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Brazil: Hope for change stimulates bonds

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Brazil tactically overweighted at the moment

Most of the fundamental economic data are currently not good. In 2016, the country is in recession; for 2017, a minor growth rate of +0.7% is expected. The nominal budget deficit of 2016 is about -10%, with a primary deficit of -2.7%. This comes as a surprise, given that investors had been used to primary surpluses from Brazil. The current account is also slightly in deficit. The only silver lining is the low foreign government debt of less than 20% of GDP, accompanied by high foreign exchange reserves. We therefore do not expect any issues for bondholders with regard to the payments they are due.

Spread of Brazilian government bonds (5y) vs. US-Treasuries

08/2011-08/2016; 5-years (in basis points)



Sources: Bloomberg; data as of 4 August 2016; CDS spread; 100bps = 1 percentage point

Good rating lost

The Workers' Party governments have run down the country in the past ten years and covered it with a wide network of corruption. Brazil used to command a good ("investment grade") rating from all international rating agencies, and has now lost that rating. President Dilma Rousseff has been removed from her office in accordance with the rule of law. The definite impeachment is expected for the second half of 2016.

The temporary government of Interim President Temer has appointed an unorthodox team of economic experts and has worked out a promising fiscal and growth plan, which has already started bearing fruit. Investors want to trust the new team: Brazilian equities and bonds have gained substantially in the year to date. However, this leap of faith is based largely on expectations of change, which will ultimately have to be validated.

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