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# **Latin America Sovereign Ratings in a Weakening Global Economy**

**Shelly Shetty, Head of Latin America Sovereigns**

October 11, 2011

# Agenda

➤ Latin America Sovereigns: Ratings Trajectory In A Weakening Global Environment

Brazil: Rating Drivers And Challenges Ahead

# Latin America Sovereign Ratings

Country	IDR Rating (As of Sep 2011)	Outlook
Chile	A+	Stable
Aruba	BBB	Stable
Brazil	BBB	Stable
Mexico	BBB	Stable
Panama	BBB	Stable
Colombia	BBB-	Stable
Peru	BBB-	Positive
Costa Rica	BB+	Stable
Guatemala	BB+	Stable
Uruguay	BB+	Stable
El Salvador	BB	Stable
Bolivia	B+	Stable
Suriname	B+	Stable
Venezuela	B+	Stable
Argentina	B	Stable
Dominican Republic	B	Positive
Ecuador	B-	Stable
Jamaica	B-	Stable

# Latin America – Sovereign Ratings

## 2011 Latin America Rating Changes

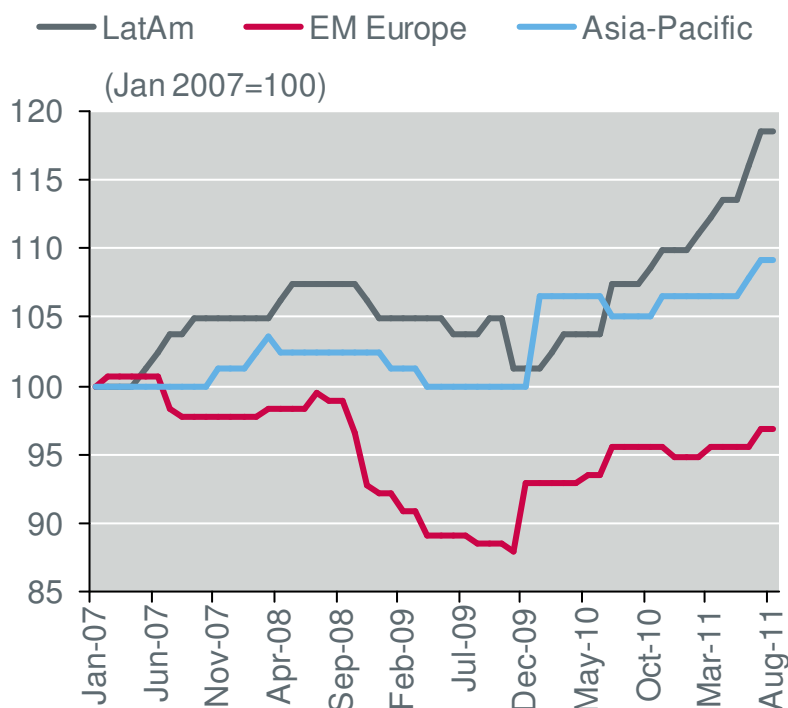
### Rating Upgrades

Brazil	'BBB-' to 'BBB'
Chile	'A' to 'A+'
Colombia	'BB+' to 'BBB-'
Costa Rica	'BB' to 'BB+'
Panama	'BBB-' to 'BBB'
Uruguay	'BB' to 'BB+'

### Outlook Changes

Dominican Republic	Positive Outlook
El Salvador	Stable Outlook from a Negative
Peru	Positive Outlook Affirmed

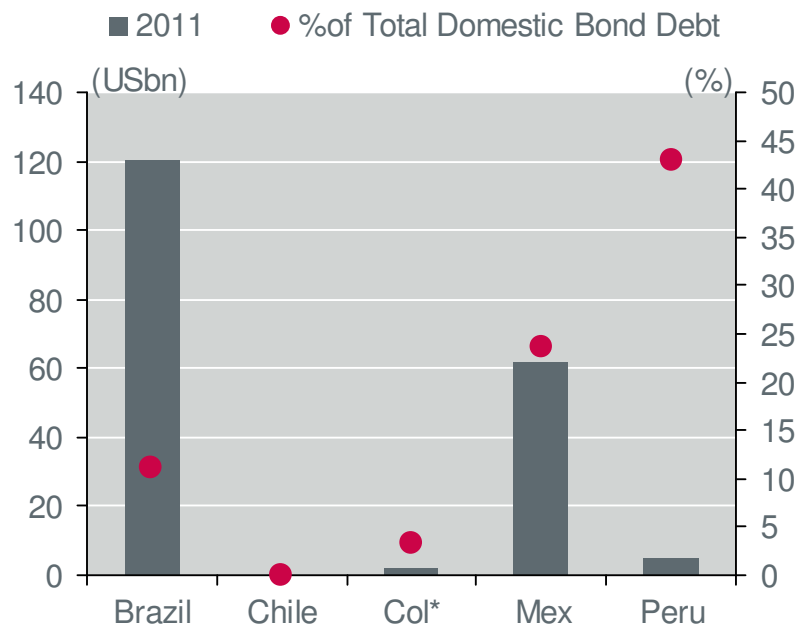
## Change in Average Regional Ratings



Source: Fitch Ratings

# Transmission Channels: Trade, Commodity Prices, and Capital Flows

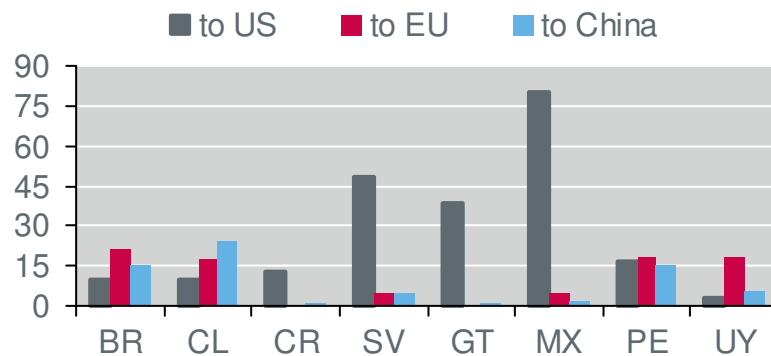
## Foreign Participation in Government Local Debt Markets



\* Colombia data = Feb 2011, all other reflect June 2011  
Source: Tesouro Nacional, Central Banks

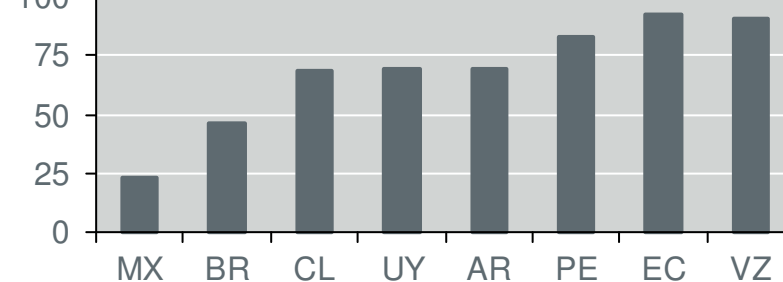
## Exports by Destination

(% of country's total exports, 2010)



## Commodity Dependence

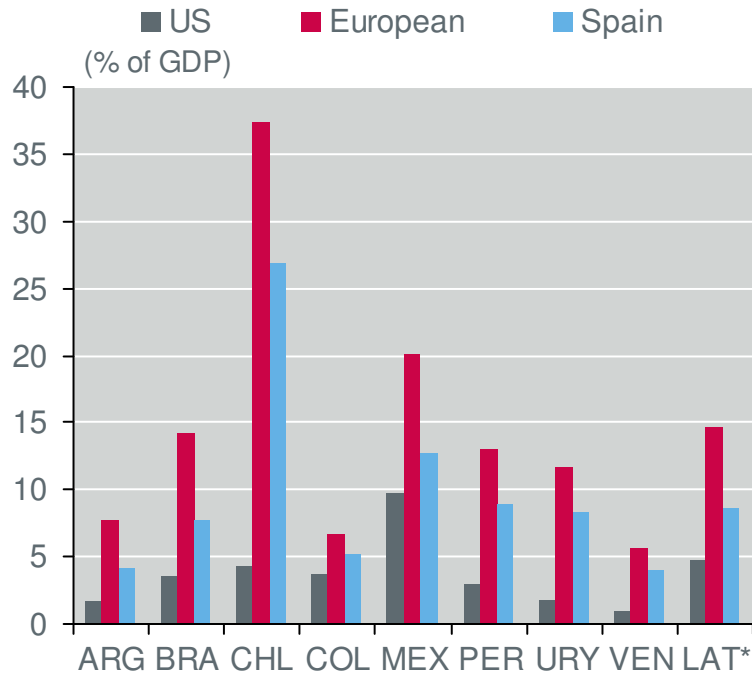
(% CXR)



