

panorama

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coface

Panorama Brazil

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CONTENTS

Part I: Macro economic analysis

/03 Current Macro-economic
Scenario in Brazil

Part II: Brazilian Industry

/05 Chemicals
Blowing against the wind

/07 Automotive
A challenging start of year

/08 Agro
Bad days seem to definitely be over

/09 Steel
World overcapacity and lack of
competitiveness remain

/10 Retail
Not as shiny as before

Part III: Sector Barometer

/11 Sector Risk Assessment

Part IV

/13 Conclusion

Brazil holds the 7th largest GDP in the world and it is the 5th biggest in terms of extension and of population (over 195 million inhabitants). It is also the main economy in Latin America, representing 40% of the total activity and with a GDP per capita of 11,1 USD⁽¹⁾. In 2001 with the creation of the acronym BRIC, together with Russia, India and China, Brazil was raised as one of the emerging economies bound to grow. The idea that the biggest economy in Latam was going to take off was based on the high commodity prices due to the Chinese rapid growth, the deep oil field recently discovered (the Pre-Salt) and the fertile land and abundant mineral sources. The country is a major producer and exporter of many commodities, such as soya and iron ore.

From 2004 to 2008 Brazil had grown, on average, by 4.8% a year, but in the former period, from 2009-2013, the average rate declined to 2.7%. It is true that activity deceleration in China contributed, but it explains just a part of what has happened. The country did not take advantage of the good winds to make important reforms, such as improving the infrastructure and the business climate. According to Global Competitiveness Index 2013-2014 of the World Economic Forum Classification, Brazil was ranked at the position 56 of 148 participants in terms of competitiveness. Table 1 breaks the index by all criteria.

TABLE 1

Brazil - Global Competitiveness Index 2013-2014 (sample 148 countries)	Position in Rank
Institutions	80
Infrastructure	71
Macroeconomic environment	75
Health and primary education	89
Higher education and training	72
Goods market efficiency	123
Labor market efficiency	92
Financial market development	50
Technological readiness	55
Market Size	9
Business Sophistication	39
Innovation	55

Source : FMI











⁽¹⁾IMF estimative for 2013





Macro-economic

It is worth mentioning that Brazil stands at a very weak position in terms of market efficiency (123/148), despite all its potential in terms of market size (9/148). Infrastructure also remains as key issue in the country. Local industry has been facing pressured margins, due to high transportation cost and wages. Competing with imported products has been a big challenge to entrepreneurs of multiple segments. In this panorama we will further discuss the current macroeconomic environment. Secondly, we will focus on the main industries: Chemical, automotive, agro, steel and retail will be explored.

Coface also develops a sector barometer which reveals financial performance of companies in different industries coupled with Coface payment experience. It indicates that risks remain significant for the corporate sector. This subject will be explored in the third part.

TABLE 2

Brazil Sector Barometer			
Sectors	Risk Level	Sectors	Risk Level
Agro-food		Automotive	
Retail		Construction	
Textile-clothing		Chemicals	
Electronics, IT		Pharmaceutical	
Pulp		Metals	

 Moderate Risk  Medium Risk  High Risk  Very High Risk

Current Macroeconomic Scenario in Brazil

Stagflation remain in the medium term

After a marginal increase of 1% in 2012, Brazilian GDP had verified a slightly better performance, high of 2.5% in 2013. Activity was mainly driven by a recovery of investment that increased by 6.3% YoY, after a drop of 4% observed in 2012. Despite the improvement, investment remains very low in the country, only 18.4% of the GDP in 2013. This rate is not only weak in comparison with China which invests 48% of GDP, but also with neighbors in Latin America. According to IMF dataset, in a sample of 30 countries in Latin America and Caribbean, Brazil holds only the 22nd position in terms of investment per GDP.

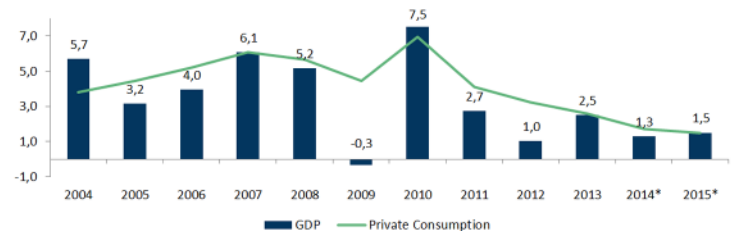
It is also worth mentioning that during many years the country had grown through household consumption. As illustrated in Chart 1, in the last ten years it has expanded above the GDP in most of the time. A new middle class and an easier credit access contributed to this scenario, this model seems to have reached exhaustion though. Interest rates have increased, pressure over inflation has raised and real wages gains have been growing at a lower pace.

Activity in Brazil had also been driven by the commodity boom associated with China rapid expansion, but it is not going to expand at the same pace as before though. Brazilians did not take advantage of the bonanza period to invest in infrastructure and in structural reforms. It has been dismantling its industry, which is not competitive in the international stage. For instance, the trade deficit in manufactured goods reached a record of 105 USD billion in 2013. The scenario has not changed even though there was a 15% devaluation of the real against the U.S. dollar.

