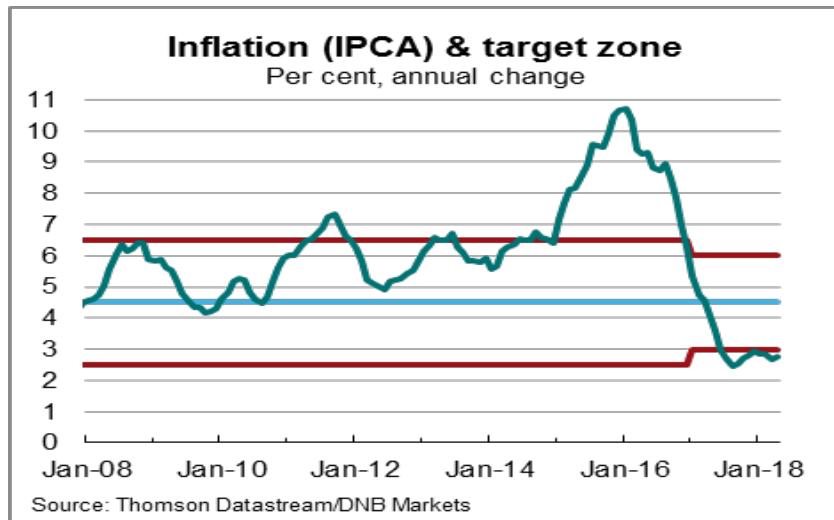


- FDI in 2017 reached USD 64.3 billion, mainly through intercompany loans and corporate direct investments

	2014	2015	2016	2017
FDI (USD bn)	96.90	75.07	78.93	64.29

Source: Focus Report (Central Bank of Brazil)

Inflation

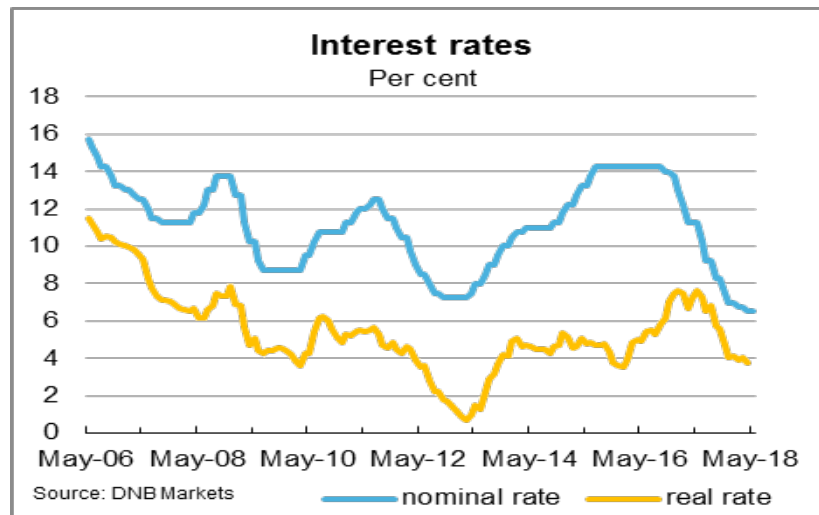


	2015	2016	2017	2018P
Inflation rate (%)	10.67	6.29	2.95	3.50

Source: Focus Report (Central Bank of Brazil)

- Due to recession, high unemployment and an active monetary policy, inflation has reached historical low levels
- The consumer price index IPCA is currently at 2.76% and below the target range
- Brazil has a target of 4.5% with a band of ± 1.5 percentage points
- The Central Bank announced a cut in the inflation target for 2019 and 2020 to 4.25% and 4%, respectively
 - The cut was mainly driven by reduction in inflationary expectations for the upcoming years and also to bring inflation down to international levels
- Food and beverage sector, strongly contributed to subdue inflation. On the other hand, healthcare and medicines contributed to the increase in the monthly inflation