Source: Central Banks, World Bank (2009)

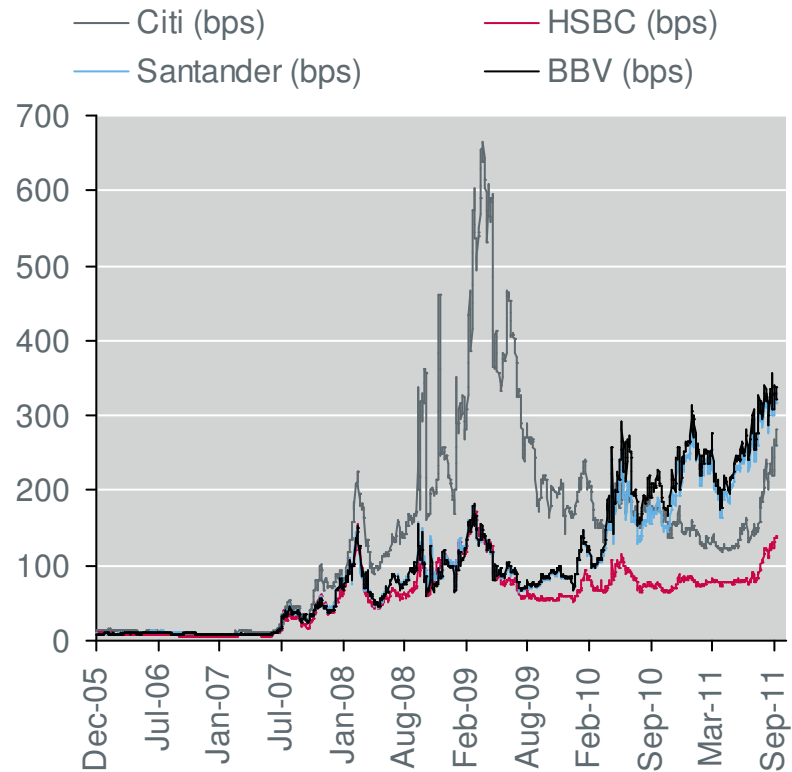
# Financial Linkages With European Banks

## Claims of Foreign Banks in Latin America



\* Latin America: GDP Weighted Average  
Source: BIS March 2011, Fitch (2011e GDP)

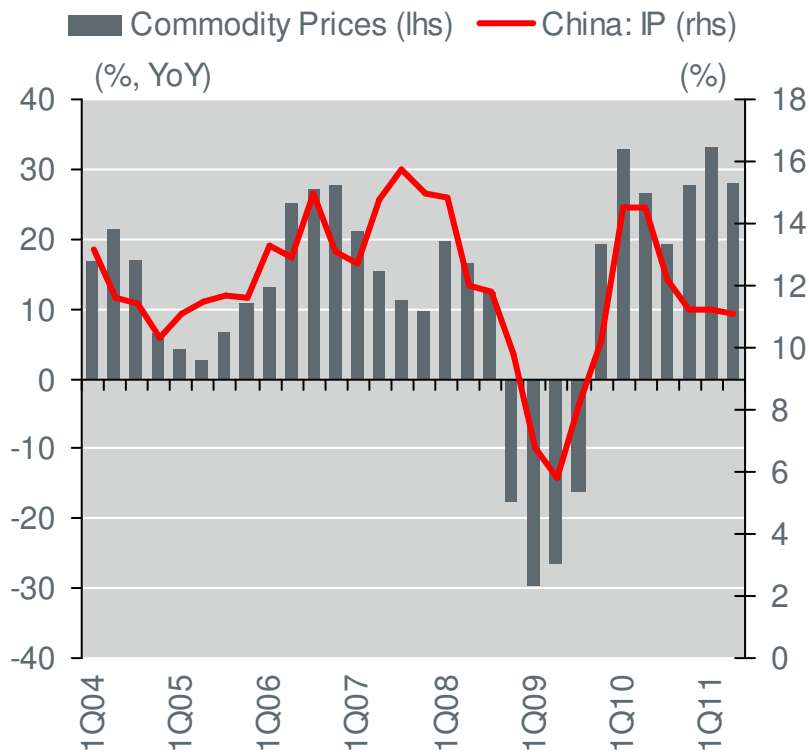
## Bank CDS Spreads



Source: Bloomberg

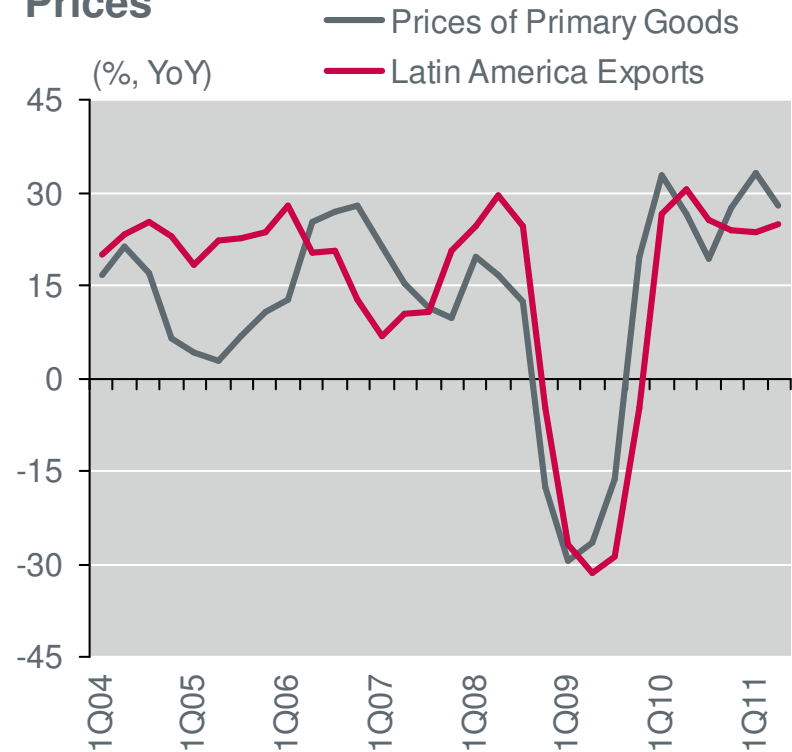
# A China Slowdown Could Further Complicate Matters