For 2014 we expect a weaker scenario in terms of GDP, Coface forecasts a high 1.3%. Brazil has already begun 2014 with a downgrade by rating agencies. In March 2014, Coface downgraded Brazil from A3 to A4⁽²⁾. The higher risk perception over the country is explained by deterioration of public figures, low investment, high inflation and activity that does get momentum.

(2) Coface holds a country risk and a business climate assessment. It is in 7 grades: A1, A2, A3, A4, B, C and D.

CHART 1



*Forecast

Source: IBGE

Trade Balance and exchange rate

Throughout the last years we have been seeing a deterioration of Brazilians trade balance, as it can be visualized in chart 2. Imports have been performing much better than exports. Industry has been losing competitiveness due to high costs, weak infrastructure and high competition in the international stage.

Brazil is still considered a closed economy, as the trade chain was of 20.67% in 2013. The degree of openness is obtained by the sum of exports and imports over GDP. The other Brics peers have much higher ratios. According to an essay of Getúlio Vargas Foundation (a Brazilian think tank) in 2011 India, Russia and China observed rates of, respectively, 54%, 52% and 59%. Being a closed economy limits the competitiveness gains, usually receiving more investments.

Despite the high deterioration of the real in the recent period, the trade balance continues weak in 2014 and may close the year in deficit. A devaluated currency tends to stimulate exports, but high volatility causes uncertainties for entrepreneurs. In addition, Brazil has been suffering with the crisis in Argentina. The country is Brazil's third trade partner and its international reserves shortage has made the neighbor increase barriers over imports. In the first few months of 2014, exports to that country decreased by 16.7%. Brazilian total exports decreased by 1.8% and imports contracted by 2.3% in the same period.

Brazil holds a free float exchange rate, but whenever an overshooting takes place, Central Bank intervenes in order to mitigate the movement. The delays in construction works to host the World Cup as well as presidential elections in October may also cause a further depreciation of the real.

CHART 2
Brazilian Trade Balance (Billions USD)



Inflations and Interest Rates

Brazil holds an inflation target of 4.5% with a standard deviation of 2 percentage points. The last time that it closed the year in the target core though was in 2007. Currently Central Bank has been facing difficulty not to overpass the debt ceiling. The 12 month accumulated inflation until April 2014 stands at 6.28%. Index is expected to close 2014 at 6.5%.

In order to contain prices, Central Bank has increased Selic (Brazil's reference interest rate) by 3.75 p.p., since April 2013. A new high of 0.25 p.p. is still expected for 2014. Regardless the elections result, 2015 will be a year of adjustments. Administered prices, which are controlled by government, are currently repressed (table 3), therefore inflation could be even higher. The president that takes office in January 2015 will need to allow reconciliation of energy tariffs as well as oil prices. In addition new raises in Selic will be observed in 2015, achieving 12.25%.

TABLE 3

IPCA (inflation target index)	Weight	12-month Acc. Inflation April 2014
Competitive Prices	77	7%
Food at home	16	6%
Services	36	9%
Industrial Products	25	5.1%
Administered Prices	23	3.8%

Ongoing of the infrastructure round

Brazil has been struggling with infrastructure. The bottlenecks need to be overcome in order to achieve a higher and sustainable growth pace. With the aim of ensuring management and investment in ports, railroads, airports and roads government began to promote auctions to the private sector in 2012. Despite that the rules had already been

changed many times and some bids had been postponed. Investors do not see this scenario of uncertainties with good eyes.

Airports and some roads have been auctioned. There are still some stretches of road to be bid, however some of them do not interest the private sector, thanks to the high investments that would be necessary. The scenario for ports and railroads are much worse, no auction is expected to occur in the near future. 2014 will be a short year due to the games and the elections, so no significant improvement in infrastructure is expected.

Brazilian Development Bank estimates that from 2014- 2017 4 trillion (around 1.8 trillion USD) will be invested in the country. This value is 30% higher than the estimation of the period of 2009-2012. Out of this amount, 250 billion USD is expected to be directed to infrastructure.

Energy

Reduction in power tariffs was announced by policymakers in the beginning of 2013, on attempt to boost activity. The timing was not favorable as the country was facing a drought. Hydroelectric is Brazil's energy matrix, but when reservoirs are at low level thermal plants are turned on (more costly and polluting). This was what happened at that time, causing a sharp deterioration in the margin of distributor's. The government spent around 4 billion USD in 2013 to cover their loss.

Brazil also faced drought during the raining season in 2014. The dry season has just started and the reservoirs are low compared to the level of the 2001 energy crisis. ONS (National Operator of the Electric System) has dismissed rationing and may only propose measures if hydrological conditions get worse in the period of May-November. Government budget for 2014 already forecasts expenses of 4 billion USD for this purpose, but it is estimated that this account can reach 14 billion USD by the end of the same year.