Interest rate

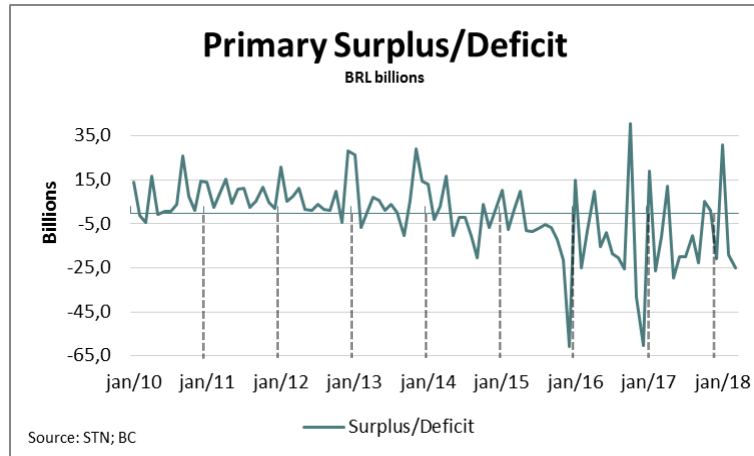


- The benchmark interest rate SELIC is currently at 6.50% p.a., after the Central Bank kept the rate in its last meeting in May
- With the recent currency volatility and the low inflation figures, that Central Bank ceased the interest rate reduction cycle
- Although inflation and the SELIC rates have been falling during the last months, the real interest rate remains high for international standards, around 4%

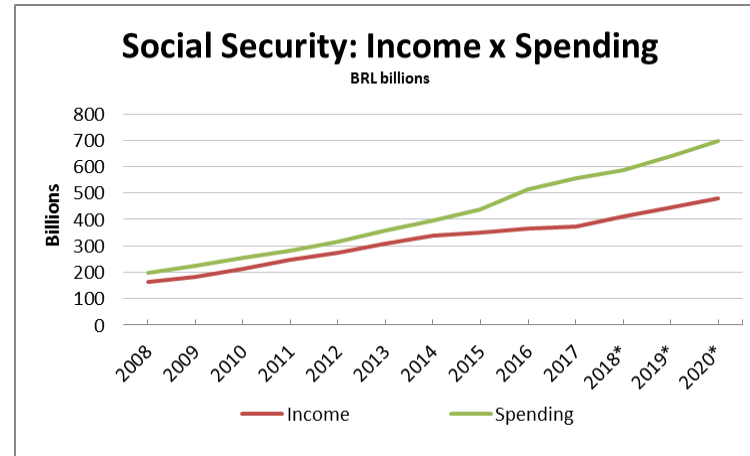
	2015	2016	2017	2018P
Selic (% p.a.)	14.25	13.75	7.00	6.25

Source: Focus Report (Central Bank of Brazil)

Government Primary Deficit and Social Security Spending

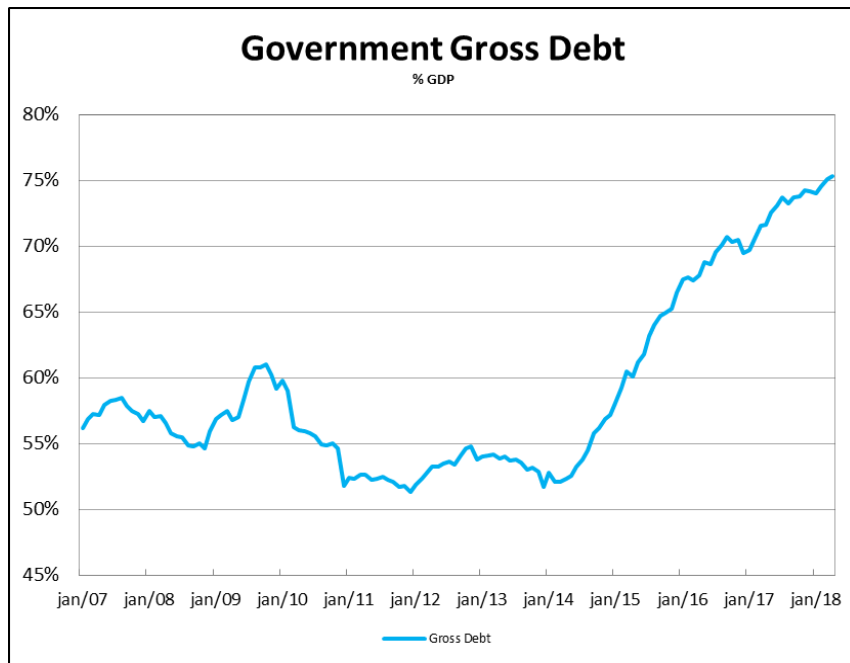


- Primary deficit in 2017 reached BRL 124.4 billion (1.9% of the GDP), within the target set of BRL 139 billion
- Government spending has been growing mainly because of subsidies and mandatory expenses, such as social security
- Tax revenues were lower than expected, impacting public accounts, although the tax burden rose in 2017