## Commodity Pressure



Source: IMF

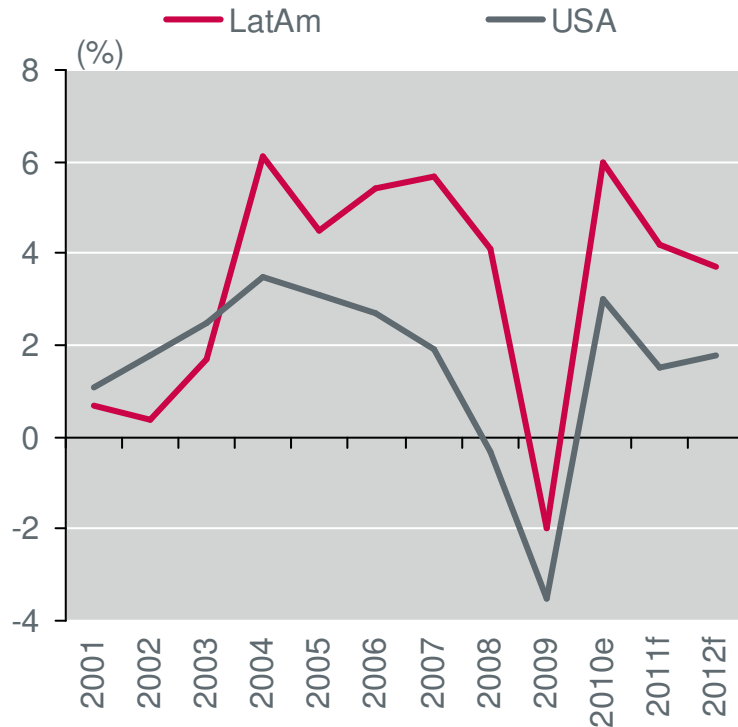
## LatAm Dependence on Commodity Prices



Source: IMF

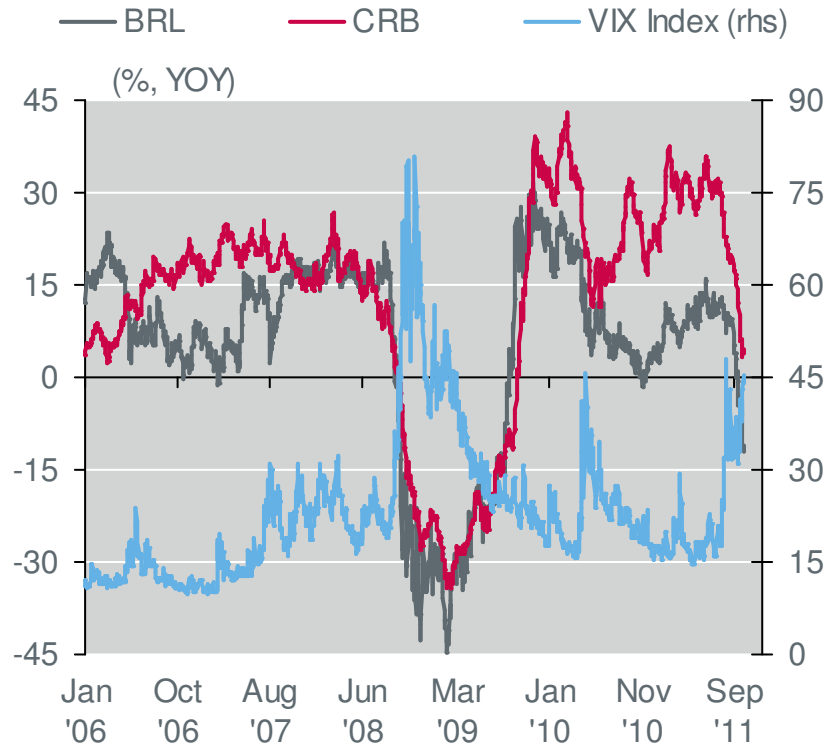
# Economic Slowdown Rather than a Crash

## Latin America Regional Growth



Source: Fitch Ratings

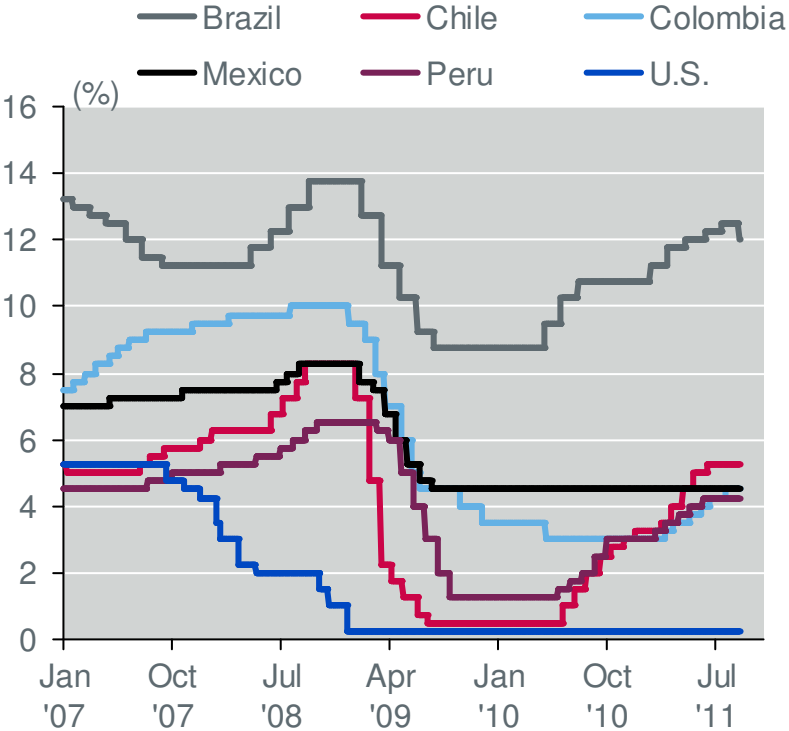
## Trend: BRL-CRB vs. VIX Index



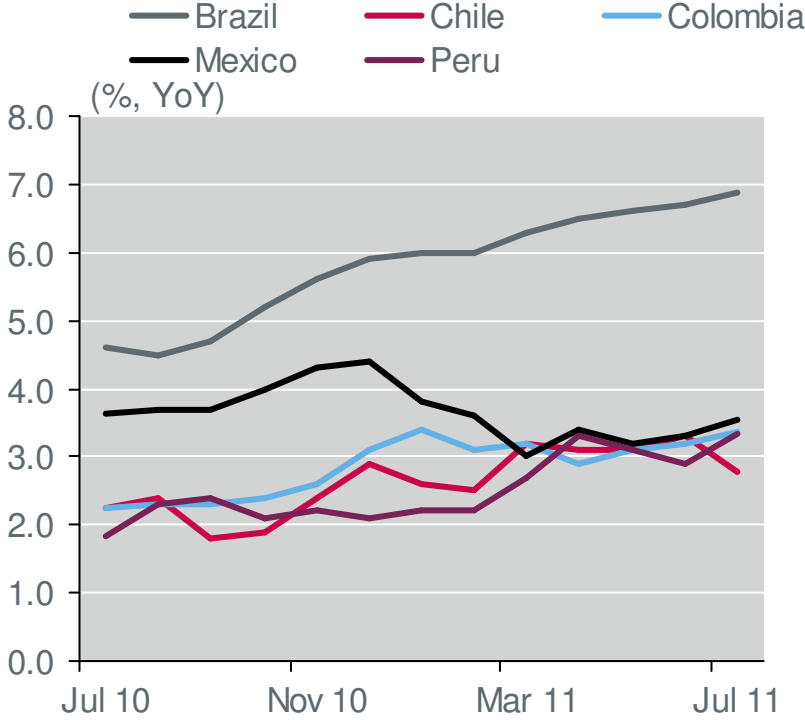
Note: BRL (% YoY) +=appreciation / -=depreciation)  
 Source: Bloomberg, Fitch Ratings

