

# Brazilian Federal Public Debt



May 14, 2012

**Macroeconomic Overview**

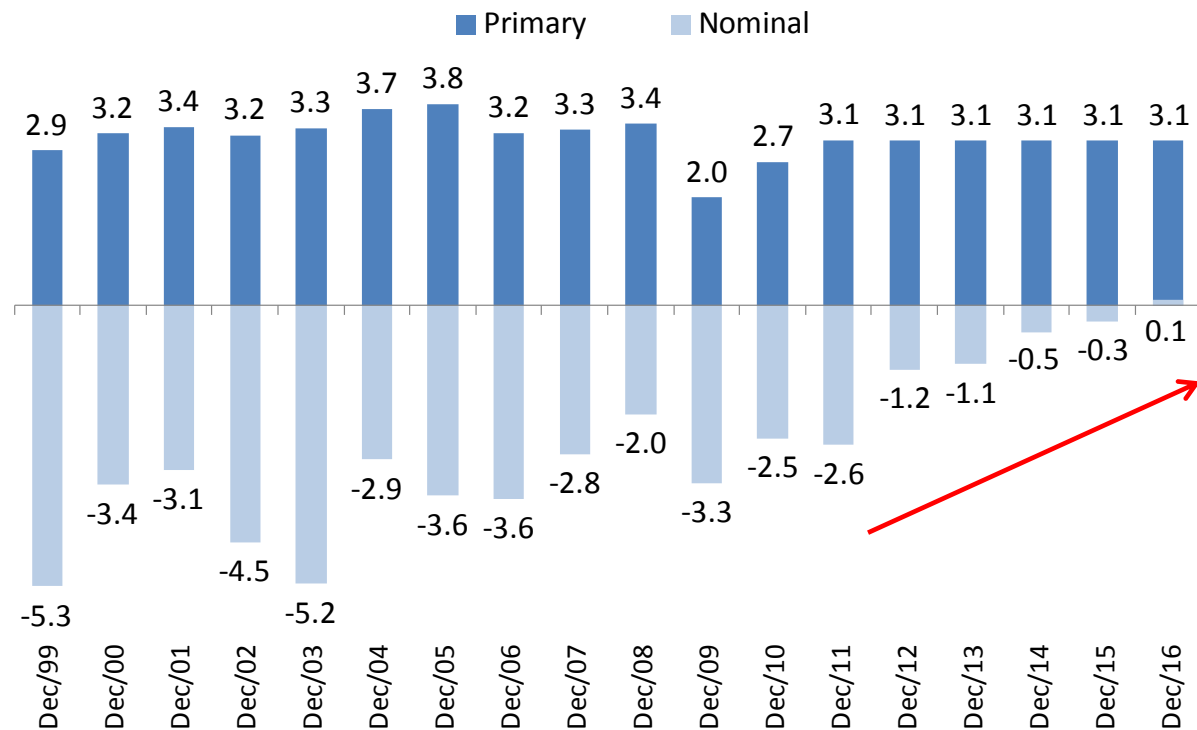
**Economic Policy**

**Economic Activity and Recent Events**

**Public Debt Management**

## Fiscal Responsibility

### Public Sector Balance (in 12 months) as % of GDP



» The Public Sector Primary Surplus in 2011 was R\$ 128.7 bn, representing more than the initial target defined for the year plus the R\$ 10 bn increase announced in August<sup>1</sup>.

» The Draft Budgetary Guidelines Law for 2013 maintains the target of 3.1% of GDP until 2015<sup>2</sup>.

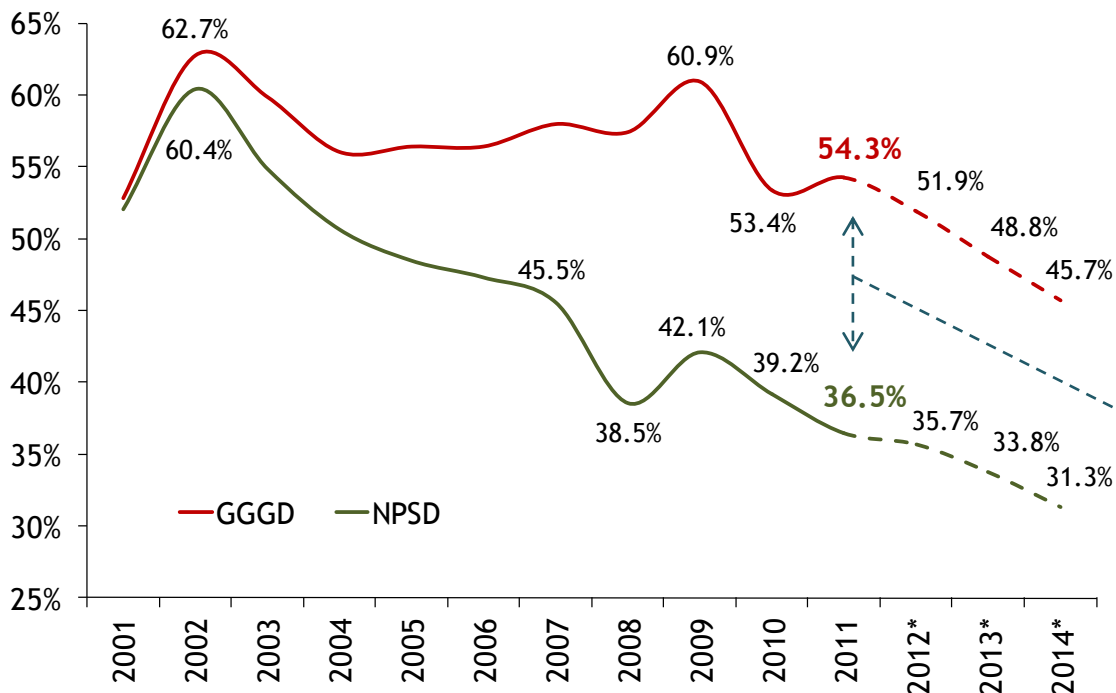
Source: Brazilian Central Bank time series and Inflation Report of Dec/11 (forecasts)

<sup>1</sup> For 2011, the Budget Law set a nominal target of R\$ 117.89 billion, equivalent to 3,1% of GDP, according to Government estimates for GDP at the time the Law was discussed. In August, the target was increased in R\$ 10.00 billion, amounting 127.89 billion.