According to the study of BNDES, investments in power electric from 2014-2017 will achieve 87 billion USD, pulled by hydroelectric generation, with 25 billion USD, followed by wind power (20 billion USD) and electric power transmission with 17 billion USD.

TABLE 4

	2012	2013	2014(f)	2015(f)
GDP	1.0	2.5	1.3	1.5
Inflation	5.8	5.9	6.5	6.5
Private Consumption	3.2	2.6	1.7	1.5
Budget balance (1)	-2.7	-3.2	-3.2	-2.4
Public debt (1)	68.2	66.3	66.7	66.4
Exports of good and services	-5.3	-0.2	1.7	6.3
Industrial Production	-3.3	2.3	0.8	0.7
Unemployment Rate (2)	5.5	5.4	5.7	6.7
Current account balance (1)	-2.4	-3.6	-3.6	-3.7

Source: Coface, IMF, IBGE and Santander Bank

*Pct change in real terms, except (1) % of GDP and (2) % of labor force

Chemicals

Blowing against the wind

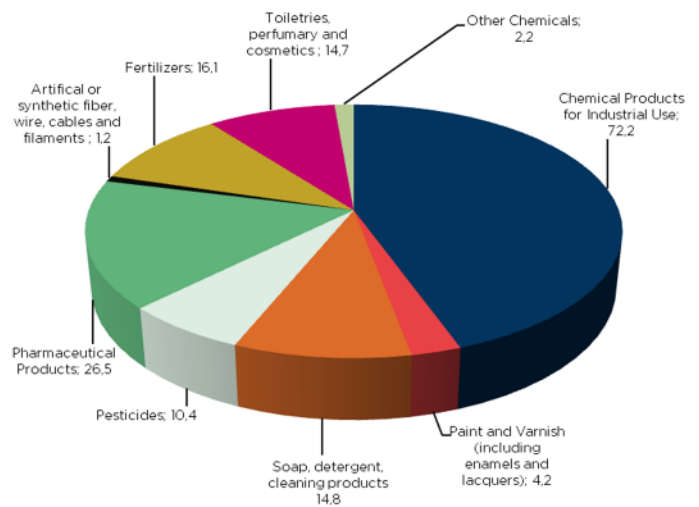
Chemicals are one of the main industries in the country and demand has grown by 8% a year in the last 15 years. Notwithstanding competitiveness has become a key issue through time and imports been increasing. Trade balance has reported deficit records on annual basis, achieving 32.2 billion USD in 2013.

In line with the scenario presented above, production increased by only 1.67% in 2013. Meanwhile apparent consumption expanded by 7.2% and even with the depreciation of real in 2013 (-15%YoY) imports kept growing (+17%YoY). Furthermore, production was strongly hit during August-October, due to energy shortfall in the Northeast region and a programmed stop in the petrochemical hub in Camaçari- Bahia. During this period activity shrank by 10.3%. Concerning utilization capacity, the chemical industry had worked at just 82% in 2013, one percentage point above the level achieved in 2012, but still far from the ideal range of 87%-90%.

Natural gas remains as one of the main points to undermine local competitiveness. Brazil is not self-sufficient and imports rose by 16% last year, in order to attend the increasing usage of thermal plants. The foreign purchase was equivalent to 58% of the gas extracted in country in the same period. As a side effect, the chemical industry ended up being affected through higher prices. On April 23th2013 the Government approved a reduction on taxes over raw materials from the first and second chemical generation, but it was not enough to contain deterioration. Furthermore, the exploitation of the shale gas by the United States has revolutionized the chemical industry in a worldly context, making it even more difficult for Brazil to compete in the international stage.

It is worth mentioning that the country also holds shale gas reserves, but its damages to the environment are not clear yet. In many places in the world, even in the United States itself, there is resistance against its exploitation and in Brazil it is not different. In November 2013, the National Petroleum Agency (ANP) auctioned areas most likely to unconventional gas exploitation, but there was no interest. Among the main reasons we may highlight the lack of well-defined rules for exploitation and production and the lack of the necessary infrastructure for the proper utilization of the feedstock.

CHART 3
Net Sales of Brazilian Chemical Industry in 2013 (US\$ Billion)



Source: ABIQUIM

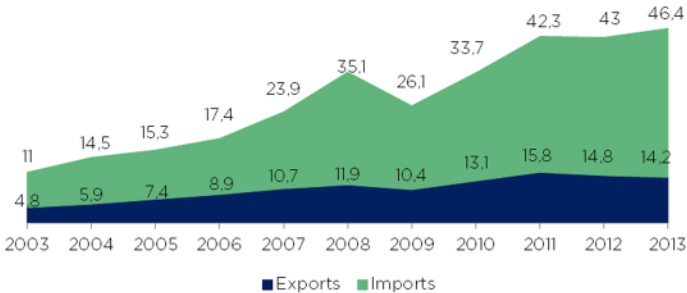
Energy cost is also relatively high in Brazil (double the cost in the USA) and this is not expected to revert in the near future. Power energy in the country is derived mainly from hydroelectric and when the water reservoirs are low, government uses thermal plants. The last one has caused more damage to the environment and its cost is also higher, as the majority of the plants depend on natural gas. This way the chemical industry is twice impacted with the increase in demand of this raw material.