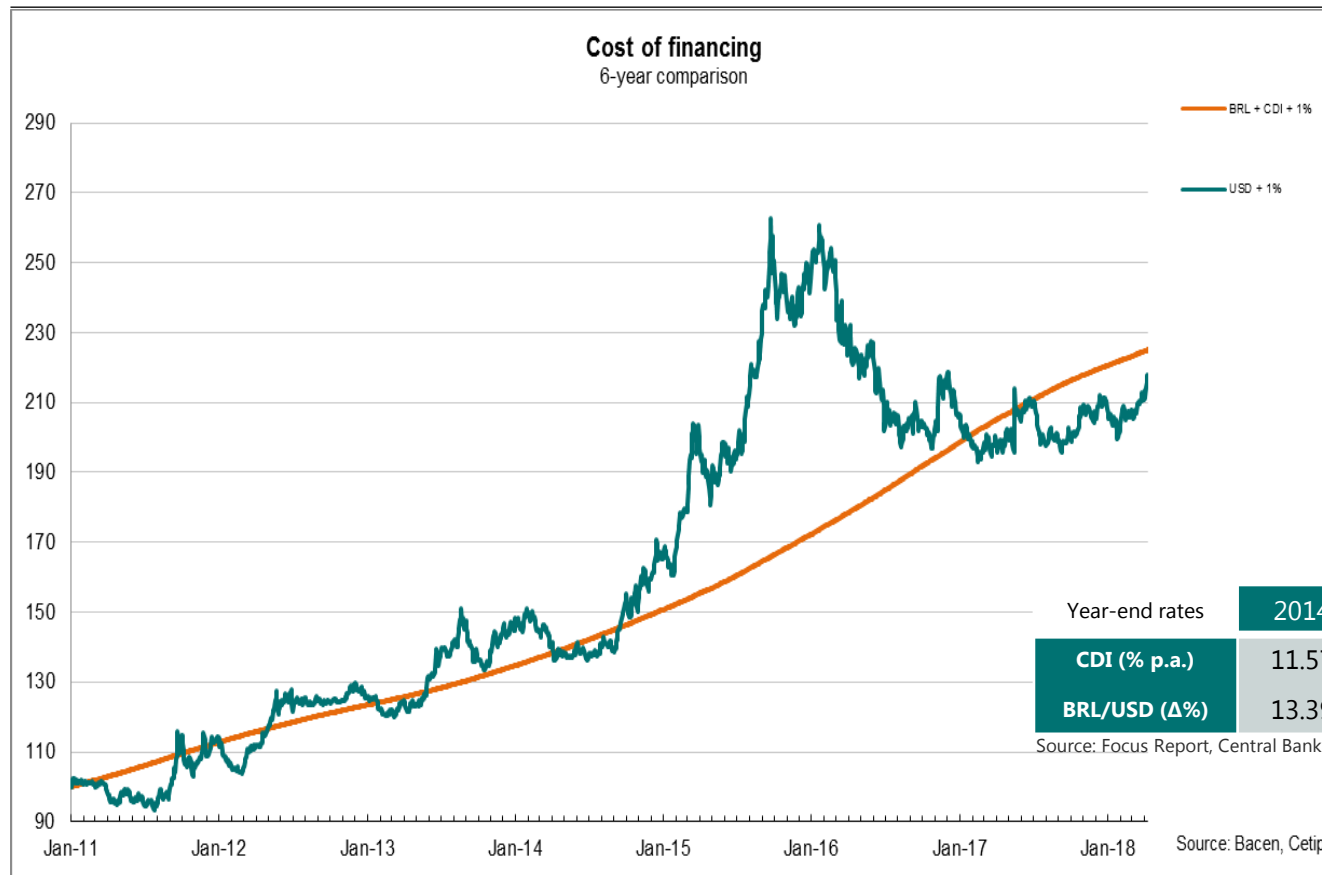
- Expenses with social security are around 8.2% of the GDP
- The government expects an increase of the social security expenses and a decrease in income
- Social security deficit was BRL 182.45 billion (2.8% of the GDP) in 2017, an increase of 21% compared to 2016