<sup>2</sup> For 2012, the Budgetary Guidelines Law set a nominal target of R\$ 139.8 billion, equivalent to 3,1% of GDP, according to Government estimates for GDP at the time the Law was discussed. For 2013, this target will be R\$ 155.9 billion, according to the Draft BGL sent to Congress.

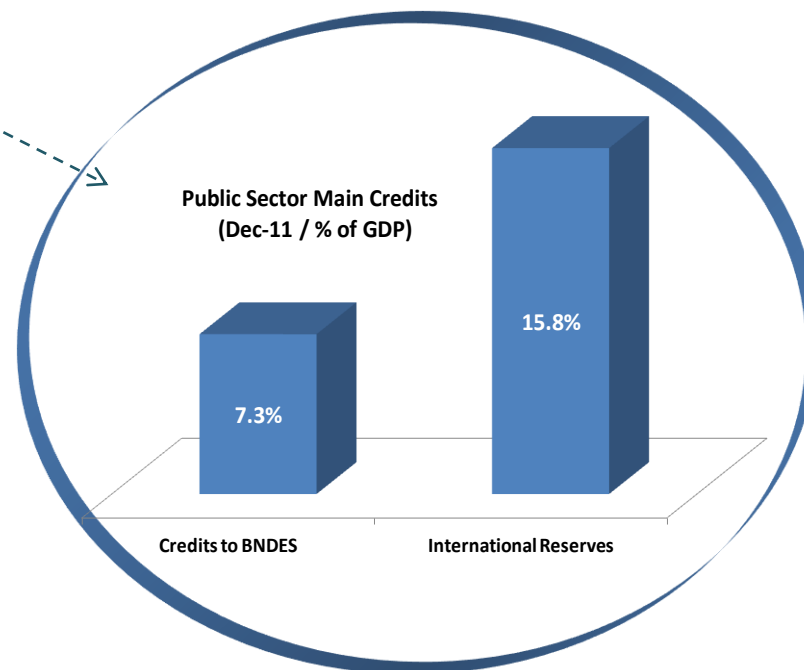
## Fiscal Responsibility

### Gross General Government Debt, Net Public Sector Debt as % GDP



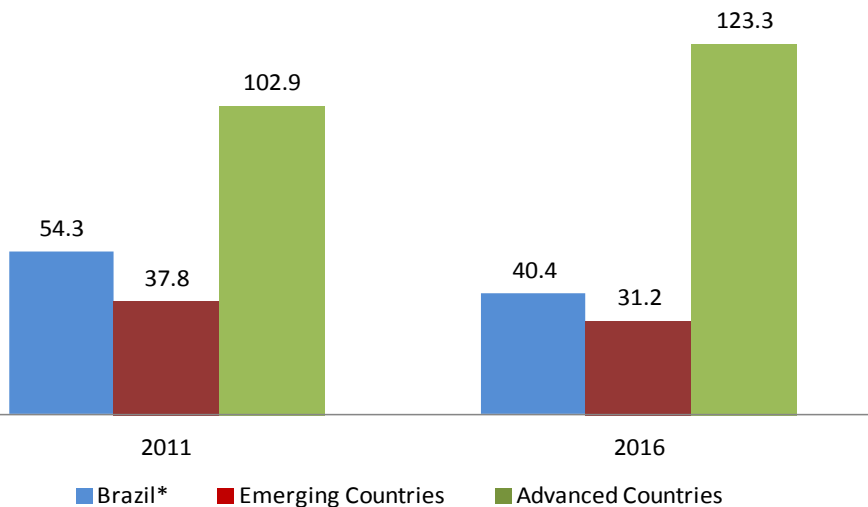
Source: Brazilian Central Bank time series and Inflation Report of Dec/11 (forecasts\*)

» The commitment with strong primary fiscal targets coupled with consistent GDP growth will allow an improvement in overall fiscal balance and promote a consistent downward trend in public debt measures.



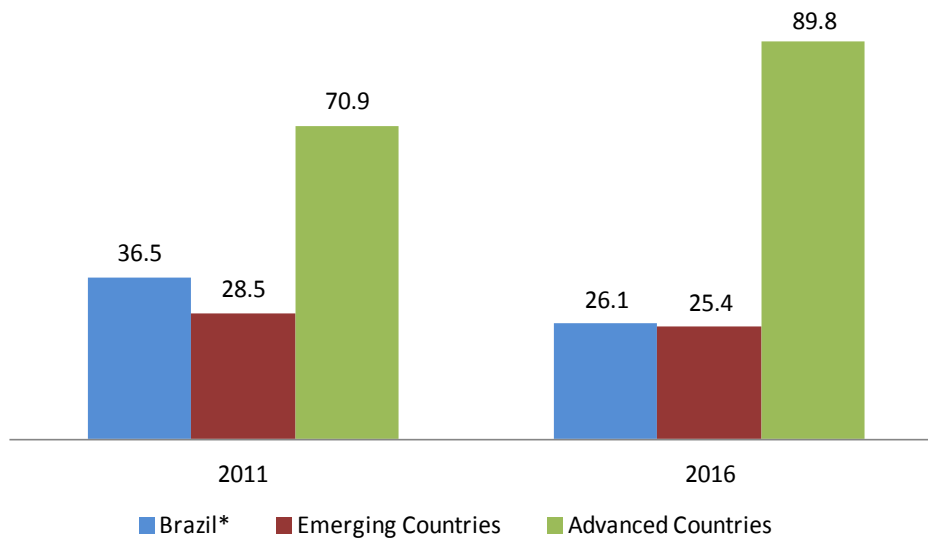
## Cross-Country Comparison

### Gross General Government Debt/GDP



Source: Brazilian Central Bank and IMF (Fiscal Monitor, set/11)

