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BRAZILIAN SOVEREIGN RATING AND COMPARISON WITH PEERS

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- Recently some of the credit agencies upgraded their ratings for Brazil's sovereign credit. We believe these were backward-looking upgrade that consider Brazil's improved fiscal and activity numbers in the last couple of years, along with the approval of important structural reforms (e.g., pension and labor reforms, BCB autonomy). In addition, in the short term, Brazil is continuing to pursue the economic agenda that helped to trigger those improvements (e.g., the new fiscal framework reducing the tail risks for the debt trajectory). However, the country's new ratings are still below investment grade, and we believe that Brazil still needs to make relevant progress (structural reforms) to regain investment-grade (IG) status. Tax reform (VAT), the legislative agenda to boost productivity, and fiscal consolidation will be in the spotlight, in our view.
- In this report, we seek to compare the main macroeconomic indicators for various countries and their respective sovereign ratings. Our focus is to analyze how Brazil compares with other emerging economies and countries that are classified as investment grade. As expected, we find that the country's fiscal metrics are more negative than those of its peers. Despite the recent recovery in GDP growth, the slower activity of the last couple of years and how it could affect future growth still need to be addressed. On the positive side, external accounts remain strong, especially the high level of international reserves.
- Brazil's primary fiscal balance has showed some improvement in recent years, yet IMF forecasts, and our own projections, indicate that in the next two years the country will face deficits. On the activity side, we have seen some recovery in short-term GDP growth, but from a low base, as the average for 2011-19 was quite low (0.8%). Reforms to increase productivity will be crucial to improving the likelihood that the country can regain an investment-grade rating. Sustainable potential GDP growth will also help the country in relation to its fiscal accounts, in our view, while addressing reforms to contain public expenditures will also be important. In our calculus, long-term GDP growth of ~2.5% (we estimate potential GDP at 1.5%) could help achieve a downward debt trajectory, which will be important for Brazil to receive further sovereign credit upgrades.
- In April 2008, the rating agency S&P granted Brazil an investment-grade rating of BBB-. At that time, according to S&P: "the upgrade reflects the maturing of Brazil's institutions and policy framework, as evidenced by the easing of the fiscal and external debt burden, and [reflects] improved growth trend prospects". The country maintained its investment-grade status for seven years (2008-15). After 2015, Brazil lost this status, mainly because of the widening primary fiscal deficit and the growth of the gross debt/GDP ratio, and because it faced increased challenges in determining corrective measures to sustain confidence and improve the country's prospects for growth, fiscal consolidation, and debt stabilization.
- Regaining investment-grade status could take more than 10 years if Brazil repeats the experience of some other emerging economies. Usually, to be rated investment grade, it is important to institute reforms to control the growth of expenditures and improve productivity in order to boost GDP growth. In this report, we explore the experience of some other countries in regaining investment-grade status.
- Ultimately, the big question remains what the trend will be for Brazil's rating in the coming years. Unfortunately, we do not have a clear answer, as it depends on many factors, especially those related to demands for social welfare spending. The country has negatives and positives regarding the potential for changes in its rating classification. In our view, fiscal adjustment is a central issue (helped — or not — by GDP growth), and the approval of reforms is essential, which requires political consensus.

IMPORTANT DISCLOSURES/CERTIFICATIONS ARE IN THE "IMPORTANT DISCLOSURES" SECTION OF THIS REPORT.
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1. Introduction

In this report, we seek to compare the main macroeconomic indicators and the respective sovereign ratings across selected countries. Our focus is to analyze how Brazil compares to other emerging economies and countries that are classified as investment grade. As expected, the country's fiscal accounts are more negative than those of its peers, and even though Brazilian fiscal accounts have recorded a positive performance recently, boosted by commodity prices (especially oil), the trend continues to be challenging, in our view. We recognize that other emerging countries have shown a recent deterioration in fiscal accounts, but most have lower debt than Brazil. Brazilian debt is on average 20 p.p. above that of the countries in the first notch considered as investment grade. Furthermore, we observe that Brazil has low GDP growth, below 1% on average for the 2011-19 period. According to Fitch, "Compared to other countries, potential growth below 2%, for example, is weak. This implies fiscal and social pressures."

On the other hand, Brazil's external accounts look quite robust, with external solvency indicators in positive territory because of the elevated level of international reserves. Despite the 9% decrease in international reserves in 2022, they continued to represent an ample buffer, above the 'BB' notch (Fitch) median of 4.5. Brazil's foreign currency assets outpaced liabilities for the first time ever in January 2008, when the country had sovereign net external creditor status and a deep local debt market. We also briefly explore the changes that the pandemic caused between 2019 and 2022, and its impact on several macroeconomic variables.

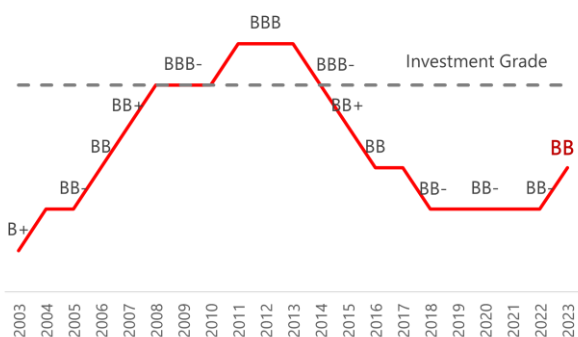
To give a quick overview of Brazil's rating history, in April 2008 S&P granted Brazil an investment-grade rating of BBB-. At that time, according to S&P: "the upgrade reflects the maturing of Brazil's institutions and policy framework, as evidenced by the easing of the fiscal and external debt burden, and (reflects) improved growth trend prospects". The country kept its investment-grade status for seven years (2008-2015). However, in December 2015, Brazil lost this status when Fitch downgraded it to BB+, mainly because of its widening primary fiscal deficit and the growth of the gross debt/GDP ratio, as well as because of Brazil's growing challenges in determining corrective measures to maintain confidence and improve the country's prospects for growth, fiscal consolidation, and debt stabilization.

In May 2016, Fitch downgraded Brazil's rating to BB. According to the agency, the downgrade reflected a deeper economic contraction than previously expected, the government's inability to stabilize the public finance outlook, and the continuing political impasse, as well as increased domestic uncertainties. In February 2018, Fitch downgraded Brazil's rating to BB-. Fitch noted that this reflected the fiscal deficit, the high level of public debt, and difficulty in implementing structural reforms.

In June 2023, S&P changed its outlook on Brazil's sovereign credit rating from stable to positive, and in July 2023, Fitch upgraded Brazil's rating from BB- to BB. Both agencies highlighted the country's improved growth outlook and the deceleration in the growth of public debt achieved through reforms. Their rating changes also reflect the country's strong external position. Therefore, the change in ratings is reinforced by expectations of pragmatic policies that could lead to the country's fiscal sustainability and growth. Figure 3 shows the most recent changes and the ratings from the three main agencies. We believe that the rating issue will gain importance following the effects of the pandemic and the monetary and fiscal policies the countries adopt.

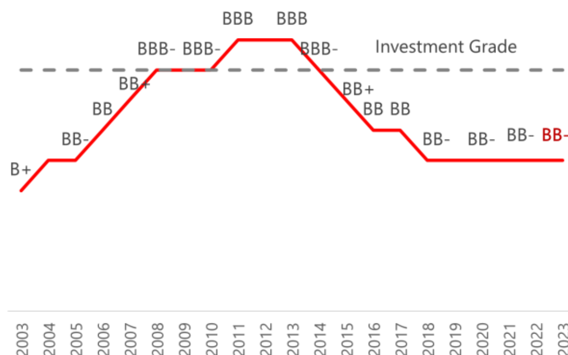
Following the recent changes by Fitch and S&P, the country is still two notches below investment grade. Regaining investment-grade status could take more than 10 years if Brazil repeats the experience of some other emerging economies. Typically, to achieve investment grade, it is important to control the growth of expenditures and improve productivity to boost potential GDP growth.