Last year, when the country was facing a drought and the energy cost was increasing, the government decided to reduce tariffs in order to improve industries competitiveness. Activity did not pick up as the policymakers were expecting and this has caused a significant deterioration in public accounts. As Brazil is also facing droughts this year, government has recently announced that tariffs will be increased in the beginning of 2015. This will certainly further deteriorate the competitiveness of local industry.

In the first two months of 2014 the accumulated chemical trade deficit was of 4.2 billion USD, down 2.5% compared to the same period of the previous year. It was the first decline in deficit, on bimestrial basis, since 2009. In addition to the slightly recovery in the trade balance, production verified a tiny increase of 1.51% and apparent consumption remain stable. Lastly the average capacity utilization was of only 78%, against 80% in 2013.

In short, the outlook for the chemical industry remains vulnerable. There are some structural problems that are not easy to overcome. Despite high tax burden in Brazil, the government does not provide well-functioning infrastructure. The progress of the auctions and its efficient accomplishment are crucial to recover entrepreneur's confidence. In a scenario of lack of competitiveness, utilization capacity will remain low and industry will not invest. They are only going to get momentum, as the industry returns to operate close to full capacity. According to Brazilian Chemical Industry Association (Abiquim), from 2014-2017 10.4 billion USD will be invested in the segment of chemical products used as input by the industrial sector. In addition, as a reference, a study conducted by the same association shows that it would be necessary to invest 167 billion USD until 2020. The industry is really far from track.

CHART 4
Chemical Trade Balance (billion USD)



Source: MDIC

Automotive

A challenging start of year

With a population of over 190 million people and with a still moderate vehicle per inhabitant ratio of 4.4 (almost four times higher than in the USA) the sector maintained its strong position in the industry world ranking in 2013. Brazil remained as the 4th largest domestic market in the world and the 7th in terms of production. In the last year it hit a new all-time record, achieving 3.7 units (+9.9%). Meanwhile sales observed a marginal decrease of 0.9% (3.8 units), which was not so bad given the sharp high reported in 2012. Despite the good performance in 2013, the year did not start well for the automotive industry

The macroeconomic environment was more positive in the former year for the domestic market as well as for the export one. 2013 began with relatively better credit conditions by the consumer perspective. Selic rate (Brazilian economy reference interest rate) began 2013 at 7.25%, but in April it started to increase due to pressure over prices. Since then, Central Bank has raised Selic by 3.75 percentage points. Banks have not taken long to assume the same behavior and rates for vehicle acquisition started to climb.

The sector has been benefited by the government since the crisis of 2008. At that time they reduced the IPI (tax over the industrialized product), but due to the category strong bargain power they had been facing difficulty to re-establish the old tax rate. A progressive returning program was created in the end of 2013, after postponing it for many times. In late January, the IPI on popular cars rose from 2% to 3% and it was predicted that from July 2014 on it would return to its previous rate of 7%.

Concerning the exports, Argentina is the destiny of almost 80% of the industry's exports, the equivalent to 15% of the total production. However, sales decelerated significantly in the first months of the year. Brazil's neighbor has been facing a serious international reserves shortage. In an attempt to contain this tendency the Argentinean government has increased imports barriers, therefore impacting Brazilian automobile industry.

In the first four months of 2014 domestic sales in Brazil decreased by 5% compared with the same period of the previous year. Production decreased by 12% in the same comparison basis and inventory level achieved 48 days in March, the highest level since November 2008. Trying to adapt to the headwinds, automakers have decided to lay off temporarily part of the labor force. Furthermore the case has already been addressed to policymakers.

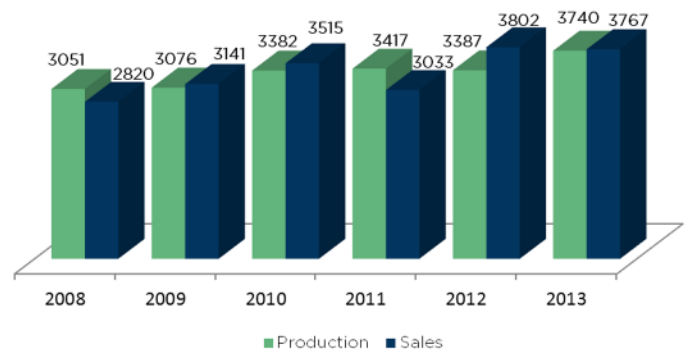
The automotive industry represents around 21% of the total industry GDP, it is responsible for employing 1.5 million people (directly and indirectly) and taxes on automo-

tive consumer prices are the highest in the world (over 30% of the final price). Due to all points exposed the strength of automakers before the government is relevant.