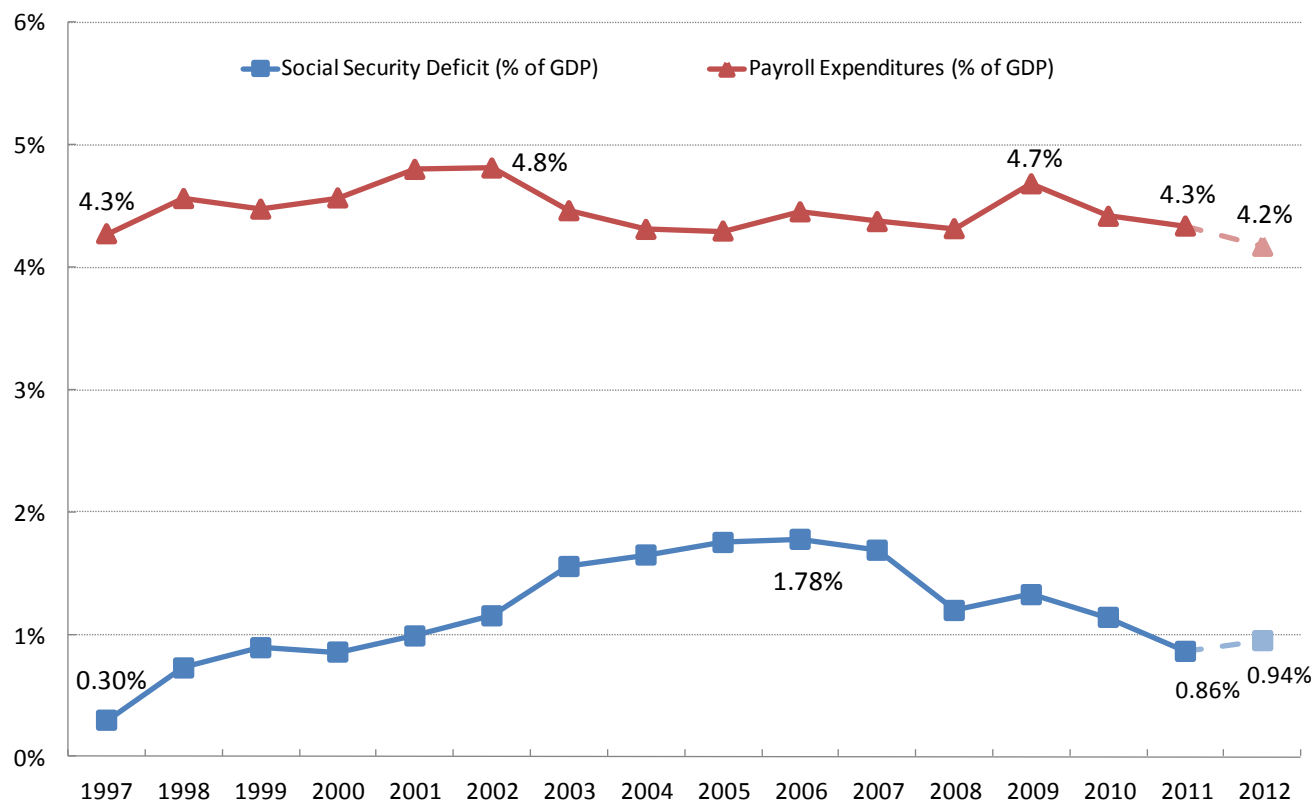
### Net Public Sector Debt/GDP



Source: Brazilian Central Bank and IMF (Fiscal Monitor, set/11)

## Fiscal Responsibility

### Social Security Deficit and Payroll – Main Expenditures Stabilized as % of GDP



Source : Brazilian National Treasury.

2012 forecast based on the Annual Budget Law for this year.

» Over the recent years, payroll expenditure has been kept stable below 5% of GDP. As a result of formalization in labor market, Social Security Deficit has declined from 1.78% of GDP in 2006 to 0.86% in 2011.

» For 2012, both indicators are expected to keep their levels stable.

## Fiscal Responsibility

Details on the R\$ 55 billion cut in 2012 budget

<b>BREAKING DOWN</b>	<b>CUT (R\$ Billion)</b>
Discretionary	35,010
Mandatory	20,512
Extraordinary Credits	(484)
Special Credits - Judiciary Power	(38)
<b>TOTAL</b>	<b>55,000</b>