# Monetary Policy Flexibility

## Monetary Policy



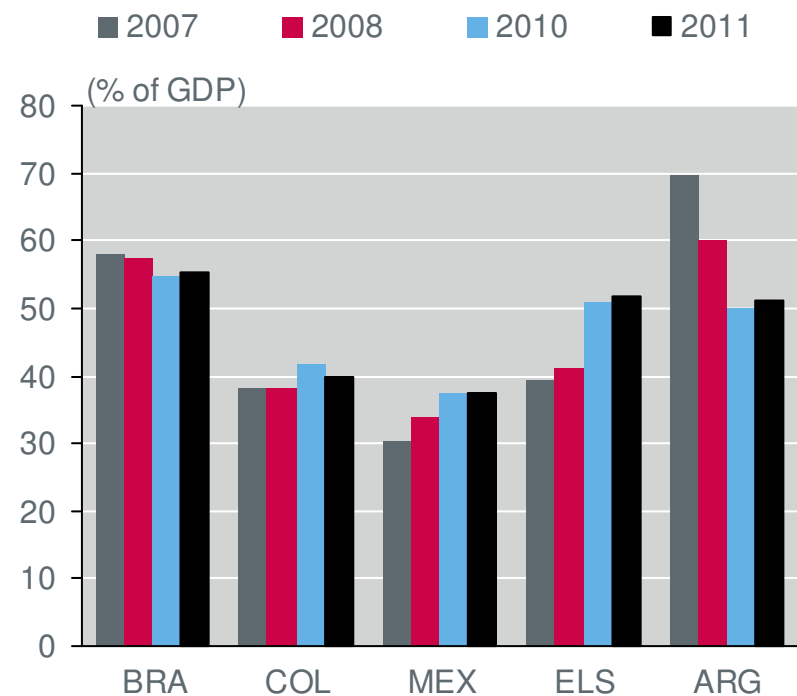
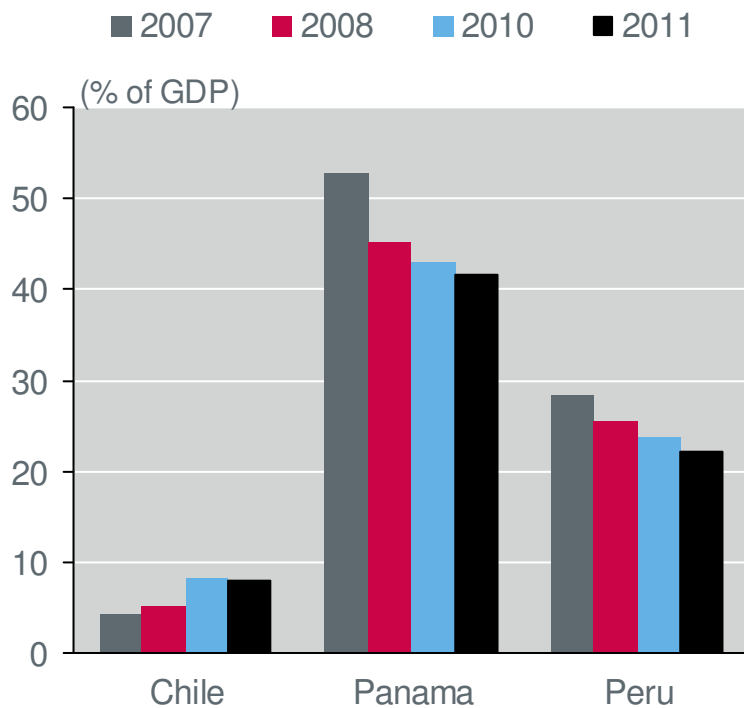
## Consumer Prices



