



ECONOMICS: LATIN AMERICA PERSPECTIVES

BRAZIL: PETROBRAS COMES CLEAN

+ Fernando J. Losada, Senior Economist—Latin America Research, fernando.losada@abglobal.com

Petrobras avoided a possible technical default this week by releasing its audited financial results for 2014. The announcement reduces uncertainty about the company and the Brazilian economy at large, and should be good news for Brazilian assets.

At Last, Results

By releasing its audited financial results for fiscal year 2014, state-controlled oil company Petrobras avoided a possible technical default that could have accelerated its debt payments. What's more, the results were fully endorsed by the company's auditors, much to the relief of financial markets. We think this is good news for the company, for Brazilian assets and for Brazil's economy.

Petrobras recognized a BRL6.2 billion loss associated with graft (the so-called Car Wash investigation), and a BRL44.3 billion charge because of asset impairment. Those figures were higher than expected and suggest the company was committed to being transparent. That should be welcome news for investors.

For Petrobras, the audit removes a veil of uncertainty that has been shadowing the company. It's true that market expectations for the data release have been growing over the last month as a result of encouraging comments from company officials (*Display 1*). But the actual release clearly lowers the risk of downgrade. In fact, we think there's a good chance that Moody's will upgrade Petrobras' rating by one notch;

the ratings agency has said the release of the results would likely lead it to partially reverse an earlier two-notch downgrade.

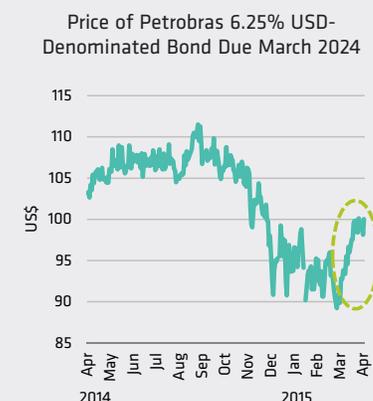
Petrobras still faces substantial challenges, including the need to reduce its high leverage through an ambitious divestment program. It will also have to streamline operations to become more competitive. But the signal conveyed by the new management, and by the government at large says the company is ready to come clean and establish new and more solid foundations. To preserve cash, Petrobras CEO Aldemir Bendine indicated that the company will not pay any dividends this year. We expect a new business plan to be unveiled within the next 30 days.

Good for Corporates, Sovereign Debt

Petrobras' decision should be supportive for the valuation of other Brazilian corporate bonds, particularly those with direct exposure to the oil company. The move could also open the door for Brazilian issuers later this year.

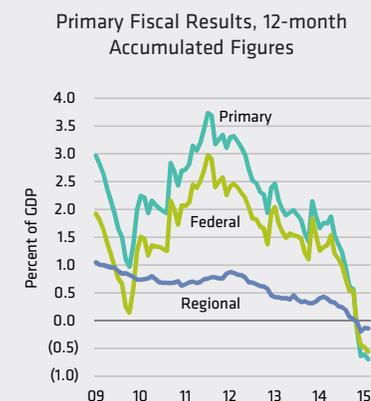
These benefits most likely will extend to the national government as well, as reduced risk of debt payment acceleration means the Treasury probably won't need to

Display 1
Fulfilled Expectations



Through April 23, 2015
Bloomberg and AB

Display 2
Still a Lot of Work on the Fiscal Front



Through February 1, 2015
Source: Banco Central do Brasil and AB

extend financial assistance to the oil giant. And given the sheer size of Petrobras in the Brazilian economy (with close to half of the country's fixed investment), better prospects at the company add up to an improved outlook for Brazil's economy.

Next Up: Fiscal Tightening

As for stabilizing overall market sentiment toward Brazil, we think Petrobras' move was the first of two necessary steps. The second thing markets want to see is evidence that the fiscal adjustment program is gaining traction, despite weak economic activity. While Finance Minister Joaquim Levy remains a market favorite and has already made progress with his policy adjustment plan, uncertainty remains about his ability to deliver on a promise to generate a primary fiscal surplus of 1.2% of gross domestic product (GDP) this year. The doubts on this score will dissipate only with three or four consecutive months of

solid fiscal numbers—something the country has so far been unable to string together (*Display 2, previous page*).

We don't think the market needs to see the government hit the precise 1.2% target. But we do think it wants clear evidence that the country has turned a corner and is headed in the right fiscal direction. Even a slightly lower primary surplus will probably do the trick—for both market participants and the ratings agencies. After all, most observers appreciate how difficult it can be to tighten fiscal policy while the economy is shrinking.