## Fiscal Responsibility

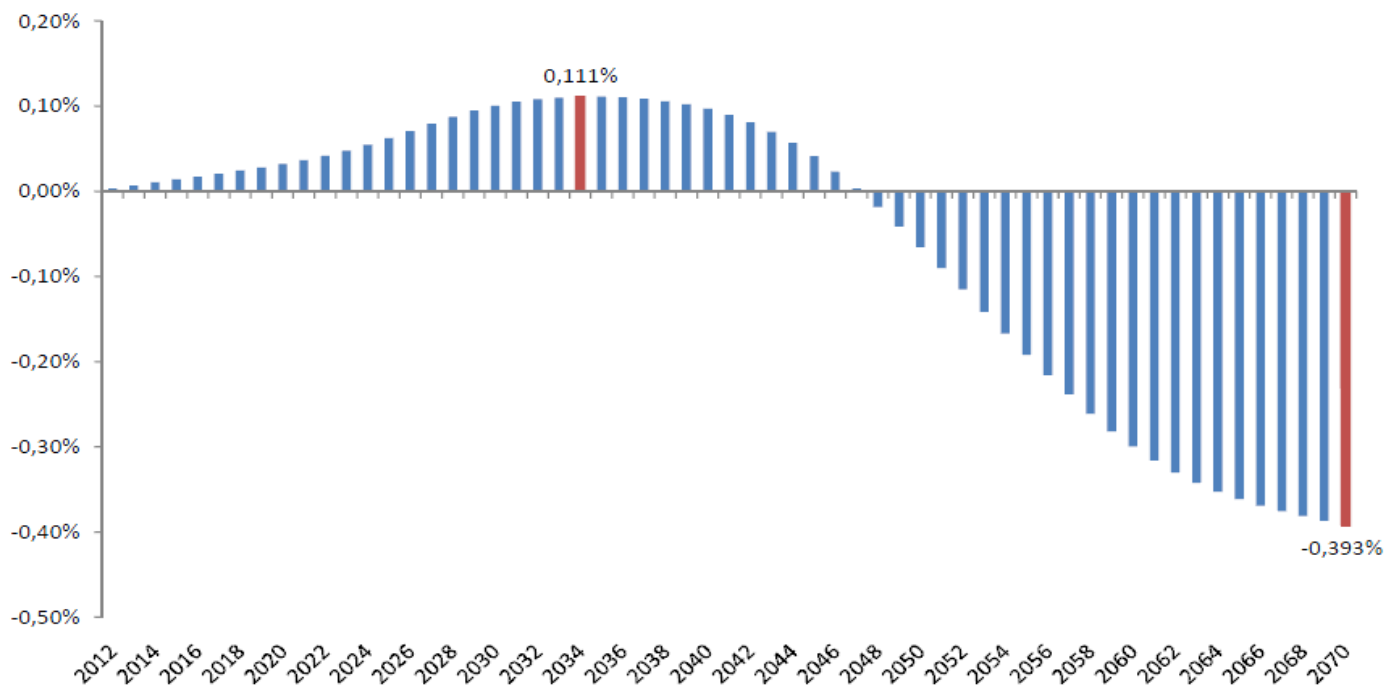
### Fiscal Impact of “Brasil Maior” Program

Item	2012	2013	2014
Payroll Contributions to Social Security	3.60	7.20	7.20
New tax over gross revenues	-1.15	-2.30	-2.30
New taxes over imports (similar goods)	-0.65	-1.30	-1.30
Tax over home appliances (3-month extension)	0.49	0.00	0.00
Investments in Ports and Railways infrastructure	0.19	0.25	0.00
Cancer Treatment Program	0.00	0.31	0.34
Investments in BroadBand Access Network	0.46	0.97	0.00
Production of Portable Computers for Students	0.15	0.20	0.22
<b>Total (R\$ billion)</b>	3.09	5.33	4.16
<b>Total (%GDP)</b>	0.069%	0.108%	0.077%

» The net fiscal impact of the new measures is very low and does not threaten the achievement of the fiscal target.

## Fiscal Responsibility

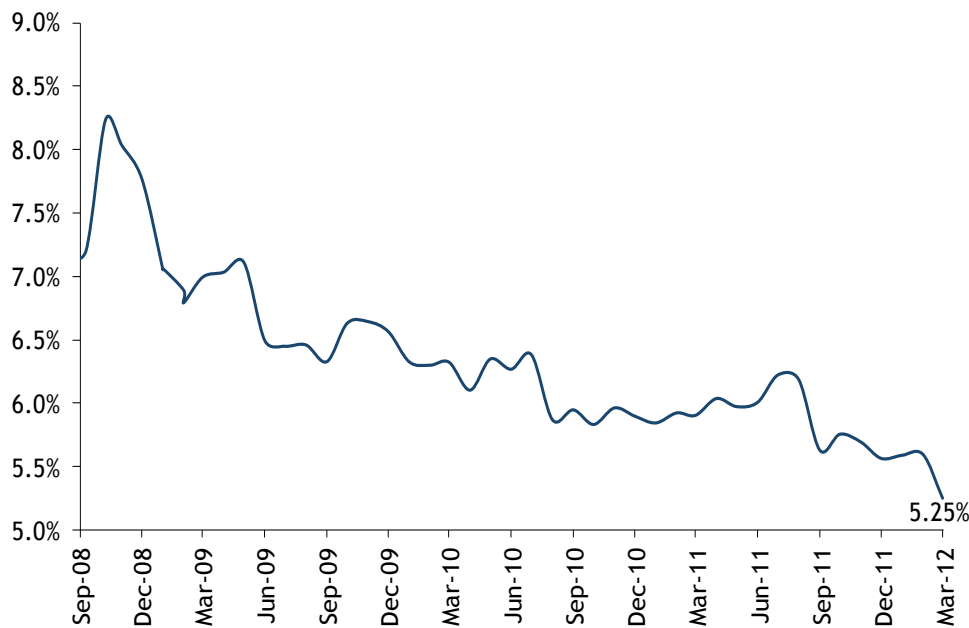
### New Pension System for Public Sector Workers (Funpresp) - Fiscal Impact (% of GDP)



» The new system will not improve the primary balance in the short run as the government will lose the contributions of new employees that will be diverted to their own pension plans, instead of financing the benefits of current retirees. But the long-term benefits will be positive, because when the new hires begin to retire, part of their pensions will be paid from the resources accumulated by their own saving.