Government gross debt



- Government bonds (which finance the govt. spending) contributed the most to the increase of Government gross debt:
 - 69% of the gross debt is composed by Federal Government bonds
- Government gross debt-to-GDP ratio rose during 2017, specially because of the increase in social security expenses
- In March, the gross debt-to-GDP reached 75.3%, the worst figure since the beginning of the series

Funding alternatives in Brazil







- Despite the low nominal rate for USD funding, the volatility of BRL against USD implicates in a higher risk
- CDI funding is becoming cheaper as the SELIC rate is decreasing and is more stable

2018 Elections

- The elections in Brazil are decided by popular vote, which is mandatory
- In 2018 the population will vote for President, 2/3 of the Senate, the entire House of Representatives, State Governors and State House of Representatives. The voting for President and Governors are decided by single majority and if not achieved, a second round is held with the 2 most voted candidates
- The election day is set for October 7th and the second round on October 28th
- The candidates need to register their candidacies by August 15th at the Supreme Electoral Court
- The main pre-candidates for President are:
 - Jair Bolsonaro
 - Marina Silva
 - Ciro Gomes
 - Geraldo Alckmin
 - Álvaro Dias
- An important factor to highlight is that all candidates have a high disapproval rating
- TV, Radio and Social Media are expected to influence the final results

Presidential Run - Candidates

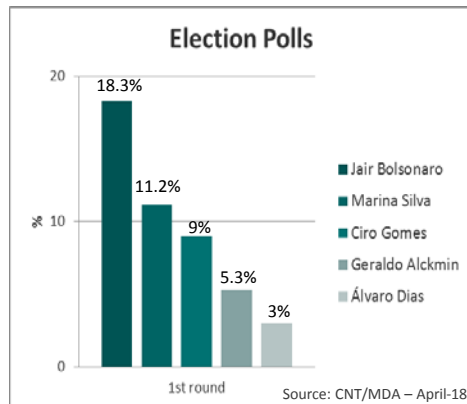
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<div>Jair Bolsonaro</div> <div></div> <div>Party: Social Liberal Party (PSL)</div> <div>Number of Seats House: 8 (1.5%)</div> <div>Main proposals: Heavy Privatization (Oil&Gas and Electric sector) Tax reform (Descentralize central government revenues to states and municipalities) Social Security Reform (Capitalization Regime)</div>	<div>Geraldo Alckmin</div> <div></div> <div>Party: Brazilian Social Democratic Party (PSDB)</div> <div>Number of Seats House: 49 (9.5%)</div> <div>Main proposals: Light Privatization (Electric sector) Tax reform Social Security reform Changes in Public Administration</div>	<div>Marina Silva</div> <div></div> <div>Party: REDE</div> <div>Number of Seats House: 2 (0.3%)</div> <div>Main proposals: Adjust fiscal accounts Tax reform Social Security reform</div>	<div>Ciro Gomes</div> <div></div> <div>Party: Democratic Labor Party (PDT)</div> <div>Number of Seats House: 2 (0.3%)</div> <div>Main proposals: Tax reform (Increase in tax income and taxes on heritage) Social Security reform (Capitalization Regime)</div>

Presidential Run - Possibilities

Right	Centre Right	Centre Left	Left
<div></div>	<div></div>	<div></div>	
Party: Progressive Party PP; PODE; AVANTE; PEN	Party: Brazilian Democratic Movement (MDB)	Party: Labor Party (PT)	
Number of Seats House: 76 (14.8%)	Number of Seats House: 50 (9.7%)	Number of Seats House: 60 (11.7%)	
Support: Despite having its own candidate for President, the coalition between of the parties above is most likely to support Ciro Gomes in the event of a second election round This coalition is a mix of right and left politicians	Support: Historically, MDB being the largest political party in Brazil, will be in political power in a coalition govt According to sources, the party will most likely support Geraldo Alckimin (PSDB) for President but other coalitions are not to be excluded	Support: PT had to change plans after Lula da Silva was arrested for a corruption scandal Yet, it is most likely that Lula will not be allowed to remain a presidential candidate If he is unable to run, Fernando Haddad is the most likely candidate	