Source: IFS, Bloomberg, Fitch Ratings

# Fiscal Policy Flexibility Varies Across the Region

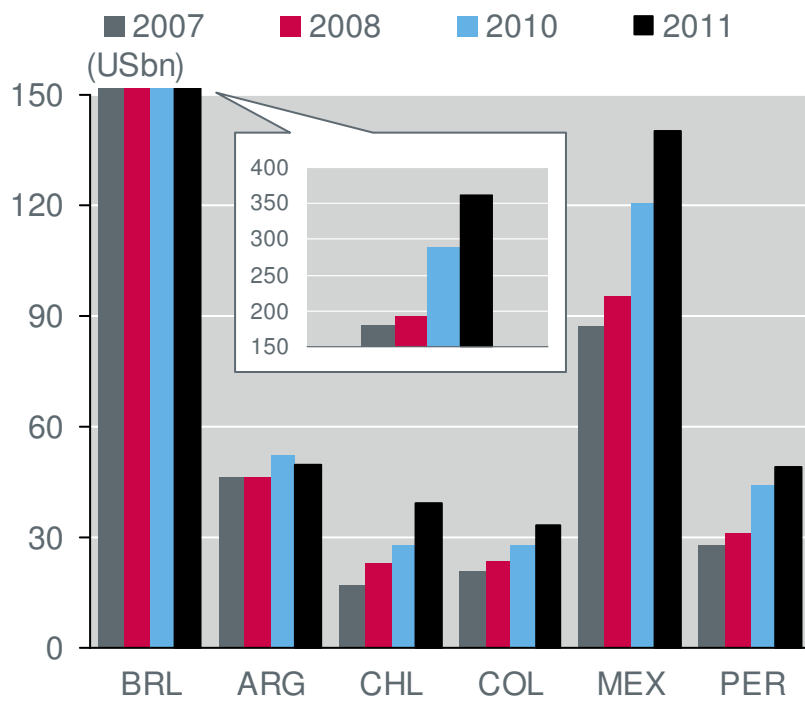
## General Government Debt



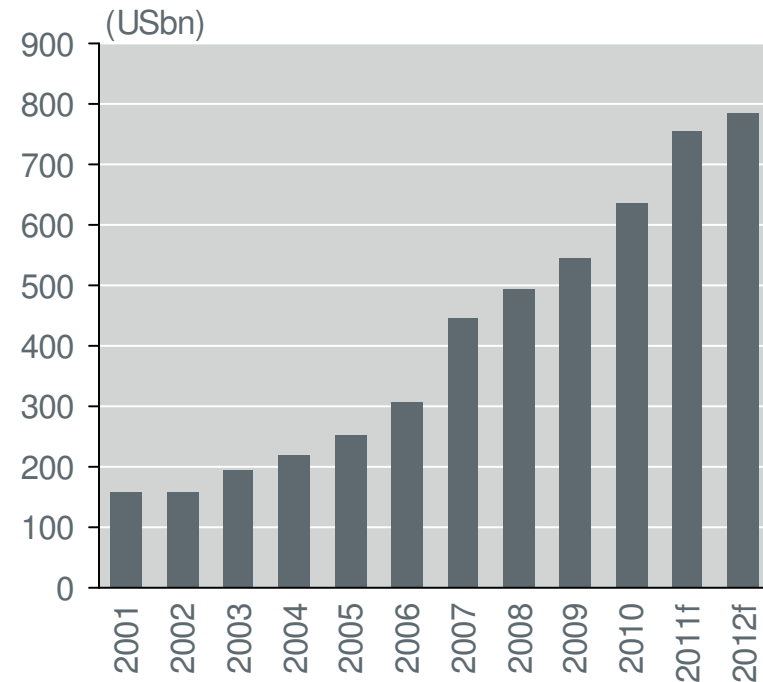
Source: Fitch Ratings

# External Shock Absorption Capacity Still Strong

## International Reserves

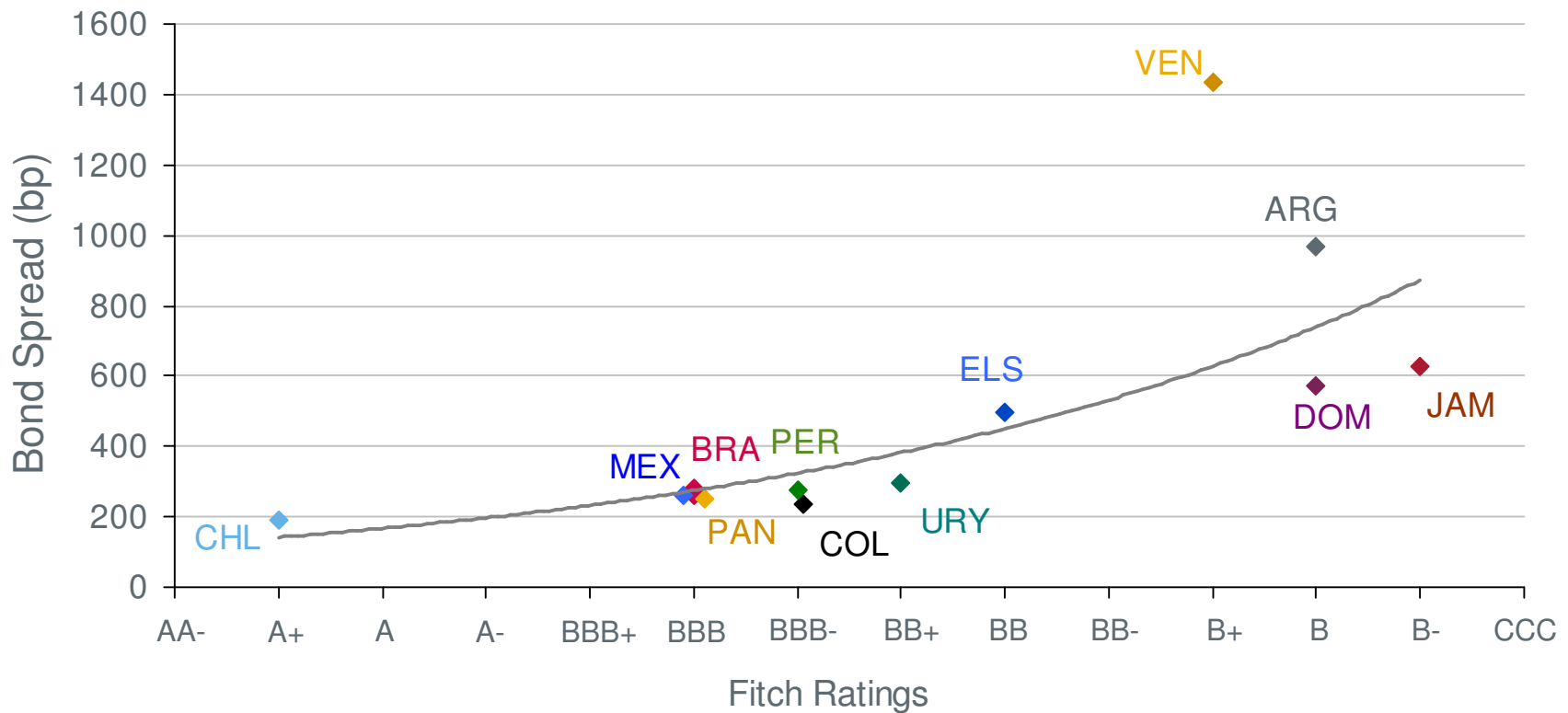


## Latin America Reserves Incl. Gold



Source: Fitch Ratings

# Latin America Sovereign Ratings versus Market Spreads



Source: JP Morgan, Fitch Ratings

# Agenda

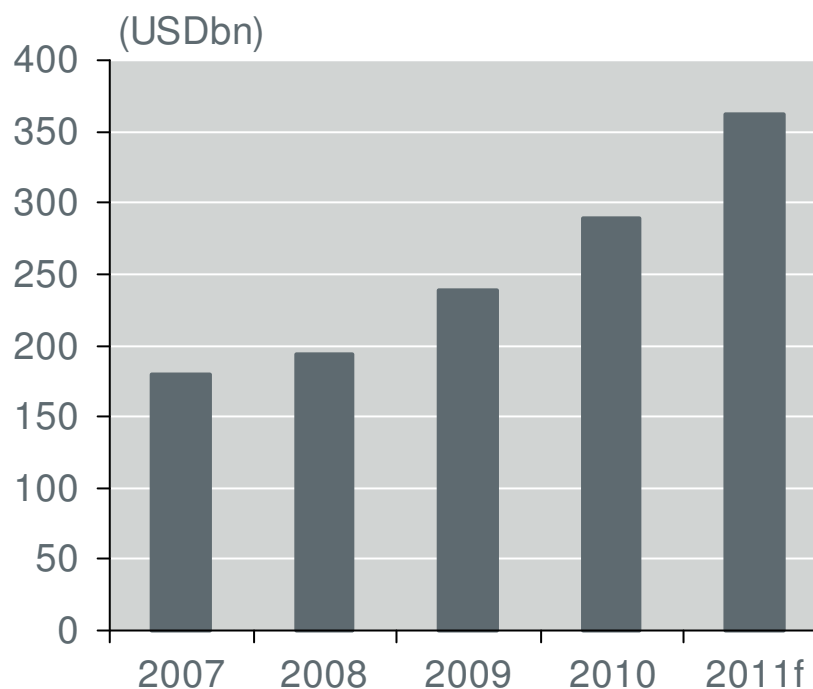
Latin America Sovereigns: Ratings  
Trajectory In A Weakening Global  
Environment

➤ Brazil: Rating Drivers And Challenges  
Ahead

# Brazil Upgraded to 'BBB'

- Fitch upgraded Brazil on April 4, 2011
  - Materialization of rating triggers
  - Enhanced medium-term growth prospects
  - Strengthened external liquidity position
  - Signs of fiscal restraint
  - Policy continuity and greater focus on investment in the Rousseff administration
- Fitch assigned positive rating outlook to Brazil's sovereign ratings in June 2010
  - Impressive economic recovery
  - Credible response to the global credit crisis
    - Monetary Policy
    - Fiscal policy
  - Further strengthening of external liquidity buffers

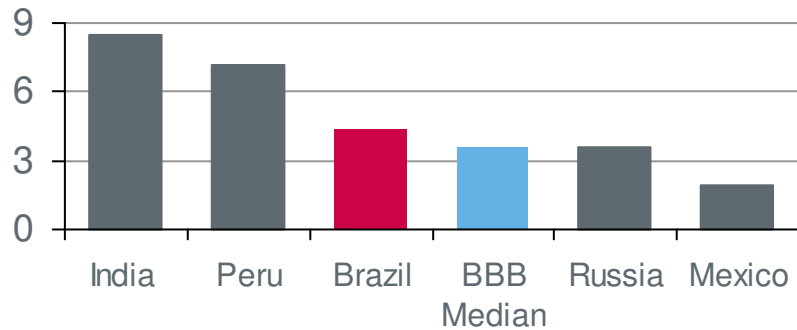
## International Reserves (incl. gold)