## Inflation under Control

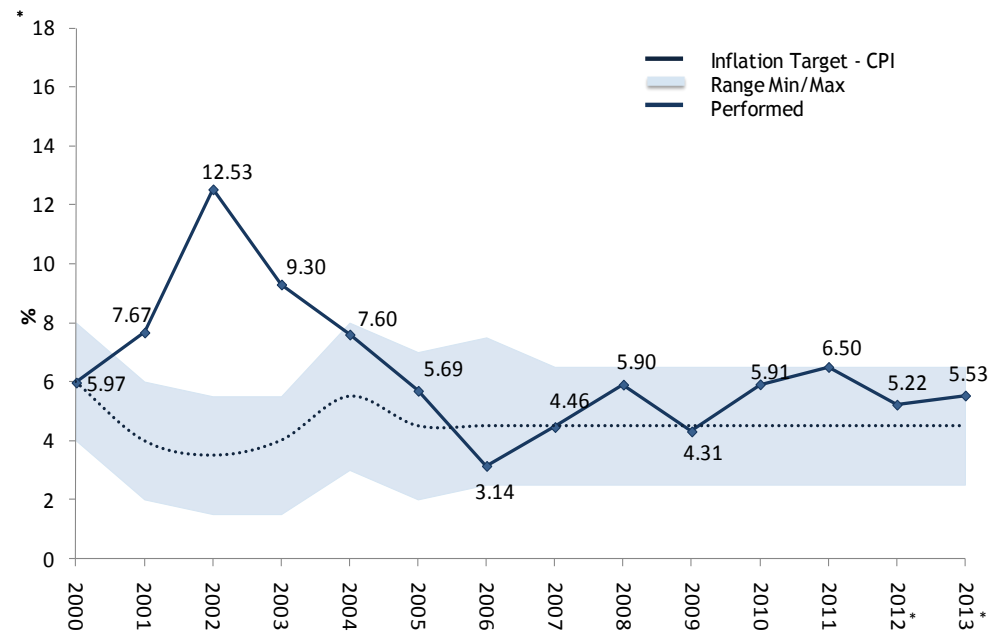
### Medium and Long Term Real Interest Rate \*



Source: National Treasury

\* NTN-B: CPI linked bonds, Until Jan-10 maturing in 2024, 2035 and 2045, after that maturing in 2030, 2040 and 2050.

### Annual Inflation – Target and Performed



Source: Central Bank

\* Market Expectations – Central Bank – FOCUS May 11/2012

» Inflation is expected to converge to the target along the following years .

## National Treasury Performance

### *Real Interest Rate Structure*

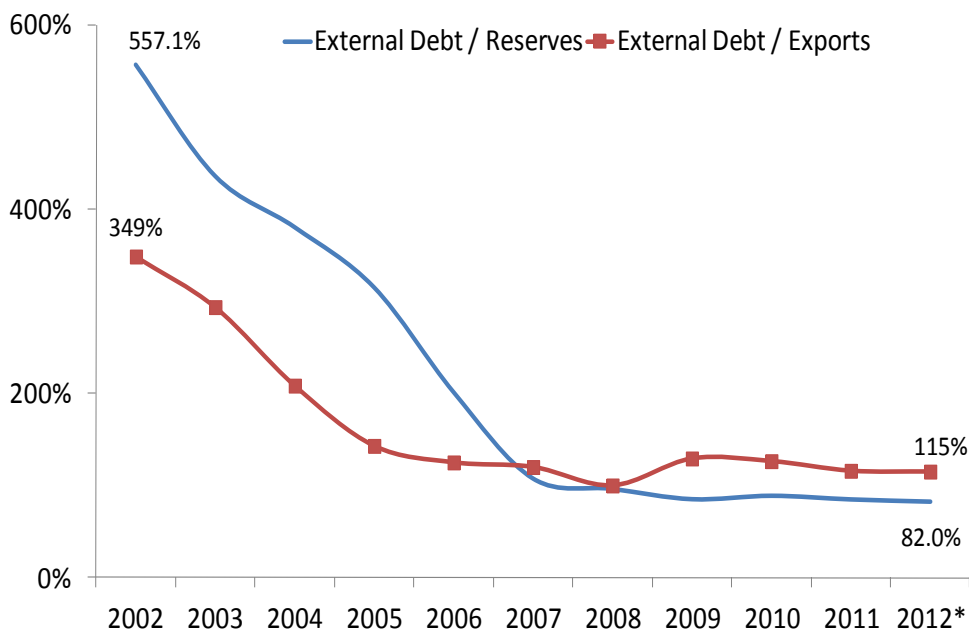


Source: National Treasury

» Strong commitment to fiscal responsibility and inflation under control are opening space for a decrease in real interest rate, which reinforces the current attractiveness of Brazilian bonds and signals more economic growth.

## Reduction in External Vulnerability

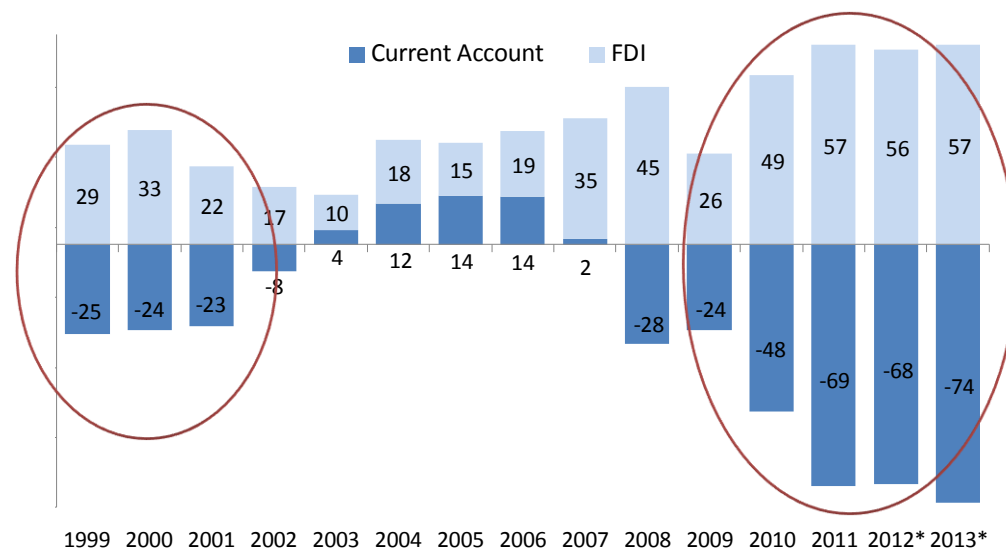
### External Debt Evolution



Source: Central Bank

### Current Account Balance x FDI (US\$ bn)

- » Low GDP growth
- » High GDP growth
- » High FX linked debt
- » Low FX linked debt
- » '02 FX-Reserves: USD 38 bn
- » FX-Reserves: USD 365.2bn (Mar/12)