Figure 1. Brazilian Rating – Fitch



Sources: Fitch, Santander

Figure 2. Brazilian Rating – S&P



Sources: S&P, Santander

Figure 3. Rating History for the Main Rating Agencies

Country	Fitch		S&P		Moody's	
	Rating	Rating History	Rating	Rating History	Rating	Rating History
Chile	A-	Oct-2020	A	Mar-2021	A2	Sep-2022
Mexico	BBB-	Apr-2020	BBB	Mar-2020	Baa2	Jul-2022
Peru	BBB	Oct-2021	BBB	Mar-2022	Baa1	Sep-2021
Colombia	BB+	Jul-2021	BB+	May-2021	Baa2	Jul-2014
Brazil	**BB**	**Jul-2023**	**BB-**	**Jan-2018**	**Ba2**	**Feb-2016**
South Africa	BB-	Nov-2020	BB-	Apr-2020	Ba2	Nov-2020

Sources: Fitch, S&P, Moody's, Santander

Figure 4. Rating Grade Description

S&P	Fitch	Moody's		Rating Grade Description
AAA	AAA	Aaa	Investment Grade	Highest Grade Credit
AA+	AA+	Aa1		Very High-Grade Credit
AA	AA	Aa2		
AA-	AA-	Aa3		
A+	A+	A1		High Grade Credit
A	A	A2		
A-	A-	A3		
BBB+	BBB+	Baa1		Good Credit Grade
BBB	BBB	Baa2		
BBB-	BBB-	Baa3		
BB+	BB+	Ba1	Speculative Grade	**Speculative Grade Credit** Brazil
BB	BB	Ba2		
BB-	BB-	Ba3		
B+	B+	B1		Very Speculative Grade Credit
B	B	B2		
B-	B-	B3		
CCC+	CCC+	Caa1		Substantial Risks - In Default
CCC	CCC	Caa2		
CCC-	CCC-	Caa3		
CC	CC	Ca		
C	C			
SD	DDD	C		
D	DD			
	D			

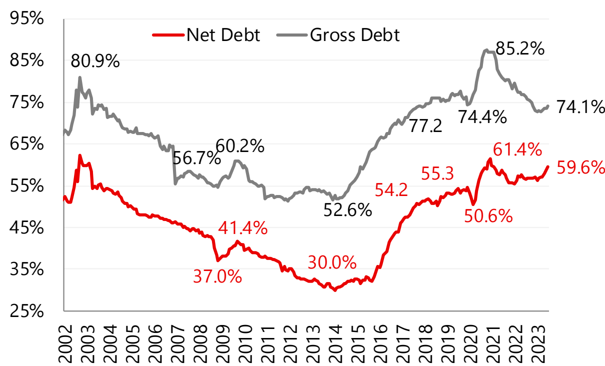
Sources: Fitch, S&P, Moody's, Santander

2. Brazilian Fiscal Situation and Risk Measures

We can see from Figures 5-8 that the fiscal issue was the central reason behind the agencies' decision to downgrade Brazil's sovereign rating. Since 2014, with the exception of last year, the country has registered a primary deficit. That is, in the last 10 years, the country has registered eight years of deficits compared to two positive years. Before 2015, Brazil saw a falling debt trajectory, approaching the average for emerging countries, but that favorable situation is receding ever further into the past.

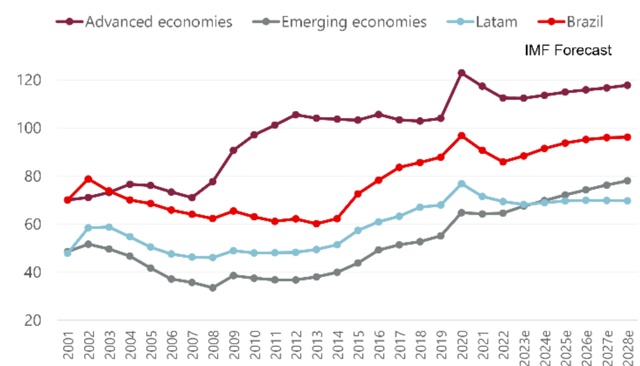
The path to fiscal consolidation is still difficult. The outlook for debt management remains challenging in the medium term, considering the higher domestic debt in the context of an increase in the cost of debt and uncertainty about the fiscal consolidation ahead. In addition, the level of liquidity reserves and favorable market conditions are important factors. In the short term, we believe liquidity is at a comfortable level to serve as a cushion for the uncertainties ahead.

Figure 5. Brazil's Public Sector Debt (12m % GDP)



Sources: BCB, Santander

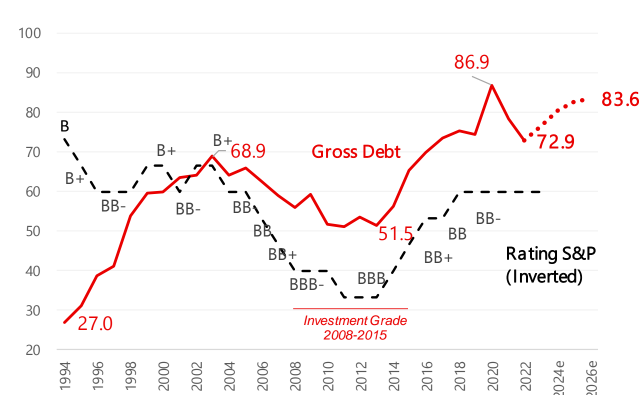
Figure 6. IMF - Government Gross Debt (% GDP)



Sources: National Treasury, Santander

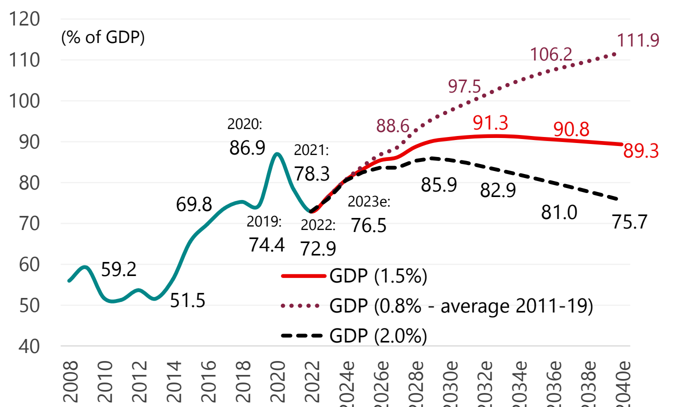
In our view, there is a relationship between the level of the debt (regardless of the methodology used) and the rating. Figure 7 shows this relationship for Brazil. For the country to receive further upgrades and regain an investment-grade rating (a process that we explore later in the report), Brazil's debt trajectory and its comparison to peers is a key element. We believe Brazil has improved at the margin, mostly helped by the price shock (inflation and terms of trade), yet the greatest challenge will be complying with the new fiscal framework and reaching a sustainable primary surplus. Thus, GDP growth will be a crucial variable to track. Figure 8 illustrates how GDP growth can directly affect debt convergence.

Figure 7. Relationship: Gross Debt vs. Rating



Sources: IMF (World Economic Outlook 2022), S&P, Santander

Figure 8. Scenarios - Gross Debt Scenario (% GDP)

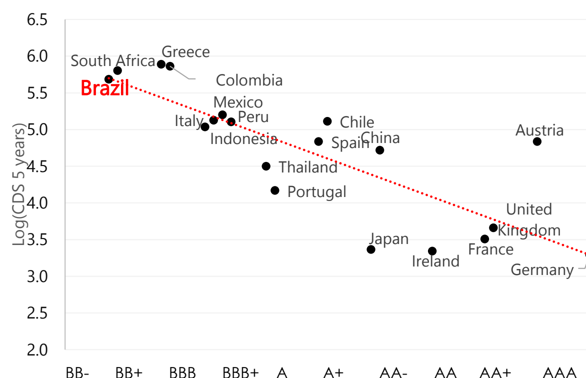


Sources: BCB, Santander

The relationship between the sovereign rating and risk measures such as the CDS is well known, as the higher a country's CDS, the lower its rating level. Countries with higher ratings, such as Germany (AAA), France (AA), and Japan (A+), have lower CDS rates and are better positioned in relation to their rating than EM countries. The Brazilian CDS is close to that of South Africa, which has the same rating.