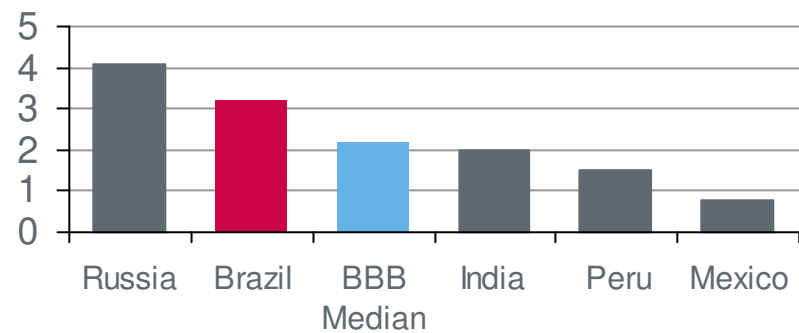
Source: Fitch Ratings

# Brazil's Macroeconomic Performance and Policies: Neutral Status Relative to Peers

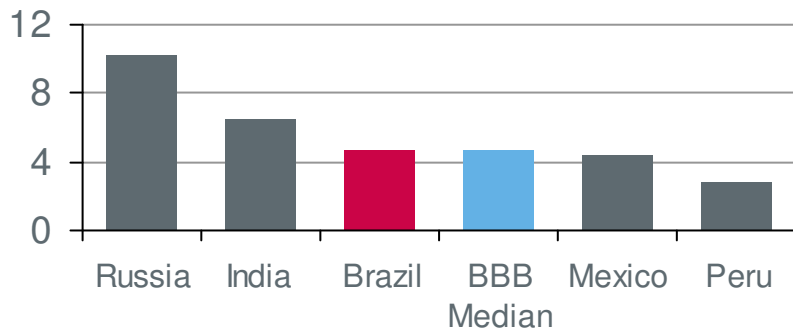
**Real GDP (5yrs average % change)**



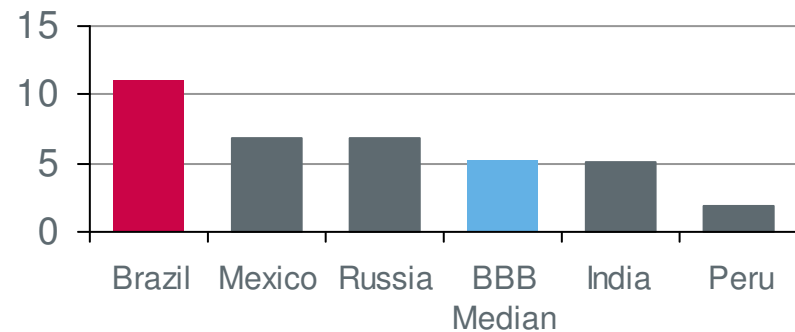
**Volatility of CPI (10yr-rolling SD)**



**Consumer Prices (5yr average)**



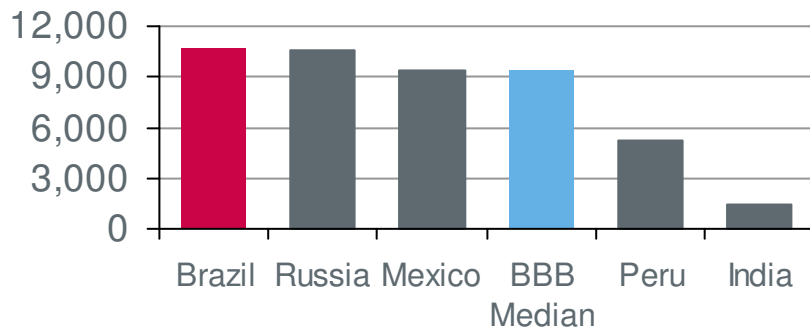
**REER Volatility (10yr-rolling SD)**



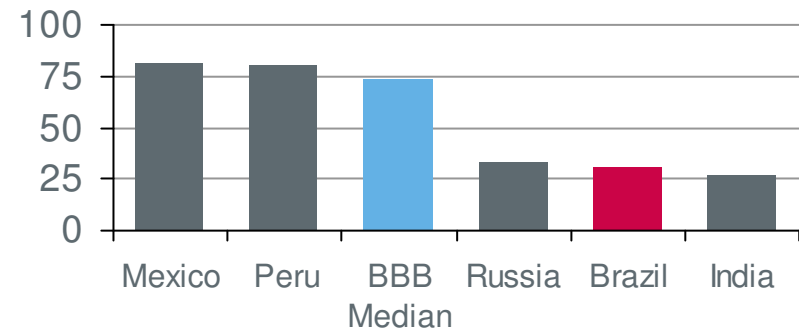
Notes: 2010 Data  
Source: Fitch Ratings

# Brazil's Structural Features: Neutral Status Relative to Peers

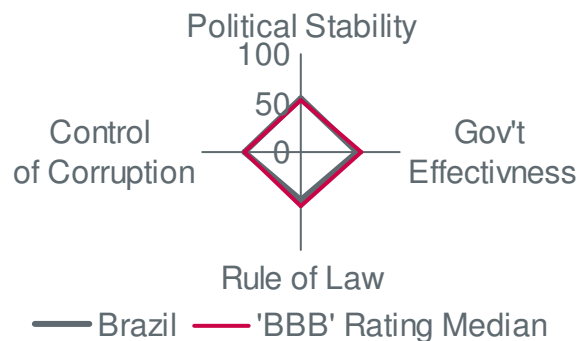
## GDP per capita (USD)



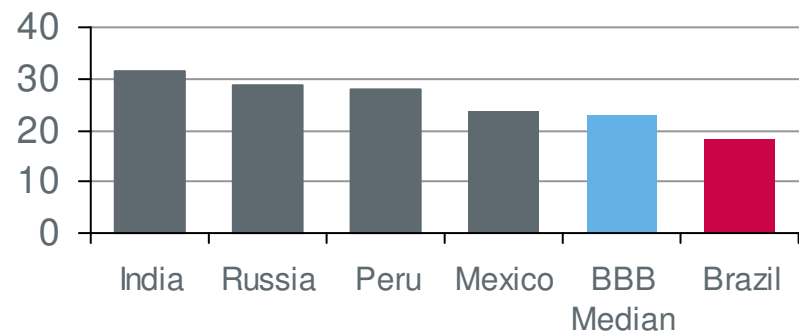
## Ease of Doing Business (%-tile, latest)



## Governance Indicators



## Gross Domestic Savings (% GDP)



Source: World Bank (2009), Fitch Ratings

Notes: Data reflect 2010  
Source: Fitch Ratings

# Strength of Policy Flexibility to Deal with External Shocks

## Transmission Channels

- ✘ External demand weakness
- ✘ Decline in commodity prices leading to lower business and consumer confidence, and hitting private investment
- ✘ Excessive FX weakness and volatility
- ✘ Capital Outflows
- ✘ Banking Sector liquidity issues
- ✘ Economic slowdown

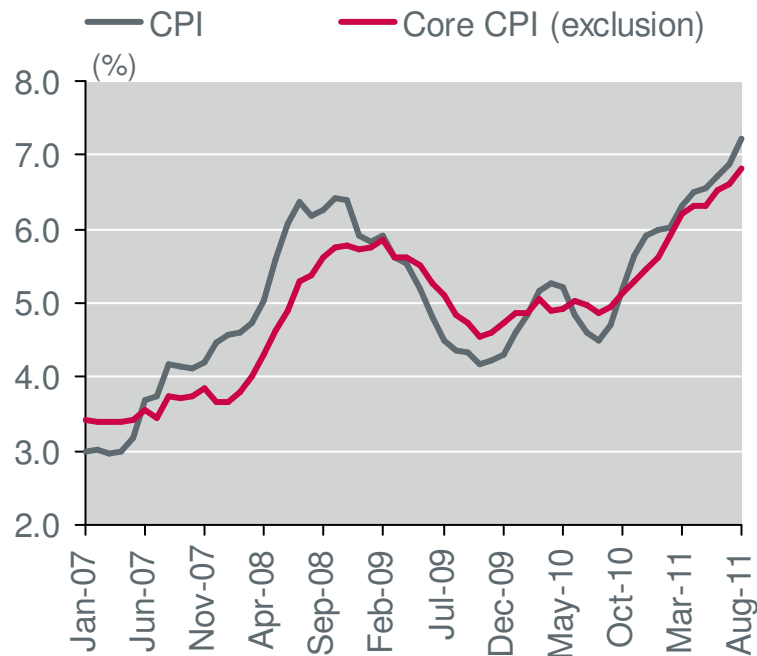


## Policy Flexibility

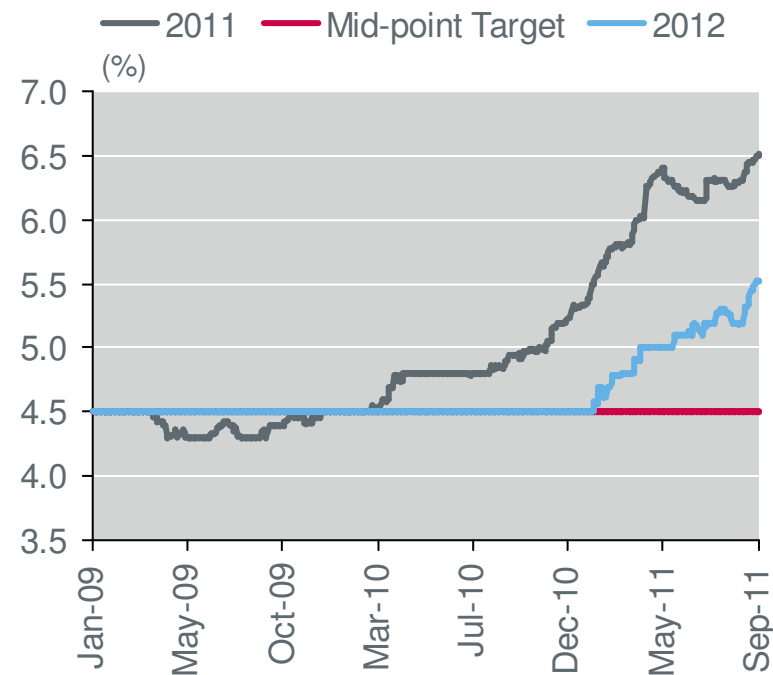
- ✓ Imports adjustment
- ✓ Flexible exchange rate
- ✓ Flexible exchange rate
- ✓ Counter-cyclical monetary policy
- ✓ FX adjustment, FX Intervention: spot markets, repo of reserves, and future markets
- ✓ FX adjustment, Govt. domestic bonds buy-backs, unwinding of capital controls
- ✓ Reduction in reserve requirements and liquidity support
- ✓ Counter-cyclical monetary policies, automatic fiscal stabilizers, and focus on private investment in infrastructure