As there will be presidential election in October, the government will certainly help them avoid massive layoffs. The low unemployment rate is Brazil's president Dilma Rousseff's greatest asset; therefore they will not let it increase in such a crucial moment.

We do not expect a further deterioration of the current scenario. Government has been trying to negotiate with banks in order to improve credit conditions. Furthermore the programmed hike of the IPI will probably be canceled; instead they may reduce taxes again. Finally policymakers have also proposed to the Argentinean government the creation of a funding mechanism for Brazilian exports to the country, but no agreement has been reached yet. Argentinian policymakers argue that the proposed plan would only benefit automakers in Brazil. They want to guarantee financing mechanisms to auto exports for Brazil too. In short it is not clear yet which measures the government will implement, but automakers will certainly be once again benefited by its strong bargain power.

CHART 5



Source: ANFAVEA

Agro

Bad days seem to definitely be over

After contracting by 2.1% in 2012, last year was marked by an impressive recovery. The agro industry grew by 7% in 2013 and hit a new record in the 2012/13 crop (+12.3%). The segment represents 4.8% of the country's GDP. Brazil is well known by its long stretch of fertile land, being a major producer and exporter of various crops. However it is worth mentioning that it is not easy to get profitability in a country of poor infrastructure, expressive tax burden and high interest rates.

The forecast for the crop 2013/14 is moderate. According to the 8th Survey of the National Supply Company (Conab) it is expected to achieve 191.2 million tonnes (+1.4%), establishing once again a new record. Soya will remain as the main crop, representing almost 45% of the total. Regarding the trade balance, soybeans and their derivatives was the 4th main exporter product, secondly only to iron ore, oil and fuel. China is the destiny of around 75% of soya's exports and despite its lower growth rhythm, the grain international price remains high relatively to other crops. For instance, due to the low quotation of the corn between the end of 2013 and the beginning of 2014, some farmers have decided to shift its production to soya.

Concerning the prices of agricultural products, it now begins to reflect the forecast of plantation in the United States, since the majority of the harvest is already defined in the southern hemisphere. Prices are especially vulnerable to expectations regarding the crops performance and to production in the USA (due its representativeness in the agro segment). After facing crop shortfall in 2012, the following year was marked by strong increases in American agriculture output, resulting in a historic season for the country. For this year the forecast remains positive, so their prices may remain stable.

The agro segment also requires good infrastructure. Currently in Brazil transportation remains very weak. Generally it is very expensive and the logistics to run off goods to the ports is not efficient. In this way, some agro companies have recently announced investment plans to improve its storage capacity and grain transportation. For instance, Dreyfus Brazil has recently announced a five-year plan to invest 1 billion USD in transportation. They expect to reduce costs significantly with this investment.

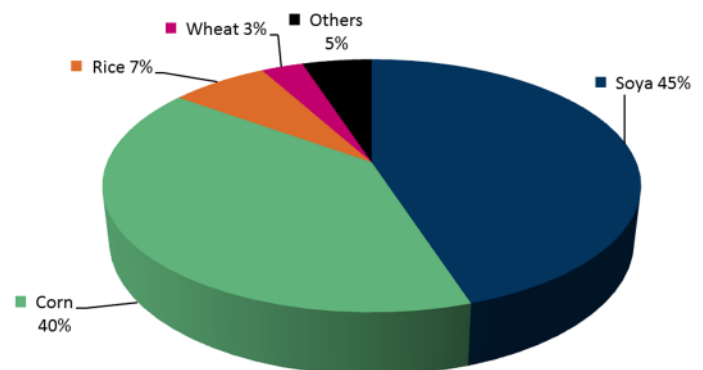
Credit is also a main challenge to this industry, as farmers need funding to finance their plantations until they start obtaining the rewards. It should not face difficulty to access the credit market this year, taking into account the latest figures of the Brazilian Central Bank. The credit stock for farmers reached 102 billion USD, a growth of 32%

compared with the same period of the previous year. In May 2014 government announced the "Plano Agrícola e Pecuário 2014/15" that would raise 156.1 billion reais (around 70 billion USD) divided for financing costs, trading and for investment planning. This represents a high of 14.7% compared with the resources available in the previous plan.

It is also worth mentioning that producers are vulnerable to exchange rate variations. Brazil is the 4th largest fertilizer consumer and imports around 65% of the nutrients used in its production. This sector has always reported trade balance deficit and ended 2013 in -8.8 billion USD, mainly because of potassium imports. Supply of this raw material is scarce in the country, since input is done only by a mine operated by Vale Company in the state of Sergipe. Environmental permits for the exploration of new fields foreclose self-sufficiency in raw materials sector. Farmers also need to import phosphates and nitrogen.

Thus we expect a moderate scenario for the agro industry, with increasing production, stable prices and with the remaining infrastructure issues. Support will come from the world economy which is estimated by Coface to grow by 3.1%, against 2.6% reported in the previous year. Emerging are also important in this regard, China, net importer of commodities, despite not registering double-digit growth as a few years ago, is expected to grow by 7.2% in the same period, contributing to Brazilian product purchases, such as soybeans.