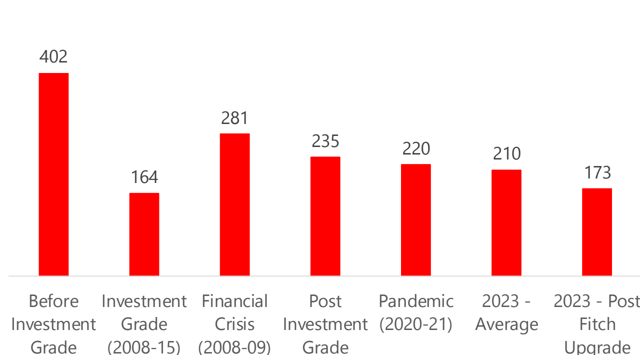
It is noticeable that the CDS decreased in 2008, allowing Brazil to receive investment-grade ratings. After the country risk level increased over time, Brazil lost its investment-grade rating in 2015. This underlines the importance for Brazil of addressing its fiscal issues in order to reduce the risk perception (lower idiosyncratic risk) and receive rating upgrades. We know that the CDS lost part of its capacity to measure fiscal risk for Brazil, especially considering that the country has a low level of external debt. However, the market and the rating agencies still look at these numbers, so we thought it was important to include them for reference.

Figure 9. CDS vs. Credit Sovereign Rating



Sources: Bloomberg, S&P, Santander

Figure 10. Brazilian CDS 5-Year Average



Sources: Bloomberg, Santander

3. Comparison Between Macro Variables and Ratings in 2011-19

Before analyzing the effects of the pandemic, we first compare the main macroeconomic variables (using international databases such as the IMF and the World Bank) during the period 2011-19. We decided to study this period because it was after the recovery from the 2008 financial crisis and before the 2020 pandemic. Note that we removed smaller countries that distort the means, as they have values above two standard deviations. The countries and ranking of the ratings can be found in Figure A1 in the appendix. We used the S&P rating classification, but we note that for the other agencies the results are quite similar.

Comparing Brazil with the first notch of countries considered as investment grade (BBB-), the main difference is related to fiscal accounts and economic activity results. Brazil's gross debt/GDP is 19.1 p.p. above its peers (India and Romania, both classified as BBB-). Despite the high level of debt, the country has recently posted better performance in the primary result, as Brazil reported fewer years with a deficit, six in the period, compared to nine for both Romania and India. This performance was influenced by the Brazilian primary result in the first part of the years 2011 to 2013, which on average was 2.2% of GDP — a result that helped the country reduce its debt and maintain investment-grade status in the period. In addition, the Brazilian budget gap contracted noticeably, with the result between 2014-19 reaching a primary deficit average of -1.5% of GDP, a level similar to the BBB- countries' average of -1.9% of GDP in that period.

From the perspective of the external sector, we note that Brazil has high reserves and a current account with a better performance than its peers. Even considering the BBB- countries, Brazil stands out for its high level of reserves, a factor that is probably associated with its risk (CDS) having returned to the values it showed before Brazil received investment-grade ratings. On the current account deficit side, Brazil remains close to other countries and is performing better than those with lower ratings. It is worth mentioning that although Brazil's deficit is likely to increase, according to our estimates, it is fully financed by direct foreign investment. Therefore, we expect Brazilian external financing needs to be met easily in the short term, in a scenario that does not forecast the collapse of commodities prices.

From an economic activity perspective, the growth of the BBB- countries is approximately 6.8 times the rate of Brazilian growth; furthermore, those countries report higher savings (+11.4 p.p. vs. Brazil) and investment rates (+11.1 p.p.). Thus, the major differences between the BBB- rated countries and Brazil are the level of fiscal debt and GDP growth, which also are reflected in lower levels of savings and lower investments.

Comparing Brazil with BB- rated countries (Bangladesh, Dominican Republic, Uzbekistan, Guatemala, Honduras, South Africa), there is also a difference in the fiscal accounts, economic activity, and social indicators. Brazil has gross debt 34.5 p.p. above this country group and in addition has higher levels of both revenue and expenditures than peers — 11.5 and 14.9, p.p. respectively. Brazil's economic growth rate is 5.2x lower than peers, and it also has lower savings and investment rates (-5.3 p.p. and -4.7 p.p.). Despite the country's relatively slower growth, Brazil's GDP per capita is higher than the average for these countries and is comparable to many countries with investment-grade ratings. The external position appears to be significantly better, in our view. Comparing Brazil with B+ countries, there is a substantial difference in the external sector, as the current account deficit of B+ rated countries is 2.3 times larger than Brazil's.

Evaluating Brazil's performance in the period from 2011-2019, it is evident that gross debt is an unfavorable factor for the country, being the highest among any of the IG-rated countries at all rating levels. In addition, the country presents a negative primary result, associated with low GDP growth. According to the S&P, the agency "could raise the ratings [for Brazil] over the next two years if more effective policy implementation than expected results in faster and more sustainable GDP growth and structurally stronger fiscal performance."

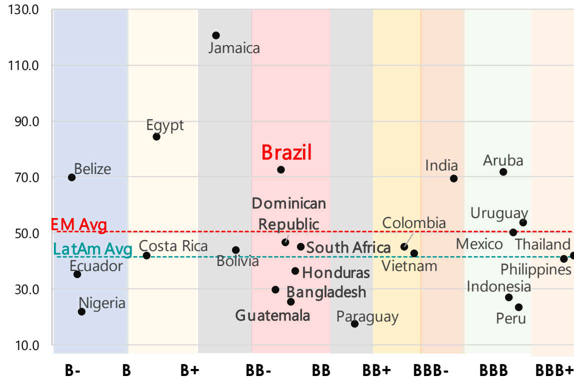
Figure 11. Main Macro Variables Average vs. S&P Rating (2011-19 average)

2011 to 2019										
Government Finance	BBB+ (Investment Grade)	BBB	BBB-	BB+	BB	BB-	Brazil (BB-)	B+	B	B-
Gross debt (%GDP)	43.9	45.9	53.6	39.7	24.8	38.1	72.7	58.9	49.6	55.5
Net debt (%GDP)	28.0	31.8	27.6	46.1	-3.4	39.8	41.2	59.8	40.4	70.0
Primary net lending/borrowing (%GDP)	0.3	-0.1	-2.1	-0.3	-1.8	-0.5	-0.3	-1.4	-2.1	-1.4
Years of deficit	3.0	4.9	9.0	6.3	5.3	6.0	6.0	6.7	6.7	6.5
2026 primary net lending/borrowing (%GDP)	0.3	1.1	-2.4	-0.4	0.4	-0.8	0.6	-0.1	-0.3	1.0
Avg 5 years - primary net lending/borrowing (%GDP)	0.0	0.3	-2.0	-0.4	-3.9	-0.5	-1.7	-1.5	-2.1	-1.6
Net lending/borrowing (%GDP)	-1.1	-2.2	-5.0	-1.8	-2.3	-2.6	-6.0	-4.1	-4.5	-3.3
Revenue (%GDP)	29.8	27.0	25.2	27.7	26.7	20.5	32.0	22.8	26.0	23.7
Total expenditure (%GDP)	30.9	29.2	30.3	29.5	29.0	23.1	38.0	26.9	30.4	27.0
External Sector										
Current account balance (%GDP)	2.2	-0.9	-2.5	0.9	-3.7	-2.3	-2.8	-6.4	-7.2	-1.8
Total reserves minus gold (Billions US$)	68	60	186	28	9	68	361	3	17	12
Economic Activity										
GDP, constant prices (% Change)	3.8	3.2	5.2	3.7	3.8	4.0	0.8	3.8	4.7	3.6
Inflation, end of period (% Change)	2.4	3.4	4.1	3.8	2.7	6.0	5.8	2.6	5.5	5.2
Gross national savings (%GDP)	26.6	22.4	26.7	28.1	22.8	20.6	15.3	17.8	16.3	19.3
Total investment (%GDP)	24.2	23.8	29.2	27.4	26.4	22.8	18.1	23.9	23.4	21.9
Social										
GDP per capita, current prices (PPP)	15,942	20,933	14,516	11,298	21,404	9,733	15,106	12,393	11,031	7,192
Gini index (%)	36.3	39.2	35.6	46.1	42.9	49.2	53.0	34.9	41.5	42.4

Sources: IMF (World Economic Outlook 2022), World Bank, S&P, Santander.