# Challenge #1: Reducing Inflation and Maintaining Monetary Policy Credibility

## CPI and Core Inflation (Rolling 12-mo)



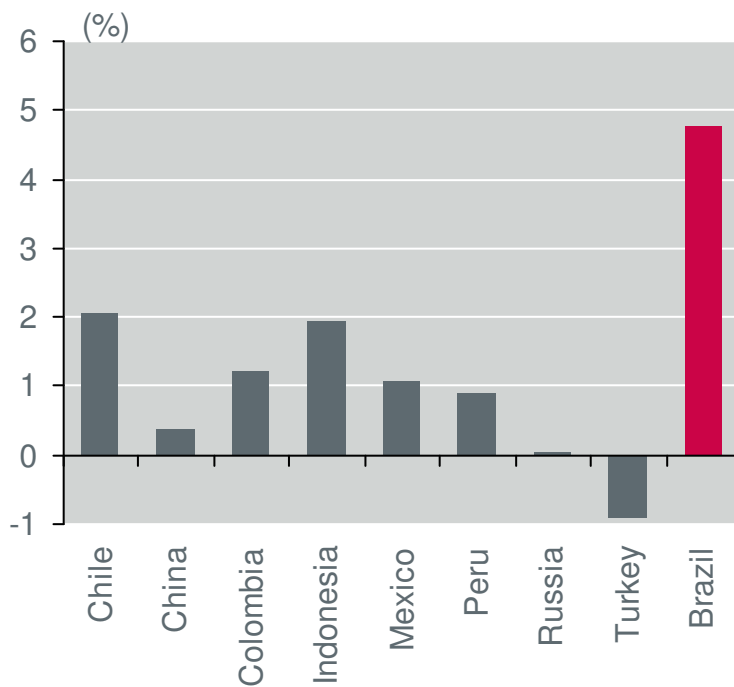
## Inflation Expectations for 2011



Source: BCB, Fitch Ratings

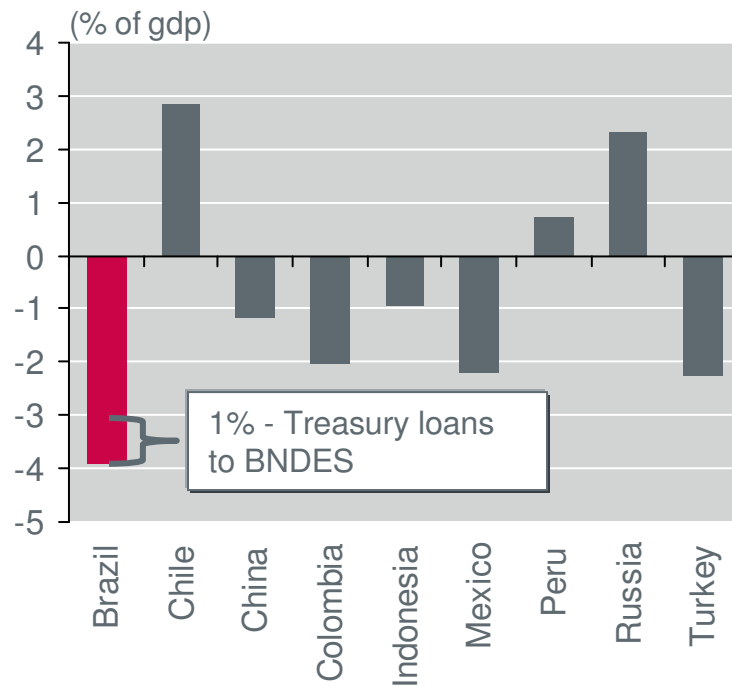
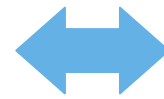
# Challenge #2: Improving the Monetary-Fiscal Policy Mix

## Real Interest Rates



Source: Bloomberg, Fitch

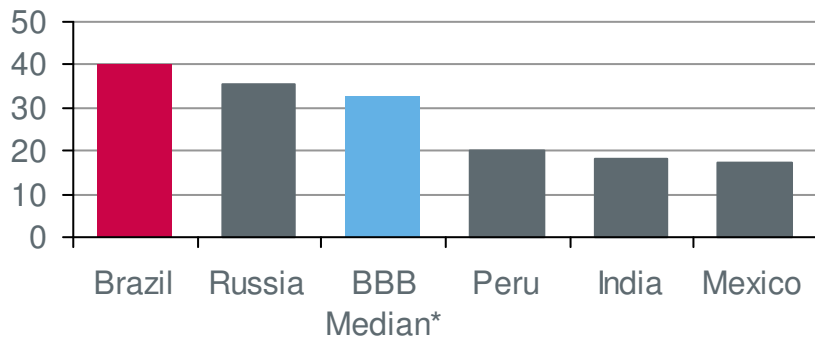
## Fiscal Balance (Average 2005-2011)



