DNB Brazil Economy and Politics Update - June 2017
I

Brazil: Economy
## Snapshot

### Brazil facts

<table>
<thead>
<tr>
<th>Population</th>
<th>Area</th>
<th>Agricultural land</th>
<th>Agricultural production</th>
<th>Freshwater reserves</th>
<th>FX reserves</th>
<th>Proven oil reserves</th>
<th>Car production</th>
</tr>
</thead>
<tbody>
<tr>
<td>6th</td>
<td>5th</td>
<td>4th</td>
<td>2nd</td>
<td>1st</td>
<td>8th</td>
<td>15th</td>
<td>9th</td>
</tr>
</tbody>
</table>

Source: World Bank; CIA Factbook

### Brazil facts

- **Population**: 206 million (85% in urban areas)
- **GDP (2016)**: USD 1.77 trillion (9th)
  - Services – 60%
  - Industry – 20%
  - Net taxes – 15%
  - Agriculture – 5%
- **Trade Balance (2016)**
  - Exports: USD 185 billion
  - Imports: USD 137 billion
- **Credit ratings**
  - Fitch: BB (outlook negative)
  - Moody’s: Ba2 (outlook negative)
  - S&P: BB (outlook negative)
- GDP contracted 3.60% in 2016
- All the sectors from the economy decreased in 2016
- Lower investments, low consumer and business confidence and low industry activity impacted the GDP
Industrial Production and Retail Sales

- Industrial production decreased 6.6% in 2016 and retail sales decreased by 5.7%
- Retail sales were negatively impacted by unemployment, high inflation and lack of confidence
- The industry was the first sector to feel the economic crisis in Brazil
- Nevertheless, the sector has been posting better figures in 2017 than the service and retail sectors
- The Industrial Production grew by 1.1% in March, on the other hand retail sales decreased by 4% (current month compared to the same month of 2016)

<table>
<thead>
<tr>
<th>Year</th>
<th>2015</th>
<th>2016P</th>
<th>2017P</th>
<th>2018P</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industrial production (%) of growth</td>
<td>-3.24</td>
<td>-6.65</td>
<td>1.49</td>
<td>2.50</td>
</tr>
</tbody>
</table>

Source: Focus Report (Central Bank of Brazil)
The industry’s confidence has been recovering after decreasing drastically in the last years. As the Government announced economic reforms, the industry started recovering the confidence.

Consumer’s confidence reached low levels during the 2015 crisis, but has been recovering in the past year. Nevertheless, political and economic uncertainties have been undermining a better recovery.
Top exports and trade balance

Exports by product group (% of total product exports)

- Commodity exports: 65%
- Manufactured goods exports: 33%
- Other exports: 2%

Exports by manufactured goods group

- Machinery and transport equipment: 44%
- Chemical products: 18%
- Other manufactured goods: 38%

Exports by commodity group

- All food items: 54%
- Ores, metals, etc: 26%
- Fuels: 14%
- Agricultural materials: 6%
- Other exports: 2%

Leading destination markets for exports

- Eastern, Southern and South-Eastern Asia: 30%
- America (excluding Canada and USA): 21%
- European Union: 19%
- United States: 12%
- Other markets: 10%
- Western Asia: 4%
- Africa: 4%

Top exports and trade balance

7% 2% 33% 65%

2% 18% 44% 38%

All food items 54%

Ores, metals, etc 26%

Fuels 14%

Agricultural materials 6%

Other exports 2%

Leading destination markets for exports

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- Africa: 4%

Export commodities:

- Manufactured goods
- Commodity exports
- Other exports

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- Ores, metals, etc: 26%
- Fuels: 14%
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Top exports and trade balance

**Internal Market x Exports**

- **Soya beans**: 54.1%
- **Sugars**: 68.6%
- **Iron ore**: 86.0%
- **Bovine meat**: 80.8%
- **Coffee**: 62.3%
- **Maize (corn)**: 73.9%

**Top 10 products exported (in share and rank of World exports)**

- **Soya beans**: 29%
- **Sugars**: 27%
- **Iron ore**: 23%
- **Bovine meat**: 19%
- **Coffee**: 16%
- **Maize (corn)**: 15%
Exchange rates and trade balance

- The BRL appreciated 21% against the USD in 2015
- Strong volatility – Ranged between 2.57 and 4.19
- Averaged at 3.48 BRL per USD in 2016
- The BRL appreciated 17% against the NOK in 2016
- The BRL is expected to remain stable in 2017

<table>
<thead>
<tr>
<th>Year</th>
<th>Exchange rate (BRL per USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>3.90</td>
</tr>
<tr>
<td>2016</td>
<td>3.26</td>
</tr>
<tr>
<td>2017P</td>
<td>3.23</td>
</tr>
<tr>
<td>2018P</td>
<td>3.40</td>
</tr>
</tbody>
</table>

Source: Focus Report (Central Bank of Brazil)