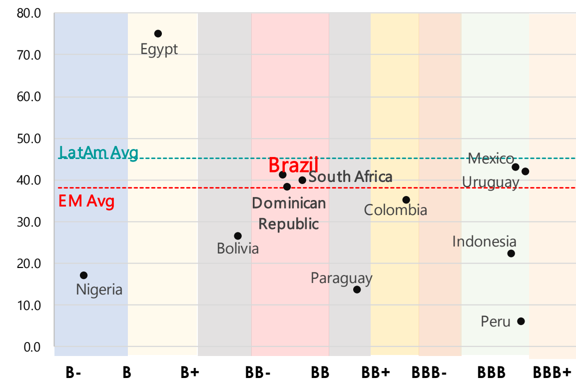
In Figures 12-13, we highlight the comparison of the main variables we explored earlier but compare them with other countries more directly, as well as showing the average of emerging countries and Latin America. Figure 11 shows that Brazil has higher gross debt than all but two countries, Egypt and Jamaica. On the other hand, Brazil's net debt (see Figure 13) is somewhat more in line with the others, probably due to Brazil's high level of international reserves.

Figure 12. General Government Gross Debt vs. S&P Rating (%GDP)



Sources: S&P, IMF (World Economic Outlook 2022), Santander

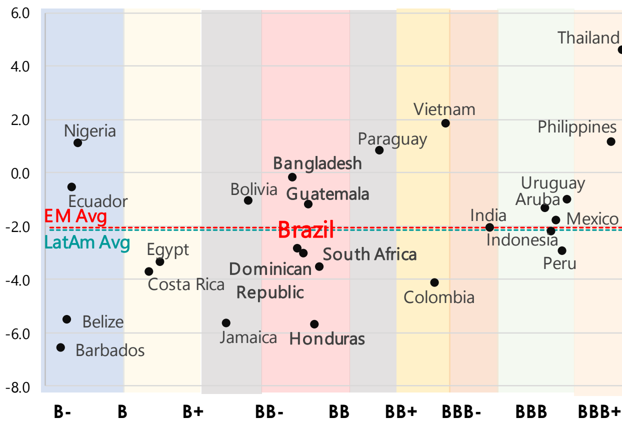
Figure 13. General Government Net Debt vs. S&P Rating (%GDP)



Sources: S&P, IMF (World Economic Outlook 2022), Santander

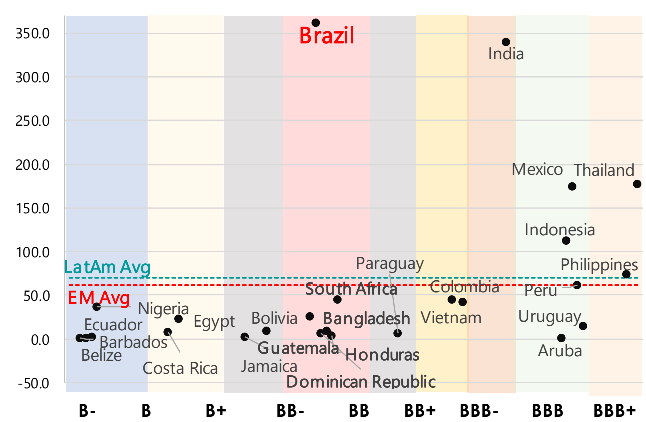
Regarding external accounts, Figure 14 shows that Brazil is in a positive position compared to its peers. This is mainly due to its high level of international reserves, the highest among countries with ratings that are close to Brazil's and higher even than some countries that are rated investment grade.

Figure 14. Current Account Balance vs. S&P Rating (%GDP)



Sources: S&P, IMF (World Economic Outlook 2022), Santander

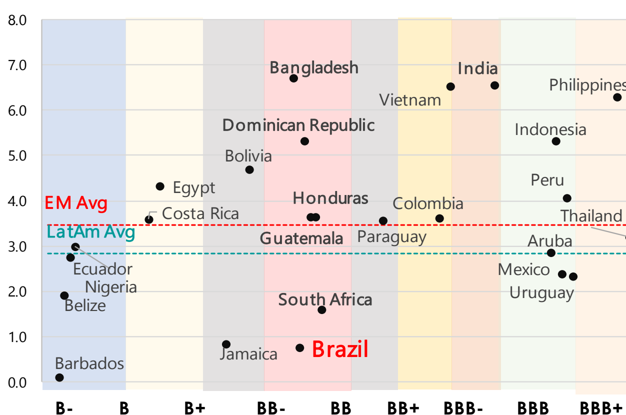
Figure 15. Total Reserves Minus Gold (current US$ billions)



Sources: S&P, IMF (World Economic Outlook 2022), Santander

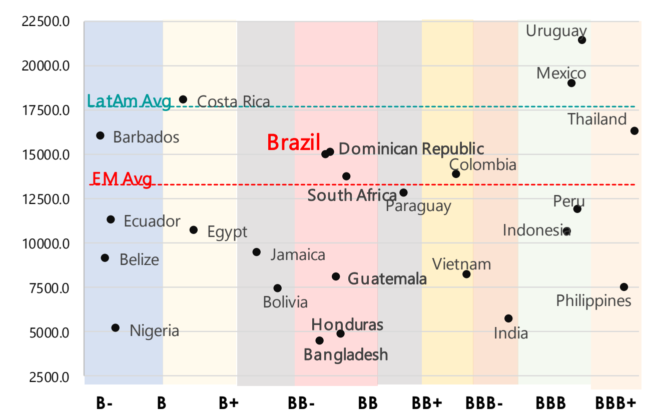
One point that the rating agencies always emphasize is Brazil's lower growth rate compared with other emerging countries. The country's GDP is well below that of other countries with the same rating, and also below that of countries rated investment grade, despite having per capita income more in line with other countries. Thus, we believe it is crucial to approve structural reforms that could improve its growth potential. In this regard, structural reforms, fiscal consolidation, and improved regulation to increase productivity are important for the country's reforms agenda.

Figure 16. Gross Domestic Product, Constant Prices vs. S&P Rating (percent change)



Sources: S&P, IMF (World Economic Outlook 2022), Santander

Figure 17. GDP per Capita, PPP (current international USD)



Sources: S&P, IMF (World Economic Outlook 2022), Santander

4. What Is the Situation Since the Pandemic (COVID-19)?

After the COVID 19 pandemic, changes occurred in all of the macroeconomic variables used by rating agencies, for both Brazil and other countries. In general, fiscal debt increased, mainly due to the fiscal stimulus that governments put in place to mitigate the pandemic's impact. As a result, countries' debt has increased. At the same time, although inflation has been high, the growth rate has improved. For Brazil, in 2022 GDP recovered to a level higher than the average of 2011-19. The other countries in general reported a deterioration in the primary result and in current account performance.

Regarding gross debt, looking at the years 2011-19 and the year 2022, and comparing BBB- level countries' average and Brazil, the gap remained almost the same (it dropped to 19.1 p.p. from 18.7 p.p. in the decade). However, it is worth noting that in 2019 the gap reached 31.9 p.p. in the IMF debt methodology. In 2022, the Brazilian fiscal situation improved, as the commodity and price shock helped reduce the debt. The biggest question remains: how can Brazil maintain this fiscal improvement in order to reduce the gap with its peers?

Brazil's primary result improved in 2022, but the nominal result was similar to that of 2019, as Brazil pays a high interest rate due to the elevated debt level. However, with the positive primary result and a favorable external sector, the country increased both its investment (+3.3 p.p.) and savings rates (+5.3 p.p.). In addition, the country's GDP grew by approximately 2.2 times compared to 2019.