CHART 6
Forecast crop 2013/14 (million ton)



Source: CONAB

Steel

World overcapacity and lack of competitiveness remain

The steel industry in Brazil was the 9th largest in the world in terms of production and the 7th net exporter, according to the figures of 2013. However it has been losing competitiveness year after year. 2013 production observed a marginal decrease of 1% and its trade balance had further deteriorated. In 1980's its participation in the industry's GDP was at 35.9% and last year ended at 13%.

The world overcapacity is one of the main issues. It is estimated in 600 million tonnes, which pressures down the steel international price. This scenario is not new and despite production keeps growing, last year observed a high of 3.5%. A key issue is that according to Brazilian Steel Institute (IABr) 38% of the steel companies in the world are state owned and the decision of how much to produce is not necessarily based on profitability. The majority is located in China, which is responsible for almost 50% of the world production and consumption. So their representativeness to determine international quotation is very meaningful.

As well as in other countries, steelmakers in Brazil have been trying to get adapted to this adverse scenario. They have been reducing cost and postponing investment plans, therefore the bottom line improved compared with 2012. Real (Brazil's currency) also devaluated by 15% last year, which let companies readjust prices recovering somewhat its margins. Entrepreneurs also argue that the government needs to protect domestic market from imports. It currently represents around 30% of the country's consumption, but it could achieve 58% in 2022, if the pace of recent years is maintained (estimation of IABr).

The Brazilian cost remains a key point to the industry. It is hard to be competitive in a country with high tax burden, electricity and natural gas costs and with heavy tax burden. Infrastructure is another sensitive issue, ports, railroads and roads still need to improve and there are many delays in the auctions promoted by the government. It is also worth mentioning that power tariffs will increase in 2015, due to the higher costs associated with the intensive usage of thermal plants.

No significant improvement has been seen in 2014 so far. In the first four months production rose by only 0.1%, mainly driven by a hike of 4.6% observed by the long steel. It was benefited by the resumption of building construction. Flat steel declined by 2.3%, due to a sharp decrease in exports (-31.2%) and the bad performance of the automotive sector. This industry is the main consumer of flat steel and has been reducing production, because of high inventory level.

Flat steel distributor is composed by independent companies and subsidiaries of the steelmakers. They are responsible for around 35% to 40% of flat steel sales in the country.

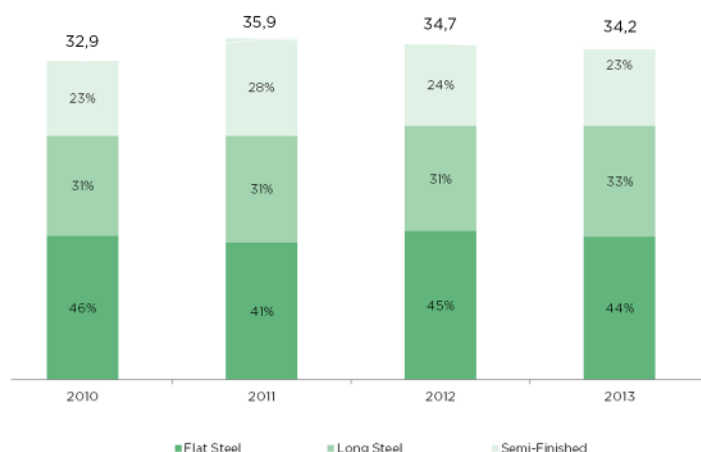
According to Inda (National Institute of Steel Distributors) the automobile industry, especially the auto parts segment, accounts for 20% of their sales. When automakers decelerate production, the auto parts companies stop buying steel and they begin consuming only their inventory.

The steel main raw materials are, respectively, iron ore and coal. Supply of iron ore is not a problem in Brazil, as the country is a major producer and exporter of this mineral commodity. The steel industry in the country is composed by 11 business groups and some of them also produce the raw material, therefore they have a natural hedge. Concerning the coal Brazil imports 100% of its consumption and despite being vulnerable to exchange rates variations; the international price is in a declining tendency.

IABr do not see sufficient demand to solve the oversupply issue, in that order it argues that it would be necessary to reduce by 300 million tons the global steel supply. This proposal will be defended in a meeting of OCDE in early June this year.

The perspectives for the steel industry in the short term remain weak. GDP growth for this year is estimated in 1.3%. The automotive industry is not expected to get momentum in the near future and construction will probably decelerate in the next months with the proximity of the World Cup and of elections in October. The business day's calendar will be shorter this year. Furthermore infrastructure and overcapacity are not easy to be solved, takes time and requires a lot of political skills.

CHART 5
Steel Production (million ton)



Source: IABR

Retail

Not as shiny as before

For many years household consumption had strongly contributed to GDP's growth in the country. Nowadays it remains increasing above country's activity, nevertheless the rhythm has decelerated. Sales in restricted retail rose by 4.3% in 2013 compared with a high of 8.4% observed a year earlier. The extended retail (which includes vehicles and construction) expanded by 3.6% against 8% in 2012. Retail depends mainly on real wages and credit conditions and both have been deteriorating.