- In April 2017, the trade balance posted a record surplus (for April) of USD 6.96 billion
- The accumulated in the first quarter reached USD 14.4 billion
- The trade balance posted a surplus of USD 47.75 billion in 2016
- The imports have been growing for the past months, but exports have been posting even higher figures as the prices of agriculture products rose
Foreign accounts

- The international reserves has been posting same level figures in the last years, maintaining the external accounts stable

- 12-month accumulated, the FDI reached USD 84.3 billion, especially through intercompany loans
- In 2016, USD 78,929 billion entered Brazil through external investors

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<tbody>
<tr>
<td>International Reserves</td>
<td>375.8</td>
<td>374.1</td>
<td>368.7</td>
<td>372.2</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>FDI (USD bn)</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>69.18</td>
<td>96.90</td>
<td>75.07</td>
<td>78.93</td>
</tr>
</tbody>
</table>

Source: Focus Report (Central Bank of Brazil)
Inflation

- The consumer price index IPCA is currently at 4.08%, within the target range

- Brazil has a target of 4.5% with a band of ± 1.5 percentage points

- The consumer price index IPCA ended 2016 at 6.29%

- Food and beverage prices rose 8.62% in average in 2016, contributing for 35% of the inflation increase

  Other price increase estimates:
  - Healthcare: +11%
  - Personal Expenditures: +8%
  - Fuel: +3.25%

- The BRL appreciation helped bring inflation down
  - Each 10% of currency depreciation produces a 70 bps increase on the annual inflation rate

- Low economic activity, high unemployment and low retail sales helped to decrease prices in 2016 and in the beginning of 2017

Source: Focus Report (Central Bank of Brazil)
The benchmark interest rate Selic is currently at 10.25% p.a. after the Central Bank cut the rate by 100 b.p. in May.

Although inflation has been decreasing in the past months, the real rate is still high.

The Central Bank has started a cycle of monetary easing as inflation is ceasing and the need of an economic recovery.

<table>
<thead>
<tr>
<th>Year</th>
<th>Selic (% p.a.)</th>
</tr>
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<tbody>
<tr>
<td>2015</td>
<td>14.25</td>
</tr>
<tr>
<td>2016</td>
<td>13.75</td>
</tr>
<tr>
<td>2017P</td>
<td>8.50</td>
</tr>
<tr>
<td>2018P</td>
<td>8.50</td>
</tr>
</tbody>
</table>

Source: Focus Report (Central Bank of Brazil)
Government Primary Deficit and Social Security Spending

- Primary deficit in 2016 reached BRL 155.7 billion (2.47% of the GDP), lower than the stipulated in 2016
- The Government is estimating 2017’s primary deficit to end at BRL 139 billion and BRL 123 billion in 2018
- Government spending has been growing mainly because of subsidies and mandatory expenses, such as social security

- 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 149.7 billion (2.4% of the GDP) in 2016
Government gross debt and budget balance

- Government bonds (which finance the govt. spending) contribute the most to the increase of Government gross debt:
  - 66% of the gross debt is composed by Federal Government bonds
  - External debt (including public and private sectors) has been decreasing and now is at USD 313.7 bn
- Net public debt-to-GDP ratio is currently at 48.3%
- Government gross debt-to-GDP ratio is currently at 71.6%
- The gross debt-to-GDP is expected to decrease as the Central Bank started cutting the interest rates
Solutions for Gross Debt, Primary Deficit, and Social Security

• The Government passed the Spending Cap bill last year, which will limit the Government’s spending growth to the previous year’s inflation
  o According to the Minister of Finance, this will allow the Government to reduce spending and reduce the extremely high debt
  o Brazil has been posting primary deficits for past two years and is expected to post a deficit of BRL 139 billion in 2017
  o To meet the target for 2017 the Government announced measures such as:
    o Cut of BRL 42 billion in public spending
    o End tax relief on some sectors to increase income
    o Bidding rounds in the electric sector

• On the Social Security side, the Government sent to Congress a new Social Security legislation, which is expected to be voted in the upcoming months
  o The main points from the proposed legislation are:
    o Increase the retirement age for both men and women
    o Increase contribution time to at least 25 years
    o Rural workers will have to contribute for at least 15 years
The Government announced measures to loosen the labor legislation and help recover employment:

- The proposed labor legislation was approved by Congress and has to be approved by the Senate
- It is expected to be approved by the end of June

The main points were:
- Increasing the time contract for temporary workers
- Employee can negotiate certain features directly with employer
- Hourly paid work (trabalho intermitente)
- End of the obligatory union contribution

The unemployment rate was 13.7% in the moving quarter January-February-March
  - 14.2 million unemployed

The unemployment rate was at 10.9% in the same moving quarter in 2016

The average worker's real income was BRL 2,110 per month

Nevertheless, the labor market created over 55 thousand formal jobs in April

<table>
<thead>
<tr>
<th>Source: Thomson Datastream/DNB Markets</th>
<th>Number of Unions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>Argentina</td>
</tr>
<tr>
<td>16,517</td>
<td>100</td>
</tr>
</tbody>
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<table>
<thead>
<tr>
<th>Number of Labor Law Suits 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
</tr>
<tr>
<td>2,756,214</td>
</tr>
</tbody>
</table>
Funding alternatives in Brazil