Tough Year Ahead

Brazil still faces a tough road back to economic health. We still think aggregate investment will be sluggish. And we think fiscal tightening and efforts to correct relative price misalignments will keep consumption subdued. We project GDP to contract by at least 1% in 2015, while the

open unemployment rate is likely to climb toward 7%. Additional headwinds may appear if water and energy shortages due to low rainfall materialize. Petrobras' divestment plan, although a necessary step, will also push activity down in the near term because of the sheer weight of the company in the country's aggregate investment.

Inflation, on the other hand, is reflecting both the change in domestic relative prices and the much weaker exchange rate. We expect headline inflation to remain above 8% during the year. In 2016, however, inflation is expected to drop significantly, most likely toward the inside of the target range, as the economy begins a very gradual recovery. In the meantime, it's critical for the authorities to press ahead with a structural reform agenda aimed at increasing productivity and growth. ■

The information contained herein reflects the views of AllianceBernstein L.P. or its affiliates and sources it believes are reliable as of the date of this publication. AllianceBernstein L.P. makes no representations or warranties concerning the accuracy of any data. There is no guarantee that any projection, forecast or opinion in this material will be realized. Past performance does not guarantee future results. The views expressed herein may change at any time after the date of this publication. This document is for informational purposes only and does not constitute investment advice. AllianceBernstein L.P. does not provide tax, legal or accounting advice. It does not take an investor's personal investment objectives or financial situation into account; investors should discuss their individual circumstances with appropriate professionals before making any decisions. This information should not be construed as sales or marketing material or an offer or solicitation for the purchase or sale of any financial instrument, product or service sponsored by AllianceBernstein or its affiliates.

Note to Canadian Readers: AllianceBernstein provides its investment management services in Canada through its affiliates Sanford C. Bernstein & Co., LLC and AllianceBernstein Canada, Inc.

Note to European Readers: European readers should note that this document has been issued by AllianceBernstein Limited, which is authorised and regulated in the UK by the Financial Conduct Authority. The registered office of the firm is: 50 Berkeley Street, London W1J 8HA.

Note to Australian Readers: This document has been issued by AllianceBernstein Australia Limited (ABN 53 095 022 718 and AFSL 230698). Information in this document is only intended for persons that qualify as "wholesale clients," as defined in the Corporations Act 2001 (Cth of Australia), and should not be construed as advice.

Note to New Zealand Readers: This document has been issued by AllianceBernstein New Zealand Limited (AK 980088, FSP17141). Information in this document is only intended for persons who qualify as "wholesale clients," as defined by the Financial Advisers Act 2008 (New Zealand), and should not be construed as advice.

Note to Readers in Vietnam, the Philippines, Brunei, Thailand, Indonesia, China, Taiwan and India: This document is provided solely for the informational purposes of institutional investors and is not investment advice, nor is it intended to be an offer or solicitation, and does not pertain to the specific investment objectives, financial situation or particular needs of any person to whom it is sent. This document is not an advertisement and is not intended for public use or additional distribution. AllianceBernstein is not licensed to, and does not purport to, conduct any business or offer any services in any of the above countries.

Note to Readers in Malaysia: Nothing in this document should be construed as an invitation or offer to subscribe to or purchase any securities, nor is it an offering of fund management services, advice, analysis or a report concerning securities. AllianceBernstein is not licensed to, and does not purport to, conduct any business or offer any services in Malaysia. Without prejudice to the generality of the foregoing, AllianceBernstein does not hold a capital markets services license under the Capital Markets & Services Act 2007 of Malaysia, and does not, nor does it purport to, deal in securities, trade in futures contracts, manage funds, offer corporate finance or investment advice, or provide financial planning services in Malaysia.

Note to Singapore Readers: This document has been issued by AllianceBernstein (Singapore) Ltd. ("ABSL", Company Registration No. 199703364C). ABSL is a holder of a Capital Markets Services Licence issued by the Monetary Authority of Singapore to conduct regulated activity in fund management and dealing in securities. AllianceBernstein (Luxembourg) S.à.r.l. is the management company of the portfolio and has appointed ABSL as its agent for service of process and as its Singapore representative.

Note to Taiwan Readers: AllianceBernstein L.P. does not provide investment advice or portfolio-management services or deal in securities in Taiwan. The products/services illustrated here may not be available to Taiwan residents. Before proceeding with your investment decision, please consult your investment advisor.

Note to Hong Kong Readers: This document is issued in Hong Kong by AllianceBernstein Hong Kong Limited (聯博香港有限公司), a licensed entity regulated by the Hong Kong Securities and Futures Commission. This document has not been reviewed by the Hong Kong Securities and Futures Commission.