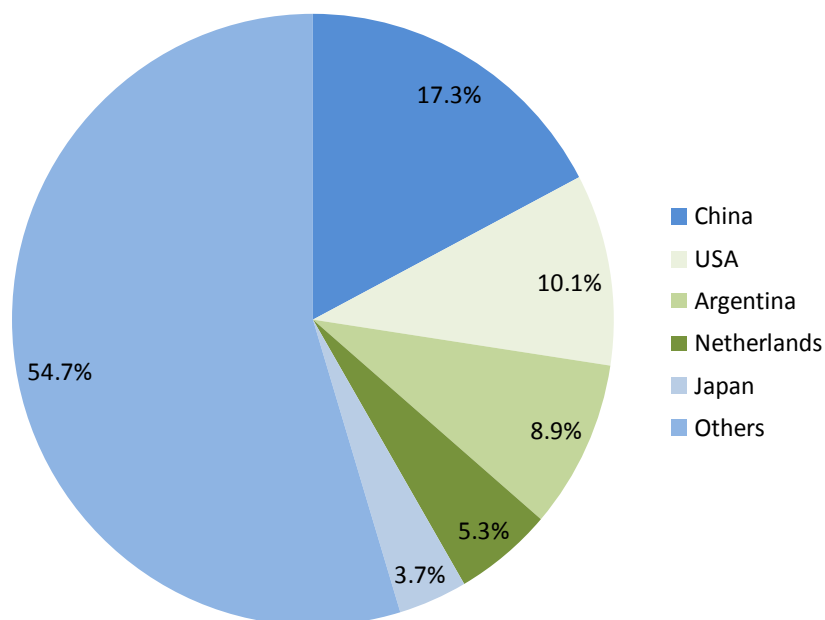
\* Source: Central Bank - Market Expectations (FOCUS May 11/2012)

» Brazil is a Net External Creditor of US\$ 84.6 bn (March- 12) and its Current Account deficit has been largely financed by FDI since 2008.