The low activity and the high inflation have contributed to decrease the gains in real wages. It grew by only 1.8% in 2013, compared with an average of 8.2% in the previous 5 years. Consumer confidence achieved in April this year the lowest level since May 2009 and remained below the historical average for the 15th consecutive month. Inflation has been accelerating the last months and agents expect it to overpass the ceiling of 6.5% in June.

In response to the higher pressure over prices, Brazilian Central Bank increased significantly the economy's reference interest rates. Banks followed the behavior and raised their rates too. With higher cost, credit for individuals has assumed a lower growth rhythm. Both retail indexes have increased in the first three months of 2014. Annualized growth for restricted and extended retail stands at, respectively, 4.5% and 3.2%. It is worth mentioning that the results of February already show a strong decrease in automotive sales.

Coface believes that the cycle of strong growth in all segments of retail is over. Consumers are getting more selective in their expenses. Thus, some segments will grow more than others. Due to the World Cup in June 2014, electronics sales are expected to outperform (especially television and smartphones). Supermarket sales that was verifying low growth rhythm is also going to get momentum in the second quarter of the year with the games (beverage sales). Home appliance is doing well, due the tax incentives that has not been fully removed yet and due the subsidized credit for borrowers of "Minha Casa Minha Vida". This is a program of the federal government that gives low-income population the chance to acquire their own homes with special conditions.

The Trade Confidence Index is also declining, due to the negative reviews of the current business conditions and of the future. Retailers do not feel safe to allocate investments in inventory, given the perception of a continuing volatility in sales.

Coface sees the sector's risk as moderate. Some subsectors, such as electronics and supermarkets, will benefit by the World Cup this year. On the other hand it is not a positive year for car sales, due to high inventory level and the increase in prices thanks to the new security rules and the

progressive return of the IPI tax (tax over industrialized product). Furthermore, construction material has reported a good start of year, but it is expected to reduce its growth rhythm in the upcoming months driven by the games and elections in October. We forecast a growth of 4% for restricted retail this year and of 3.3% for the extended one. As long as activity remains low and interest rates continue to increase, we do not believe that retail will get momentum.

TABLE 5

Physical Sales Volume Index - % in YoY terms	2012	2013
Restricted Retail Trade	8.4%	4.3%
Fuels and lubricants	6.9%	6.3%
Supermarkets	8.5%	1.9%
Textiles, clothing and footwear	3.5%	3.5%
Furniture and household appliances	12.2%	5%
Pharmaceutical articles and similar products	10.3%	10.1%
Books, newspaper, magazines and office products	5.4%	2.6%
Office, computer and comm. equipment and material	7%	7.2%
Other articles	9.3%	10.3%
Extended Retail Trade	8%	3.6%
Vehicles, motorcycles and auto parts	7.3%	1.4%
Construction material	8%	6.9%

Source: IBGE

Sector Risk Assessment

Brazil Sector Barometer			
Sectors	Risk Level	Sectors	Risk Level
Agro-food	●	Automotive	●
Retail	●	Construction	●
Textile-clothing	●	Chemicals	●
Electronics, IT	●	Pharmaceutical	●
Pulp	●	Metals	●

● Moderate Risk
 ● Medium Risk
 ● High Risk
 ● Very High Risk

Source: Datastream, Coface

Construction: medium risk

It observed a marginal improve in 2013, as it expanded by 1.9% compared with 1.4% reported in 2012. The tiny increased was mainly driven real state and infrastructure works.

2014 did not start well. The level of activity fell for the fourth consecutive month in March, according to the Survey of Construction released by the National Confed eration of Industry (CNI). The indicator sector scored 47 points in March. In the survey, the results vary from zero to 100 points, with results below 50 indicate contraction in activity from the previous month.

Furthermore The Construction Confidence Index (CCI) of Getulio Vargas Foundation in May 2014 recorded the biggest drop since August 2012. Indicator decreased by 8.7% in the three months to May, compared to the same period last year.

Sharp deterioration in confidence in the sector has been mainly credited to the decline in expectations for the coming months than to the current situation. The general result suggests that the level of activity in the sector has been slowing in the 2Q2014 and the prospects are not favorable for the remainder of the year. A more difficult access to credit and presidential elections in October has

Textile-clothing: high risk

In 2013 production decreased by 1.6% in terms of volume and expanded by 4.4% in terms of value. High tax burden on the textile industry, exchange rates volatility and bottlenecks in infrastructure contribute to an increasing deficit in

trade balance. Most of the products come from Asia, mainly from China. Participation of imported products was at 22% in that year.

In 2014 the scenario has been maintained. From January to March 2014, production decreased by 5.3% in terms of volume. Considering the value, it observed a high of 2.3%. The accumulated trade deficit from January - April 2014 deteriorated by 33% in a yearly comparison. The participation of imports reached 24.8% in March 2014. This scenario has been taking place for a long time already and there is still no rebound signal.