- In the long-term CDI funding is still better than USD funding, despite its high nominal rate
- TJLP is the cheapest long-term funding alternative in Brazil
- The Government is replacing the TJLP for a new type of funding called TLP, which will be more market driven
- The TLP rate will vary alongside the NTN-B rate, which is a Government bond

Funding alternatives in Brazil

<table>
<thead>
<tr>
<th>Year-end rates</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>CDI (% p.a.)</td>
<td>9.77</td>
<td>11.57</td>
<td>14.14</td>
<td>12.88</td>
</tr>
<tr>
<td>TJLP (% p.a.)</td>
<td>5.00</td>
<td>5.00</td>
<td>5.00</td>
<td>7.50</td>
</tr>
<tr>
<td>BRL/USD (Δ%)</td>
<td>14.64</td>
<td>13.39</td>
<td>47.01</td>
<td>-16.54</td>
</tr>
</tbody>
</table>

Source: Focus Report, Central Bank of Brazil, Cetip, BNDES
Temer administration – a bend to the right

- Main priorities of Temer’s administration:
  - Reduce government spending, specially through PEC 241
  - Control inflation
  - Social Security reform through a constitutional amendment
  - Privatizations and concessions, including new legislation in the Oil Sector
  - Recover consumer and business confidence
  - Stimulate and make the industry sector to grow again
Operação Lava Jato (Car Wash) overview

• 155 plea agreements with executives
• 10 leniency agreements with companies involved
• International cooperation with over 30 countries

• 103 temporary arrests
• 87 people were sentenced in first instance
• 22 people remain arrested
  • Antônio Palocci – Former Finance Minister
  • Eduardo Cunha – Former Congressman
  • Gim Argelo – Former Senator
  • Renato Duque – Former executive of Petrobras
  • Sergio Cabral – Former Governor of Rio de Janeiro

• BRL 38,1 billion is demanded as indemnity to the State
• BRL 11,5 billion were recovered through agreements, fines and sanctions
• Switzerland blocked USD 1 billion from companies involved in the corruption scandal
• The DoJ has sentenced Brazilian companies

Photo credits: Agência Brasil; Agência Estado; Agência Senado; Associated Press
II

DNB in Latin America
DNB South America - 2 offices, 35 years & 13 Employees

- Direct interaction with DNB Head Quarters in Oslo, Norway
- Offices in Santiago, Chile and Rio de Janeiro, Brazil
  - The Santiago branch opened in 2008 as the first Scandinavian international bank in Chile, aimed at following DNB clients.
  - The Rio de Janeiro representative office opened in 2012.
- 13 people on the ground in South America with extensive knowledge of the region and financial products
- Dedicated project finance team for Latin America based in Santiago and New York, executed more than 15 project financings
- DNB Markets supports Latin American out of New York
- In Latin America, DNB follows key clients and has industry focus

Santiago Branch
- Established in 2008
- Staff: 11
- Key Industries:
  - Energy - Power & Renewables
  - Seafood

Rio de Janeiro Rep. Office
- Established in 2012
- Staff: 3
- Key Industries:
  - Energy / Oil & Gas
  - Shipping / Offshore
  - Nordic Corporates
DNB – 35 years in Brazil

• Presence in Brazil since 1982 and expanded representative office in Rio de Janeiro since 2012.

• The leading Nordic bank with focus on Energy, Shipping, Offshore and Logistics.

• Extensive knowledge and experience with BNDES financing and structuring of financial solutions in Brazil.

• Structured first Norwegian High Yield Bond for the Brazilian market.

• Financial advisor to the largest companies in the Brazilian Oil & Gas market.
Broad product range adapted to local needs

- Trade Finance
- Project Finance
- Letters of Credit and Guarantees
- Cash Management solutions
- Sourcing of funding and risk capacity from Export Credit Agencies (ECAs)
- BNDES structured financing
- Corporate Finance
- Bonds
- Syndication
The Brazilian Development Bank is the main source for long term financing in Brazil.

DNB is one of the main foreign bank partner of BNDES, presenting extensive knowledge and experience in joint financing. In total DNB has structures over 2 billion USD of BNDES financing.

Along with guarantees, we can provide all support necessary to make BNDES financing easier and faster.

DNB has strong cooperation both with BNDES commercial area as well as international legal area in developing attractive solutions for your company.

DNB has a dedicated BNDES team on the ground in Rio.
DNB in Chile

- Branch of DNB Bank ASA
- Local booking unit
- Focus on core industries:
  - Seafood
  - Renewable energy
- Key to success: Global client teams with industry expertise and local presence
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Although DNB believes that the expectations reflected in any such forward-looking statements are reasonable, no assurance can be given that such expectations will prove to have been correct.

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