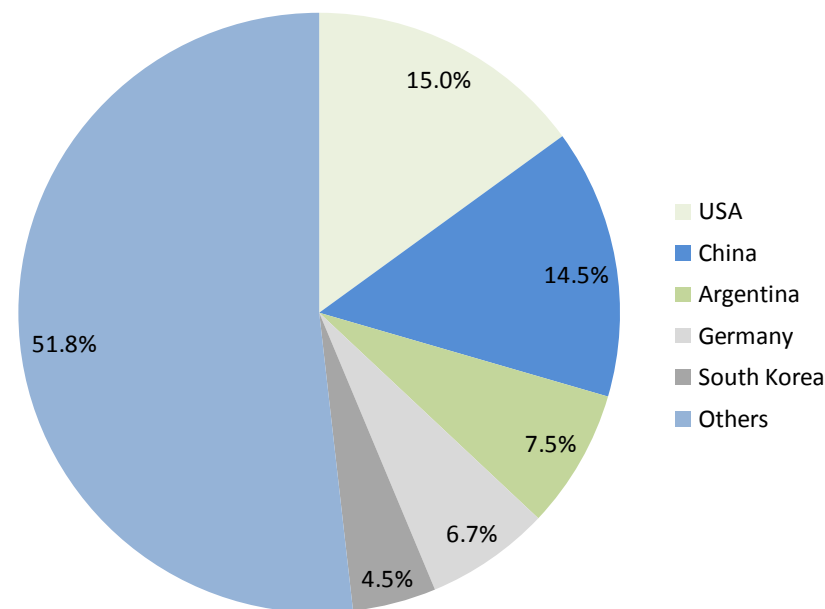
## Reduction in External Vulnerability

### Trade Balance Partners

**Brazilian Exports in 2011  
Participation By Destination**



**Brazilian Imports in 2011  
Participation By Origin**

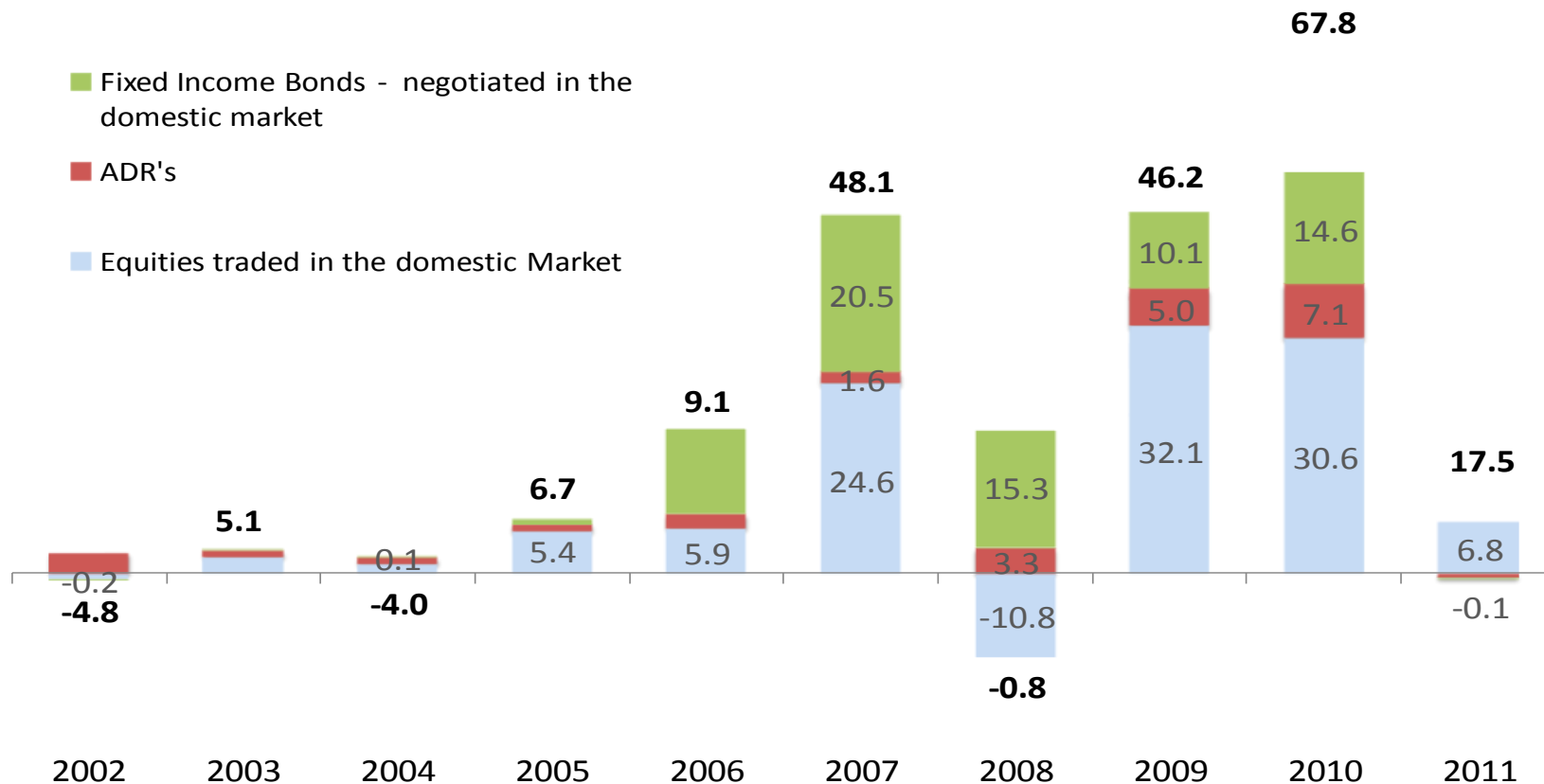


Source: Ministry of Industry

- » Brazil's export structure provides an additional degree of resilience to ongoing global challenges. Commodity products represent only 35% of total exports in Brazil.
- » Europe receives about 20% of Brazilian exports, an important but not determinant share.
- » The share of exports in Brazilian GDP was only 11%, in 2011.

## Reduction in External Vulnerability

### Foreign Investment in Portfolio – US\$ bn



» In 2011, the net inflow of portfolio investment was considerable lower than previous years. For 2012, this declining trend is expected to continue.