Comparing Brazil with the B+ countries, we observe a large difference between the fiscal and external sectors. The B+ countries have debt levels similar to Brazil's, but there is a significant difference in the level of net debt, due to the difference in reserves between the countries. In addition, the B+ countries have performed worse in the fiscal sector, reporting increases in their primary deficits due to declines in government revenue and increased expenditures.

Figure 18. Main Macro Variables Average vs. S&P Rating (2022 average – some are estimates)

2022										
Government Finance	BBB+ (Investment Grade)	BBB	BBB-	BB+	BB	BB-	Brazil (BB-)	B+	B	B-
General government gross debt (%GDP)	53.6	55.2	66.5	48.1	41.5	52.7	85.2	79.0	65.5	66.2
General government net debt (%GDP)	14.6	40.0	41.0	61.7	25.4	56.1	57.5	81.6	53.9	86.1
General government primary net lending/borrowing (%GDP)	-2.5	-1.2	-4.7	1.9	0.8	-1.3	1.3	-2.2	-1.6	0.2
General government net lending/borrowing (%GDP)	-3.8	-3.5	-8.1	0.2	-0.8	-4.2	-4.7	-5.3	-4.7	-1.8
General government revenue (%GDP)	29.8	26.7	25.1	29.3	26.9	21.0	32.4	23.6	25.6	23.6
General government total expenditure (%GDP)	33.7	30.3	33.2	29.1	27.7	25.1	37.6	28.9	30.3	25.4
External Sector										
Current account balance (%GDP)	-0.2	-1.1	-6.0	5.6	-1.6	-2.1	-2.9	-7.1	-7.3	1.5
Total reserves minus gold (Billions US$)*	91.1	72.4	320.1	52.4	11.1	83.0	354.6	3.6	17.5	10.8
Economic Activity										
GDP, constant prices (% Change)	4.8	4.1	5.8	4.8	4.5	4.2	2.9	5.4	4.6	4.9
Inflation, end of period consumer prices (% Change)	8.4	10.3	10.6	8.5	6.3	8.4	5.8	6.3	15.8	9.2
Gross national savings (%GDP)	25.1	22.8	24.4	30.1	20.8	23.4	17.3	20.6	17.1	21.4
Total investment (%GDP)	25.3	24.3	30.3	24.7	22.4	25.7	18.8	26.7	24.9	22.6
Social										
GDP per capita, current prices (PPP)	22,052	28,172	23,195	14,756	25,156	13,075	17,684	15,732	15,879	8,108

Sources: IMF (World Economic Outlook 2022), World Bank, S&P, Santander

* Total reserves minus gold data have been collected from the World Bank up to the year 2021.

Figure 19. Comparison of 10-Year Average (2011-19) and 2022

2011 to 2019 x 2022	BBB-			BB-			Brazil			B+		
	2011-19	2022	Delta	2011-19	2022	Delta	2011-19	2022	Delta	2011-19	2022	Delta
Government Finance												
Gross debt (%GDP)	53.6	66.5	12.9	38.1	52.7	14.6	72.7	85.2	12.5	58.9	79.0	20.0
Net debt (%GDP)	27.6	41.0	13.4	39.8	56.1	16.3	41.2	57.5	16.4	59.8	81.6	21.7
Primary net lending/borrowing (%GDP)	-2.1	-4.7	-2.6	-0.5	-1.3	-0.7	-0.3	1.3	1.6	-1.4	-2.2	-0.7
Net lending/borrowing (%GDP)	-5.0	-8.1	-3.1	-2.6	-4.2	-1.6	-6.0	-4.7	1.3	-4.1	-5.3	-1.2
Revenue (%GDP)	25.2	25.1	-0.1	20.5	21.0	0.5	32.0	32.4	0.3	22.8	23.6	0.7
Total expenditure (%GDP)	30.3	33.2	3.0	23.1	25.1	2.1	38.0	37.6	-0.4	26.9	28.9	2.0
External Sector												
Current account balance (%GDP)	-2.5	-6.0	-3.5	-2.3	-2.1	0.3	-2.8	-2.9	-0.1	-6.4	-7.1	-0.7
Total reserves minus gold (Billions US$)*	186	320	134.1	68	83	15.3	361	354.6	-6.6	3.4	3.6	0.2
Economic Activity												
GDP, constant prices (% Change)	5.2	5.8	0.6	4.0	4.2	0.2	0.8	2.9	2.1	3.8	5.4	1.6
Inflation, end of period (% Change)	4.1	10.6	6.4	6.0	8.4	2.5	5.8	5.8	0.0	2.6	6.3	3.8
Gross national savings (%GDP)	26.7	24.4	-2.4	20.6	23.4	2.8	15.3	17.3	2.0	17.8	20.6	2.8
Total investment (%GDP)	29.2	30.3	1.1	22.8	25.7	3.0	18.1	18.8	0.7	23.9	26.7	2.8
Social												
GDP per capita, current prices (PPP)	14,516	23,195	60%	9,733	13,075	34%	15,106	17,684	17%	12,393	15,732	27%

Sources: IMF (World Economic Outlook 2022), World Bank, S&P, Santander

* Total reserves minus gold data have been collected from the World Bank up to the year 2021.

5. Rating Upgrades in 2023

In June 2023, S&P changed its outlook on Brazil's sovereign credit ratings from stable to positive. According to the agency, the decision reflects an "expectation that continued measures to address economic and fiscal rigidities could reinforce our view of the resilience of Brazil's institutional framework and reduce risks to its monetary flexibility and the net external position".

In July 2023, Fitch upgraded Brazil's sovereign credit rating from BB- to BB. In the release, Fitch noted that it expects a "better-than-expected macroeconomic and fiscal performance amid successive shocks in recent years, proactive policies and reforms that have supported this, and Fitch's expectation that the new government will work toward further improvements".

Both agencies highlight the country's stronger growth outlook and the slowdown in the growth of public debt. According to S&P, "signs of greater certainty of fiscal and monetary policy stability could benefit Brazil's GDP growth prospects". Fitch revised its GDP growth forecast for the year 2023 to 2.3% (previously 0.7%). According to Fitch, the growth of public debt could be "at a slower pace and much better starting point than we previously expected, particularly at the time of Brazil's 2018 downgrade". S&P revised its debt/GDP projection from 84.7% to 77.1 for 2023, reaching 81.8% in 2025 (previously 91.4%).

Here, we highlight the contribution of the reforms promoted to raise Brazil's rating, such as pension reform and central bank independence. Therefore, S&P's outlook revision and the upgrade of Brazil's rating by Fitch are reinforced by backward-looking analysis and by expectations of pragmatic policies. In addition, these changes highlight the importance of pursuing reforms in order to accelerate the country's growth and ensure debt sustainability.

Figure 20 shows the ratings assigned to Brazil by S&P. The factors range from 1 to 6, where 1 represents the strongest grade and 6 the weakest grade. Note that the external sector is Brazil's strongest point, whereas economic activity and fiscal policy are the weakest. Figure 21 shows the main drivers for Fitch's rating.

Figure 20. Key Credit Factors – S&P

Key credit factors	Evaluation	Background
Institutional	4	Brazil has a stable and solid democracy, with solid checks and balances, along with a robust private sector and an active press. At the same time, it has shown slow and unequal progress in addressing fiscal and economic imbalances. Data dissemination is widespread and timely, and such data is analyzed by the federal accounting agency for irregularities after release.
Economic	5	The trend of weighted average GDP per capita growth over a 10-year period is 1.2%, below the trend of sovereign governments in the same GDP category.
External	2	Considering the large stock of foreign direct investment in Brazil, the country is vulnerable to a possible significant change in international financing conditions.
Fiscal: flexibility and performance	6	Based on change in general government net debt (% of GDP) : **2022**: 1.3 / **2023 E**: 8.0 / **2024 E**: 6.0 / **2025 E**: 5.7 / **2026 E**: 5.6
Fiscal: debt burden	6	Based on general government net debt (% of GDP) and general government interest expenditure (% of general government revenue). **Net debt/GDP: 2022**: 52.3 / **2023 E**: 56.9 / **2024 E**: 59.8 / **2025 E**: 62.2 / **2026 E**: 64.5 **Interest/revenue: 2022**: 10.8 / **2023 E**: 13.1 / **2024 E**: 12.9 / **2025 E**: 13.3 / **2026 E**: 13.7 Banking sector exposure above 20% of assets. The number of lawsuits against the government is significant, which adds to long-term pressures on fiscal accounts.
Monetary	3	The BRL is a floating exchange rate currency, and the Central Bank intervenes occasionally. The Central Bank has a history of independence, and acquired legal independence in 2021. It also has the capacity to act as lender of last resort.