Presidential Run - Election Scenarios

First Round

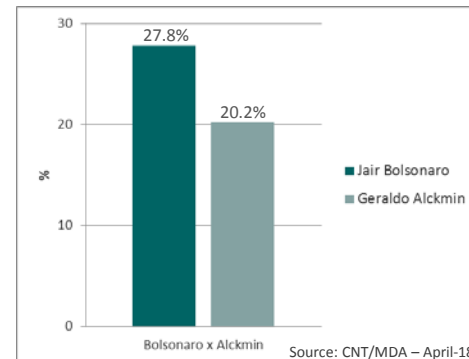
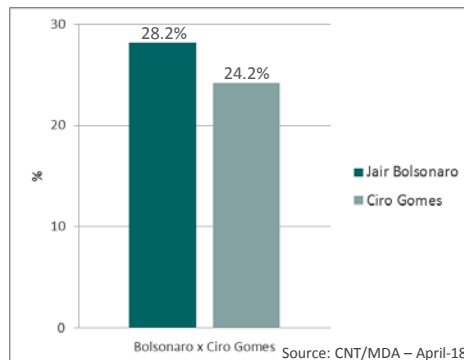
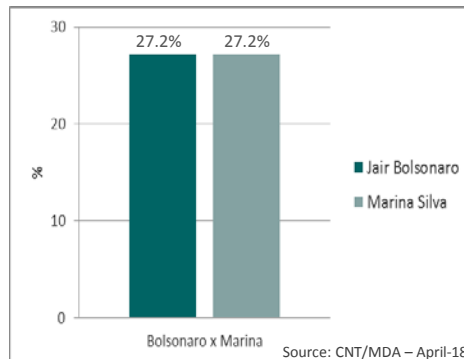


Disapproval Ratings

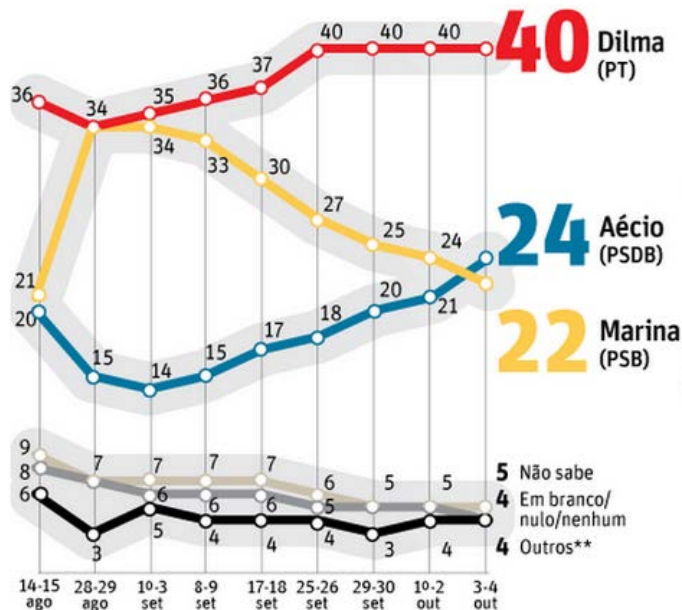
Jair Bolsonaro	58%
Marina Silva	62%
Ciro Gomes	65%
Geraldo Alckmin	68%

Source: IPSOS – February-18

Second Round



Presidential Run – 2014



- In 2014's election, Marina Silva was the Vice-President of Eduardo Campo's campaign
- After his death, Marina gathered all his vote intentions and became a strong candidate
- As the TV debates started, Ms. Silva was bashed by all sides and soon a downfall in vote intentions started
- She finished 2014's election in third, with 22 million votes
- Dilma, supported by the coalition PMDB-PT, won the second round of the election against Aécio Neves

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