Pharmaceuticals: moderate risk

Brazil holds the 6th largest pharmaceutical market in the world. Despite the slower economic activity and the lower gains in real wages, this industry has proved resilient. Drugs and cosmetics retail market grew by 10.1% in 2013, against 4.3% of the retail general index. A strong performance was also verified in the 1Q2014, as the segment grew by 12.7% in comparison with the same period of the previous year.

Investments in pharmaceuticals also overpass the ones in the transformation industry. Brazilian National Development Bank expects 4.5 billion USD in investments from 2014 to 2016.

Construction: medium risk

A marginal improvement was observed in 2013, as it expanded by 1.9% compared with 1.4% reported in 2012. A slight increase was mainly driven by real state and infrastructure works.

The year of 2014 did not have a good start. The level of activity fell for the fourth consecutive month in March, according to the Survey of Construction released by the National Confederation of Industry (CNI). The indicator sector scored 47 points in March. In the survey, the results vary from zero to 100 points, with results below 50 indicating contraction in activity in comparison with the previous month.

Furthermore The Construction Confidence Index (CCI) of Getulio Vargas Foundation recorded in May 2014 the biggest drop since August 2012. The indicator decreased by 8.7% in the three months until May, compared to the same period of the former year.

Sharp deterioration in construction confidence has been associated with declining expectations for the coming months. The general result suggests that activity level in the sector has been slowing down in the 2Q2014. Prospects are not favorable for the remaining months of the year. A more difficult access to credit and presidential elections in October has certainly played an important role in the segment.

Pulp: medium risk

Brazil is the world's fourth largest producer of pulp, with a high export bias. The shortest cycle of wood and lower production costs make the country very competitive. Production achieved 15 million tonnes (+7.7% YoY) in 2013 and increase in eucalyptus pulp exports was also reported, mainly to China and North America.

Since the beginning of 2014, prices of hardwood pulp has been falling in China and accumulate lower than 60 USD per tonne. The drop in prices and the prospect of a new downward has influenced the stock prices of producers in Brazil. The openness of new plants, the lowest level of Chinese activity, the constraints in credit and the reduction in the inventory level explain the lower prices. Despite that, a high of 6% in Brazilian pulp production is expected for 2014. Brazilian National Development Bank estimates that 14 billion USD will be invested in the sector from 2014-2017.

Part IV

Conclusion

After having increased by 2.5% in 2013, Coface expects a high of 1.3% in 2014. On the demand perspective household consumption growing at lower pace (associated with lower wage gains), investments that do not get momentum (as it would be expected) and a weak trade balance explain the slowdown.

The ups and downs of an uncompetitive industry and the lower agro commodities prices explain the slower activity on the supply perspective. Thanks to the World Cup and presidential elections, business calendar will be shorter in Brazil in 2014. Entrepreneurs are expected to postpone investments of the second quarter of 2014. It is not clear yet, if investments will get momentum in 2015. The next government will need to use contractive measures to put inflation back on track.

Chemical industry will probably remain at high risk assessment, due to the lack of competitiveness. Energy tariffs will raise and the dependence on imported natural gas is not expected to revert in the medium term. Investments will remain low, due to the lack of entrepreneur's confidence and to the increasing costs of investments (higher Selic rate).

Automotive sector will not miss 2014. The taxes increase, the new security rules and the Argentinian market restrictions have seriously impacted this industry in the beginning of the year. Despite this deterioration, Coface considers as a medium risk, due to its high bargain power and its representativeness 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 verify a slight growth in 2014, due to stable prices and marginal increase in 2013/14 crop. The scenario is of medium risk, with no significant weather restriction and with higher credit supply. In counterpart higher interest rates and poor ports infrastructure will negatively affect profitability.

Steel sector in Brazil, as in many other parts of the world, will depend on the level of production in China. Coface expects oversupply to remain in 2014, so steel prices are not going to increase in a short term. That being said, steel producers profitability will continue at low level.

Retail is expected to grow above the GDP, but not at a high pace as before. Lower gains in real wages and higher interest rates will also play a negative role in this segment. Therefore some segments are expected to outperform in 2014, such as TVs, smartphones and tablets.

Low activity and high inflation will mark 2014. The World Cup will benefit only in specific segments, such as tourism, restaurant and clothing. On the other hand many industries and services will need to stop activity in the days of games, as transportation infrastructure is not enough to absorb a bigger volume of people on the streets.

Investments usually loose pace in the second half of presidential election years. The main reason is the entrepreneur's fear of changes in macroeconomic policies. Therefore investment is expected to slowdown in the second half of 2014.

Finally, 2015 forecast still shows a low GDP rate and inflation will keep accelerated. Despite that, Coface estimates a year of adjustments, with the repressed administered prices returning to their equilibrium. This would negatively affect activity in a short term, but would recover investors' confidence, boosting GDP in the medium term.

RESERVATION

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