Sources: S&P, Santander

Figure 21. Key Rating Drivers - Fitch

Key Rating Drivers	
Reform Progress	Brazil has achieved important policy breakthroughs, including pension reform and central bank independence. Key fiscal reforms are still pending final approval but have seen important progress.
Resilient Growth	Economic momentum continues in 2023 after a healthy post-pandemic rebound, supported by a bumper agricultural harvest. Consumption has cooled on tight monetary policy, but it remains supported by a strong labor market, fiscal spending, and continued credit growth.
Upside from Economic Agenda	The consumption tax reform offers the most upside, as it addresses one of Brazil's greatest competitiveness bottlenecks.
Prudent Monetary Policy	The central bank (BCB) has maintained prudent and proactive monetary policy during the recent inflation shock.
New Fiscal Rule Takes Shape	Fiscal outturns in coming years will be guided by a new fiscal framework to replace a spending cap, which imposes a looser limit on spending set as a function of past revenue growth, targets gradually improved primary balances and includes contingency measures (ex ante and ex post) to prevent and correct for target noncompliance.
Better Debt Trajectory	Fitch expects weaker primary balances and high real interest rates to lift debt to 75% in 2023 and gradually thereafter, but at a slower pace and much better starting point than we previously expected.
Robust External Position	Brazil is on track to achieve a record trade surplus in 2023, supported by strong agricultural output and lower import costs. Fitch projects this will reduce the current account deficit.

Sources: Fitch, Santander

It is not news that Brazil still needs to improve in terms of fiscal accounts and potential growth, so in the next section, we will take a look at how Brazil was positioned in 2008 when the country first received an investment-grade rating and at the current environment.

6. Comparison Between 2008 (Brazil First Granted IG Rating) and the Current Environment

In this section, we compare the economic variables in the year when S&P first granted Brazil received an investment-grade rating (2008) with the current environment, as well as future projections. These projections for 2023 have been collected from the IMF and the World Bank.

Figure 22. Comparison Between Macro Variables in 2008 and 2023F-2026F

Brazil	2008	2023 F	2024 F	2025 F	2026 F
Government Finance					
Government gross debt (%GDP)	62.3	88.4	91.5	93.7	95.2
Government net debt (%GDP)	37.6	61.2	65.3	68.4	70.6
Government primary net lending/borrowing (%GDP)	3.3	-2.0	-1.0	-0.5	0.2
Government net lending/borrowing (%GDP)	-2.0	-8.8	-8.2	-6.6	-5.5
Government revenue (%GDP)	35.8	35.8	35.5	35.4	35.3
Government total expenditure (%GDP)	37.8	44.6	43.7	42.0	40.8
External Sector					
Current account balance (%GDP)	-2.1	-2.7	-2.7	-2.6	-2.6
Total reserves minus gold (Billions US$)*	192.8	317.1			
Economic Activity					
Gross domestic product, constant prices (% change)	5.1	0.9**	1.5	1.9	2.0
Inflation, end of period consumer prices (% change)	5.9	5.4	4.1	3.0	3.0
Total investment (%GDP)	21.6	18.3	18.1	18.1	18.0
Gross national savings (%GDP)	19.5	15.5	15.5	15.4	15.4
Social					
Gross domestic product per capita, current prices (PPP)	13,397	18,686	19,277	19,916	20,583

Sources: IMF (World Economic Outlook 2023), World Bank, Santander

* Total reserves minus gold data have been collected from the World Bank up to the year 2021.
** Updated to 2.1% in July 2023.

In 2008, when S&P granted Brazil an investment-grade rating, the country was experiencing robust growth and a favorable fiscal outlook. From the perspective of economic activity, the country was growing 5.1% YoY (above the average growth of 2.2% since 1996). From a fiscal standpoint, the agency highlighted Brazil's commitment to meeting its fiscal targets. The country had a positive primary result, reaching 3.3% of GDP. In addition, the country had a strong external sector.

Comparing this scenario with the current one, we can observe a slowdown in the country's growth, reaching an expected average of 0.9% YoY (slightly higher than 0.8% in the 2011-19 period). From a fiscal perspective, we note that Brazil kept revenue stable at 35.8% of GDP for that period, but expenses increased by 6.8 p.p. In addition, we highlight the change in the primary result in 2023 from positive to a deficit of 2.0% of GDP. The country's nominal result deteriorated by approximately 3.4 times, contributing to the increase in the national debt. Moreover, it is important to mention the decline in Brazil's rate of investment and savings, which are important factors for long-term sustainable growth. Regarding the current account, however, it continues to be robust and is a favorable factor for the country.

In general terms, in the next few years we forecast an improvement in GDP growth but some challenges for fiscal consolidation. For economic activity, we expect higher GDP growth than in the 2011-19 period. Regarding the fiscal accounts, we expect two years of primary deficits contributing to the growth of the debt, which we project will reach 95.2% of GDP in 2026. In the following section we discuss the cases of countries that regained investment-grade ratings.

7. Historical Experience of Countries Regaining Investment-Grade Ratings

In this section we briefly explore the experience of other countries that lost their investment-grade ratings and later regained them. Only a few countries have regained their investment-grade status. Some of these countries are: Indonesia (14 years between losing the IG rating and regaining it); Colombia (took 11 years and lost the status again in 2021), Uruguay (9 years), Romania (9 years), Slovakia (3 years), Latvia (3 years), Malaysia (<1 year), and South Korea (<1 year). On average, the countries took 6-7 years to regain investment-grade status. The longest wait was Colombia's (11 years), and the shortest was South Korea's (one year). In our view, Brazil is likely to take some years to regain investment-grade status, because of potential difficulties in the adjustment of fiscal accounts and the outlook for GDP growth. In 2008, the upgrade to Brazil's long-term debt ratings, according to S&P, was attributable to the maturity of the country's institutions and to the responsible policies

implemented, illustrated by the reduction in the domestic public debt burden and in the external debt, along with improving growth prospects.

Despite having regained investment grade, Colombia lost it again in 2021. On May 20, 2021, the rating agency S&P (followed by Fitch on July 1, 2021) downgraded Colombia's long-term sovereign rating from investment grade to speculative grade. The downgrade came following the failure to approve fiscal reforms. The credit rating agencies assumed that public finances would not be fixed quickly enough and that public debt would remain above 60% of GDP in the medium term.

Usually, the agencies' decisions to downgrade have many factors in common. Taking the examples of countries such as Russia in 2015, Portugal in 2011, Hungary in 2011, and Greece in 2010, the main reasons are as follows: (i) GDP contracts in both the year of the downgrade and the following year; (ii) fiscal adjustment is usually implemented but is not sufficient to stabilize or reduce the debt/GDP ratio, which continues to rise in the years following the downgrade; (iii) the currency loses value against the USD before the downgrade, and the trend is reversed only after the downgrade, without offsetting all the devaluation; this correction usually stimulates competitiveness and leads to a faster adjustment in the external accounts; (iv) inflation rises close to 2 percentage points in the year of the downgrade, but usually falls in the following year; (v) risk perception (CDS spreads) jumps, anticipating the investment-grade loss; and (vi) domestic interest rates rise in the period before the downgrade, but this movement usually is short lived.