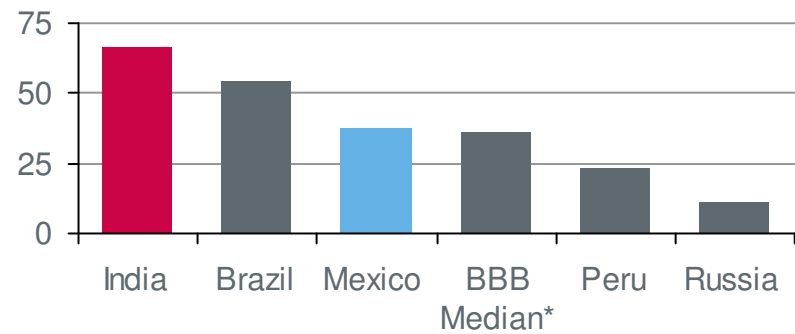
Source: Fitch

# Challenge #3: Differentiating Brazil's Fiscal Policy and Dynamics

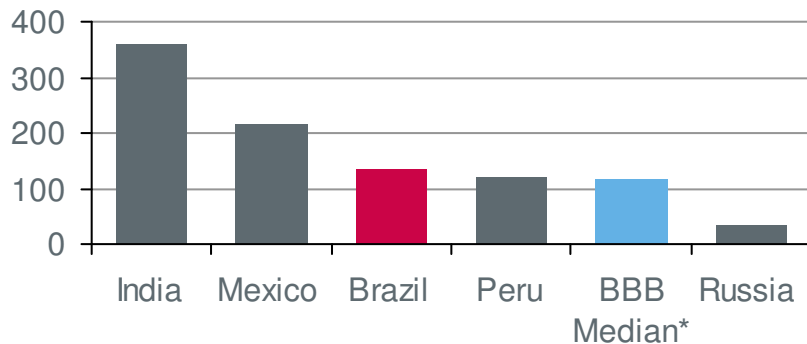
**Revenues and grants (% gdp)**



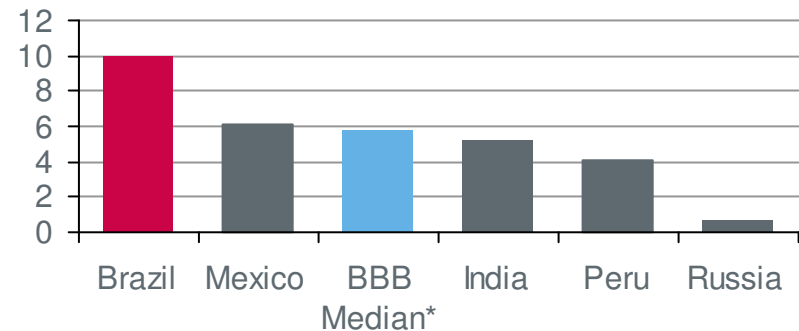
**Debt (% gdp)**



**Debt (% revenue)**



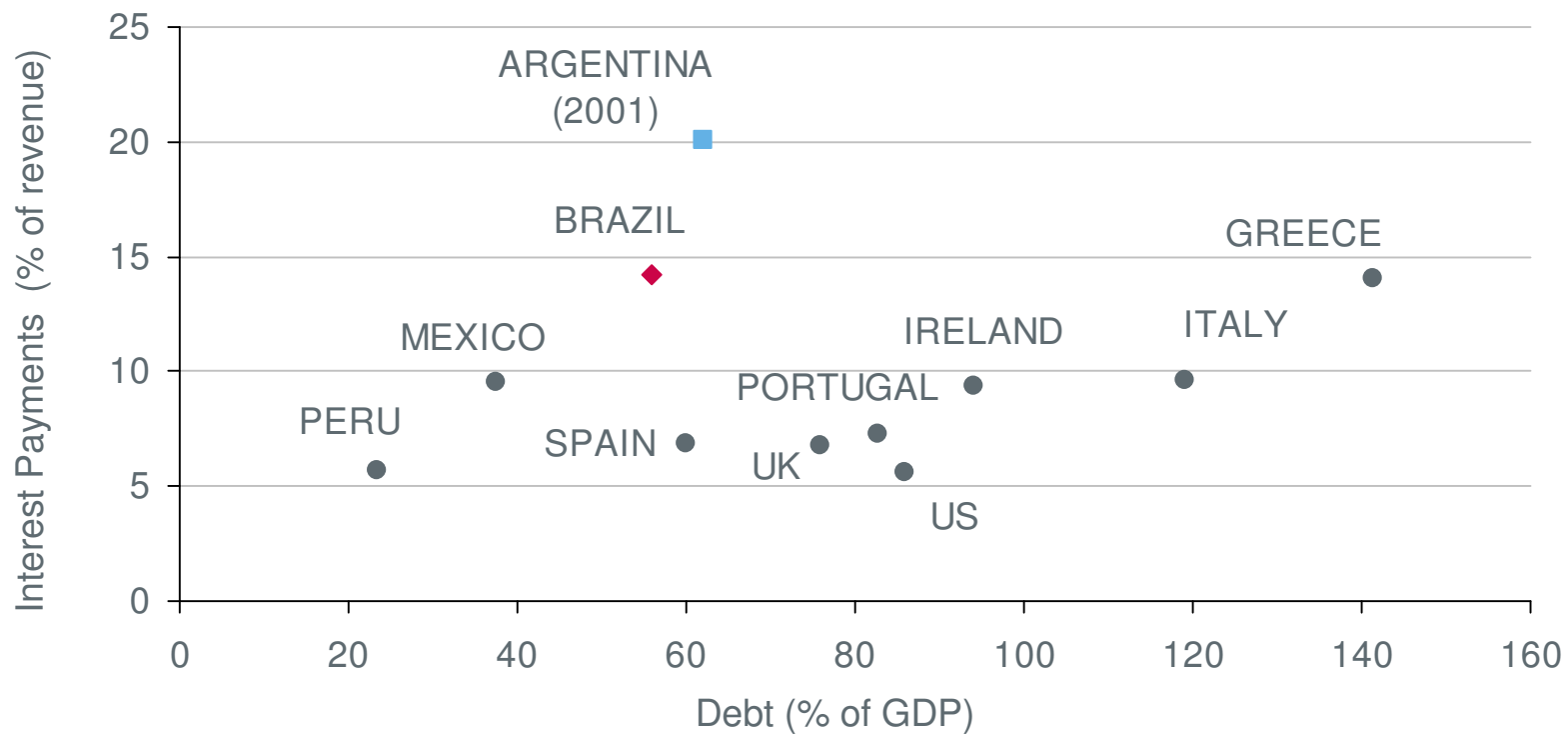
**CG debt maturities (% gdp)**



Note: GG if not otherwise specified. \*BBB Median - Average of 10 years  
Source: Fitch Ratings

# Interest Burden Still High

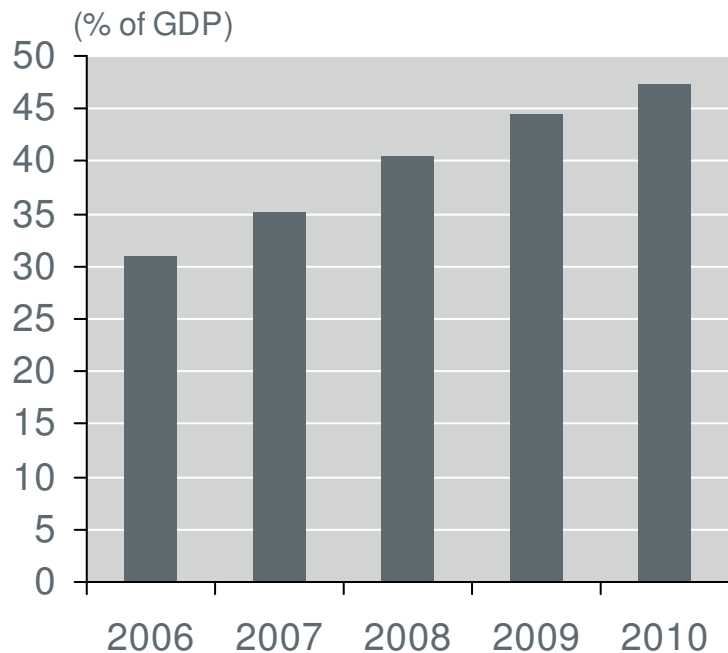
## General Government, 2010



Source: Fitch Ratings

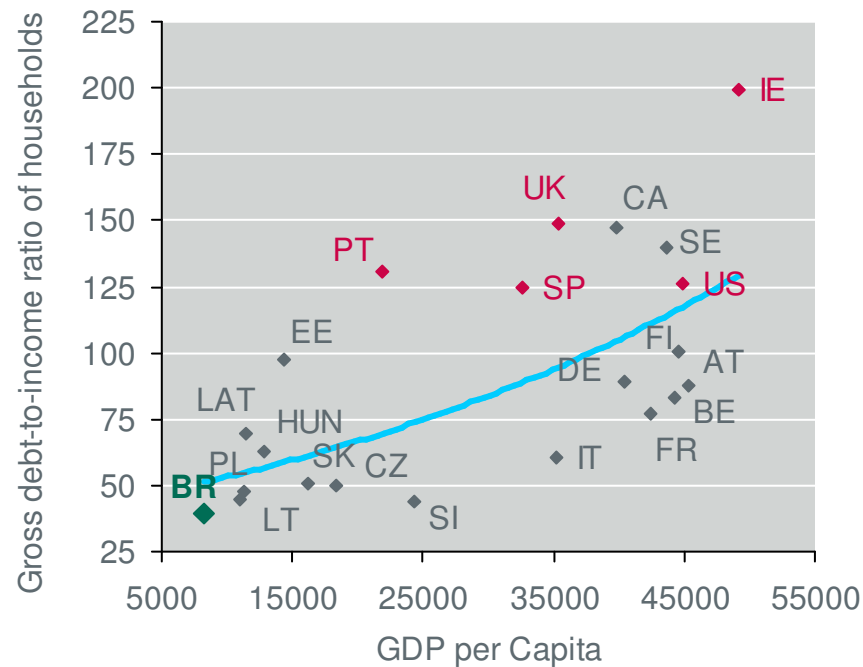
# Challenge #4: Managing the Credit Cycle

## Total Loans



Source: Bloomberg, Fitch

## Household Leverage



Notes: Gross debt-to-income ratio of households:  $(AF4, liab)/(B6G+D8net)$   
Source: Fitch

# Brazil's Future Rating Drivers

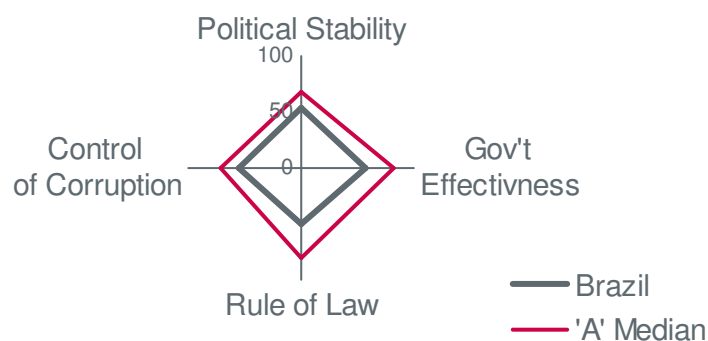
## Positive Rating Drivers

- Sustained improvements in fiscal and external balance sheets
- Further improvement in economic growth dynamics
- Continued consolidation of macroeconomic stability
- Progress on economic reforms

## Negative Rating Drivers

- A sharp increase in public debt burden
- Crystallization of significant contingent liabilities from the financial sector

## Governance Indicators



Source: World Bank (2009), Fitch Ratings

2010	Brazil	'A' Median
GDP per head at market exchange rates (USD)	10691.2	17291.9
Real GDP growth (% , 5-year average)	4.4	4.0
Volatility of GDP	2.6	2.8
Gross domestic savings (% of GDP)	18.3	29.7
Commodity dependence	47.7	11.2
Consumer prices (annual average % change)	5.0	2.1
Volatility of CPI	3.2	1.6
General government debt (% of GDP)	54.7	39.7
General government debt maturities (% of GDP)	10.0	4.2
General govt. interest payments (% of revenue)	14.2	5.5
Current account balance (% of GDP)	-2.3	2.8
NXD (% of CXR)	24.0	-10.9
Net sovereign external debt (% of CXR)	-49.9	-25.8

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