Figure 23. Summary of Countries That Regained Investment-Grade Ratings

Country	Downgrade year	Year the investment grade was regained	Outlook when country regained investment grade
Uruguay	2002	2013	• Uruguay's five-year average GDP growth at 5.6% is well above the 'BBB' median and its medium-term prospects remain favorable. • Social and political stability, strong institutions and relatively high per capita income are characteristics that are fully in line with investment-grade sovereigns. • Prudent fiscal management has led to a decline in government indebtedness and a significant improvement in debt composition in recent years.
Colombia	2000	2011	• Track record of prudent economic policies demonstrated resilience to external and domestic shocks, as well as the improvement in its external credit metrics. • Colombia's five-year average growth is expected to equal 4.2% in 2011, above the 3.1% of the 'BBB' median. • Colombia is also likely to maintain broad macroeconomic stability with inflation slightly above 3% in 2011 and 2012.
Indonesia	1997	2011	• Indonesia's cyclical resilience to large external shocks points to sustainably high trend growth over the medium term. • A more favorable assessment of Indonesia's economic strength is underpinned by gains in investment spending, improved prospects for infrastructure development following key policy reforms, and a well-managed financial system.
Romania	2008	2011	• The upgrade reflects Romania's progress in recovering from the effects of the financial crisis, evident in a return of GDP growth, a strong export performance, narrowing in the current account deficit and reduction in its budget deficit

Sources: S&P, Santander

In Figure 23, we have compiled the main reasons for changes in ratings. For Brazil, in order for the country to be upgraded, it must show progress in the following areas: achieving fiscal consolidation, which would increase confidence that government debt/GDP will stabilize over the medium term; improving the outlook for economic growth in the context of macroeconomic stability and contained inflation; and timely passage of reforms that strengthen public finances and growth prospects.

Figure 24. Summary of the Rating Outlook for Selected Countries in LatAm

Country	Outlook
Brazil (BB-)	• Rating History: 26-Jul-2023 • Large and diverse economy; High per capita income. • Deep domestic markets and a large cash cushion that support the sovereign's financing flexibility and its high local-currency debt share. • Shock-absorption capacity, underpinned by a flexible exchange rate, robust international reserves and a sovereign net external creditor position. • High government debt, fiscal rigidities, weak economic growth potential, and relatively low governance scores. • **Factors that could lead to downgrade:** Material policy shifts that undermine fiscal policy credibility and threaten medium-term public debt sustainability; A deterioration in the sovereign's domestic and/or external market borrowing conditions; Policies that increase macroeconomic instability and/or undermine medium-term growth prospects. • **Factors that could lead to upgrade:** Progress on fiscal consolidation that puts government debt/GDP on a downward path over the medium term; Evidence of an improvement in investment and economic growth prospects in the context of macroeconomic stability and contained inflation.
Mexico (BBB-)	• Rating History: 15-Apr-2020 • Stable and robust external finances; Government debt/GDP projected to remain stable. • **Factors that could lead to downgrade:** A weakening in the consistency and credibility of the macroeconomic policy framework. • **Factors that could lead to upgrade:** Improvement in growth prospects; Declining government debt path.
Chile (A-)	• Rating History: 15-Oct-2020 • Relatively strong sovereign balance sheet; Government debt/GDP well below peers; High commodity dependence. • **Factors that could lead to downgrade:** Persistent large fiscal deficits that lead to markedly higher government debt/GDP and/or depletion of sovereign assets. • **Factors that could lead to upgrade:** Credible fiscal consolidation consistent with a declining trajectory of government debt/GDP; Improvement in economic growth, easing of social tensions and improved fiscal dynamics.
Peru (BBB-)	• Rating History: 20-Oct-2021 • Moderate public debt, net external creditor position, and track record of solid macroeconomic policy and fiscal frameworks. High commodity export dependence. • **Factors that could lead to downgrade:** Sustained economic growth underperformance, increase in general government debt/GDP. • **Factors that could lead to upgrade:** Higher economic growth performance and prospects; Easing of political gridlock and uncertainty that improves governability.
Colombia (BB+)	• Rating History: 01-Jul-2021 • High fiscal deficits and high commodity dependence. • **Factors that could lead to downgrade:** Deterioration of investment and medium-term growth prospects with adverse social ramifications, such as high unemployment and poverty levels. • **Factors that could lead to upgrade:** Improvement in governance indicative of better social cohesion and momentum around reforms that could improve Colombia's structural fiscal position and medium-term growth prospects.
South Africa (BB-)	• Rating History: 20-Nov-2020 • High and still rising government debt, low trend growth. • Favorable debt structure. • **Factors that could lead to downgrade:** A further weakening of trend growth or a sustained shock that further undermines fiscal consolidation efforts and raises socioeconomic pressures in the face of exceptional inequality. • **Factors that could lead to upgrade:** Greater confidence in stronger growth prospects.

Sources: Fitch, Santander

8. Final Remarks

Our purpose in this report has been to show and compare the performance of the Brazilian economy with its peers and investment-grade countries. As we expected, we saw that the country's negative fiscal indicators, mainly in terms of debt, are at higher levels than those of other countries. We observe that Brazil's debt expanded the gap with BBB- countries by more than 30 p.p. in 2019, but in 2022 it returned to values close to the 2011-19 period, approximately 19 p.p. in the IMF methodology.

The Brazilian primary result has showed some improvement in recent years, yet IMF forecasts (in line with our scenario) indicate that in the next two years the country will face deficits of 1.0% of GDP and 0.5%, respectively. On the activity side, we have seen some recovery in short-term GDP growth, but from a low base, as the average of 2011-19 is quite low (0.8%). Reforms to increase productivity will be crucial to improving the country's rating outlook. Sustainable GDP growth would also help the country in relation to its fiscal accounts, in our view, and addressing the reforms to contain public expenditures will be important as well.

From the perspective of the external sector, the country has been showing current account deficits for the past several years. IMF projections indicate that this negative performance will continue until 2028. Despite these increases, the deficits in the current account are still comfortably covered by direct investments in the country (a less volatile source of funding), thus keeping Brazilian external financing needs under control. We expect the continuation of historically favorable commodity prices to help the trade balance register sizeable surpluses in the coming years, while remittances of profits and dividends and services expenditures are likely to lose steam as the economy slows, due to the lagged effects of prior interest rate hikes. That is, although higher than previously calculated, we expect the current account deficit to remain manageable and to stay off the markets' list of concerns.

In the end, the big question remains: what will be the trend for Brazil's sovereign rating in the coming years? Unfortunately, we do not have a clear answer, as this depends on many factors, especially those related to social welfare spending. The country has negative and positive points for consideration of changes in its rating classification, but we believe Brazil will try to regain an investment-grade rating by continuing to improve its growth outlook and fiscal accounts. In our view, fiscal adjustment is a central issue, and the approval of reforms is essential, which requires political consensus.

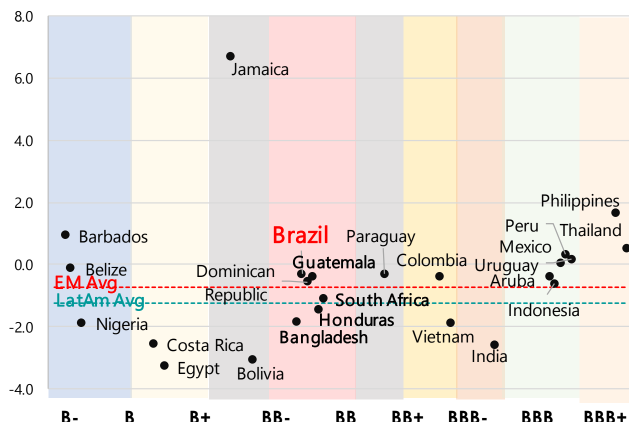
Appendix

Figure A1. List of Countries with Each Rating

S&P Rating	Country
BBB+	Botswana, Croatia, Philippines, Thailand.
BBB	Aruba, Bulgaria, Indonesia, Mexico, Peru, Uruguay, Hungary.
BBB-	India, Romania.
BB+	Azerbaijan, Colombia, Morocco, Vietnam.
BB	Georgia, Oman, Paraguay.
BB-	**Bangladesh, Brazil, Dominican Republic, Uzbekistan, Guatemala, Honduras, South Africa.**
B+	Albania, Benin, Fiji, Jamaica, Jordan, Senegal, Armenia, Bahrain, Rwanda.
B	Bolivia, Bosnia and Herzegovina, Costa Rica, Egypt, Kenya, Mongolia, Montenegro, Togo, Türkiye, Uganda.
B-	Angola, Barbados, Belize, Cabo Verde, Cameroon, Ecuador, Iraq, Madagascar, Nigeria, Papua New Guinea, Tajikistan.

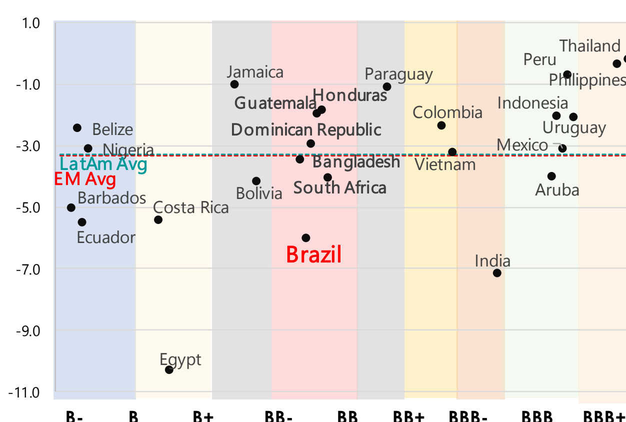
Sources: S&P, Santander

Figure A2. General Government Primary Net Lending/Borrowing vs. S&P Rating (%GDP)



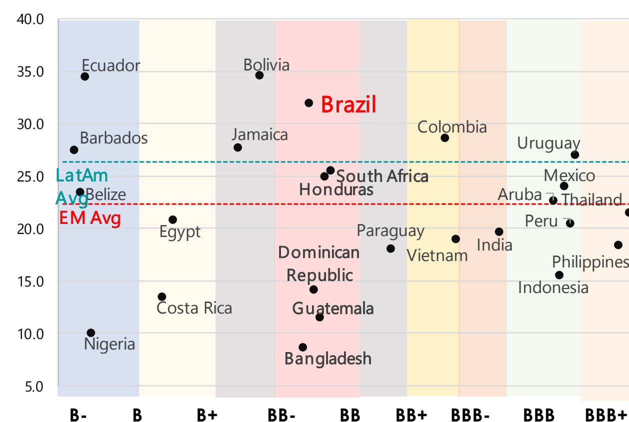
Sources: S&P, IMF (World Economic Outlook 2022), Santander

Figure A3. General Government Net Lending/Borrowing vs. S&P Rating (%GDP)



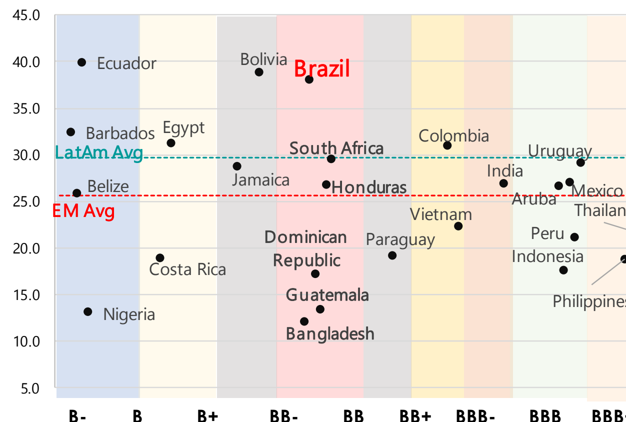
Sources: S&P, IMF (World Economic Outlook 2022), Santander

Figure A4. General Government Revenue vs. S&P Rating (%GDP)



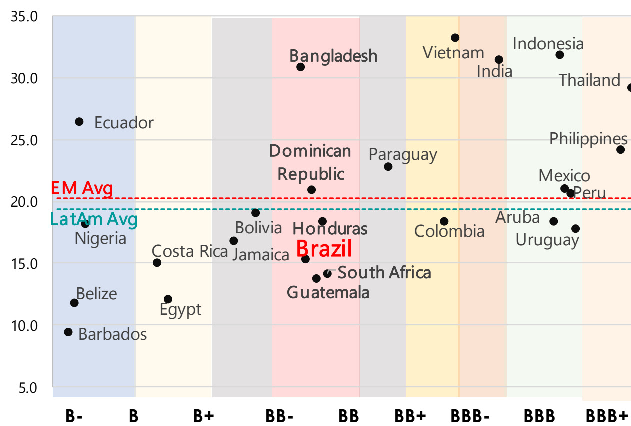
Sources: S&P, IMF (World Economic Outlook 2022), Santander

Figure A5. General Government Total Expenditure vs. S&P Rating (%GDP)



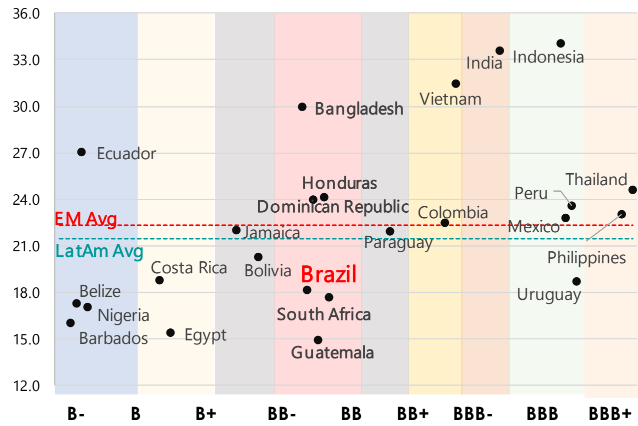
Sources: S&P, IMF (World Economic Outlook 2022), Santander

Figure A6. Gross National Savings vs. S&P Rating (%GDP)



Sources: S&P, IMF (World Economic Outlook 2022), Santander

Figure A7. Total Investment vs. S&P Rating (%GDP)



Sources: S&P, IMF (World Economic Outlook 2022), Santander

Figure A8. Main Macro Variables Average vs. S&P Rating - 2019

	2019									
Government Finance	BBB+	BBB	BBB- (Investment Grade)	BB+	BB	BB-	Brazil (BB-)	B+	B	B-
Gross debt (%GDP)	41.4	46.7	56.0	42.9	39.6	46.7	87.9	66.1	56.8	65.5
Net debt (%GDP)	3.4	33.4	28.7	51.5	16.9	49.6	54.7	62.0	45.1	73.1
Primary net lending/borrowing (%GDP)	-1.5	0.5	-3.3	2.1	-2.6	-0.8	-0.9	-0.4	-0.7	0.4
Net lending/borrowing (%GDP)	-2.7	-1.6	-6.2	0.4	-3.5	-3.0	-5.9	-3.3	-3.6	-1.7
Revenue (%GDP)	28.9	26.9	24.4	28.6	26.8	20.7	31.5	23.8	25.8	23.0
Total expenditure (%GDP)	31.6	28.5	30.6	28.2	30.2	23.6	37.4	27.1	29.4	24.7
External Sector										
Current account balance (%GDP)	0.5	0.2	-2.9	1.2	-3.6	-2.1	-3.5	-6.4	-5.2	0.5
Total reserves minus gold (Billions US$)	80.9	62.9	234.7	40.7	9.2	68.1	353.6	2.7	19.2	12.6
Economic Activity										
GDP, constant prices (% Change)	3.7	2.4	4.0	3.9	1.2	3.8	1.2	3.9	4.2	3.3
Inflation, end of period (% Change)	1.7	3.8	5.4	3.1	3.2	5.7	4.3	1.9	4.0	5.0
Gross national savings (%GDP)	26.5	23.1	24.0	26.7	21.0	21.8	12.0	19.1	18.2	19.6
Total investment (%GDP)	26.0	23.4	26.9	26.0	24.6	23.9	15.5	24.1	23.7	21.9
Social										
GDP per capita, current prices (PPP)	19,057	24,355	19,099	12,543	21,227	11,123	15,424	13,983	13,300	7,550

Sources: IMF (World Economic Outlook 2022), World Bank, S&P, Santander

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