**Macroeconomic Overview**

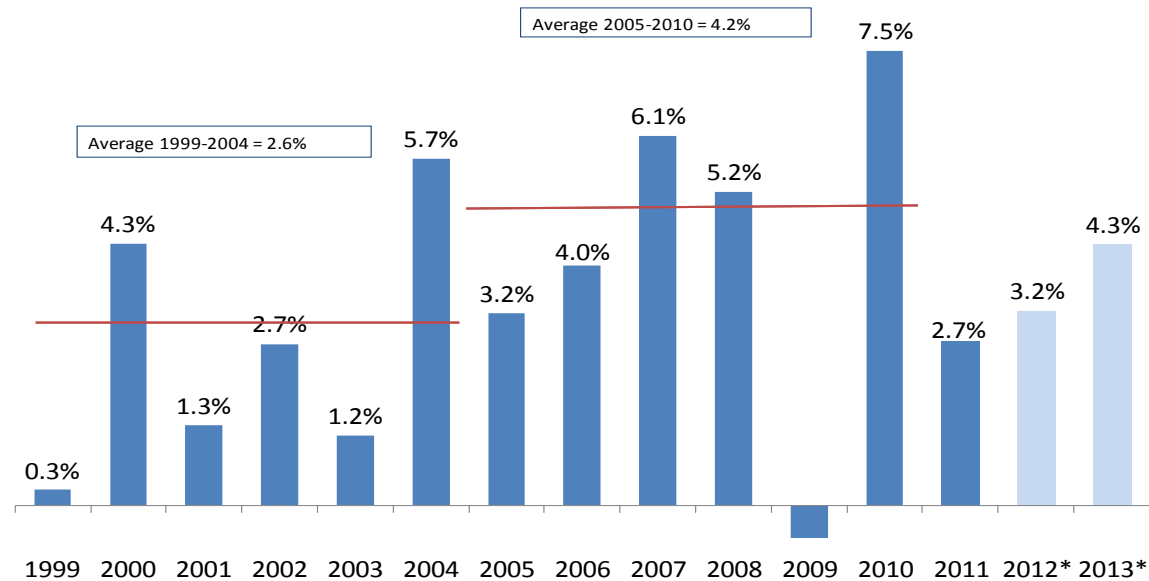
Economic Policy

**Economic Activity and Recent Events**

Public Debt Management

## Growth supported by domestic demand

### *GDP Growth (Q-o-Q accumulated)*

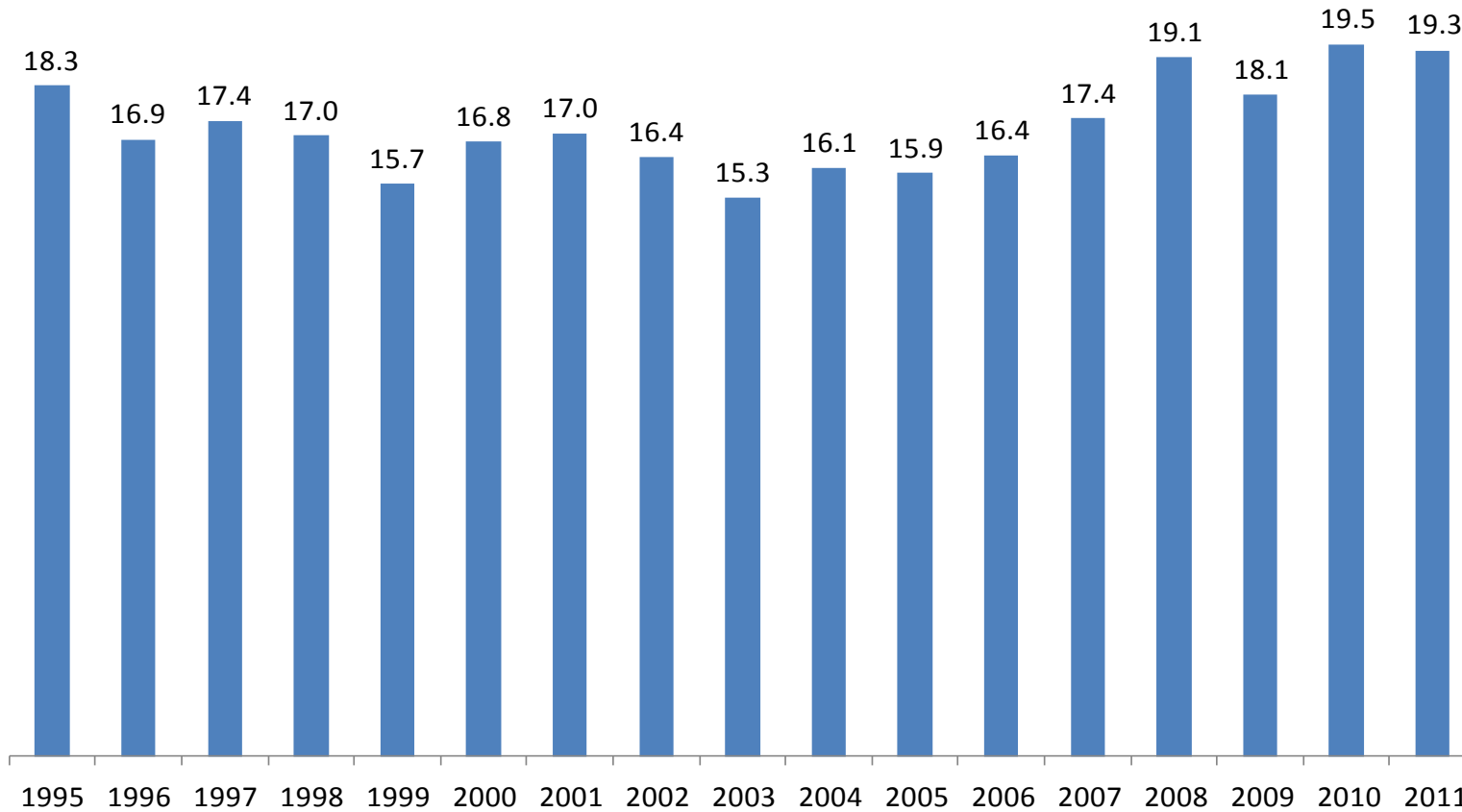


Source: IBGE

Market Expectation - Central Bank/FOCUS\* – May 11/2012.

- » Average GDP growth of 3.7% through the last 10 years;
- » Consumption is boosted by the strength of job market, higher income and credit;
- » Similarly, investment rate is increasing to meet this consumption and make GDP growth sustainable

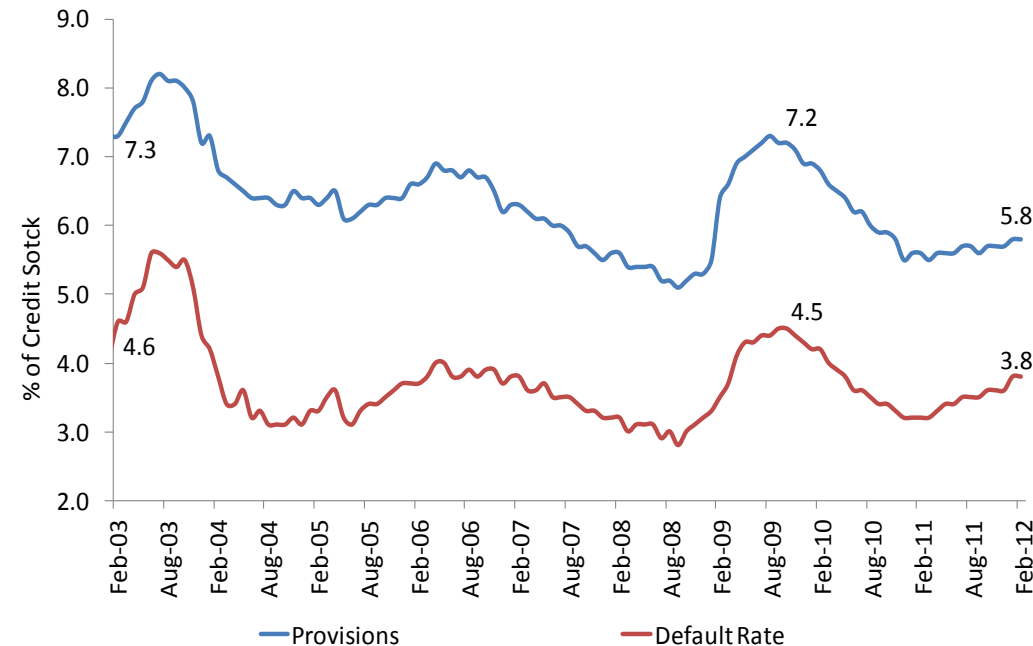
## Gross Fixed Capital Formation (% GDP)



Source: IBGE

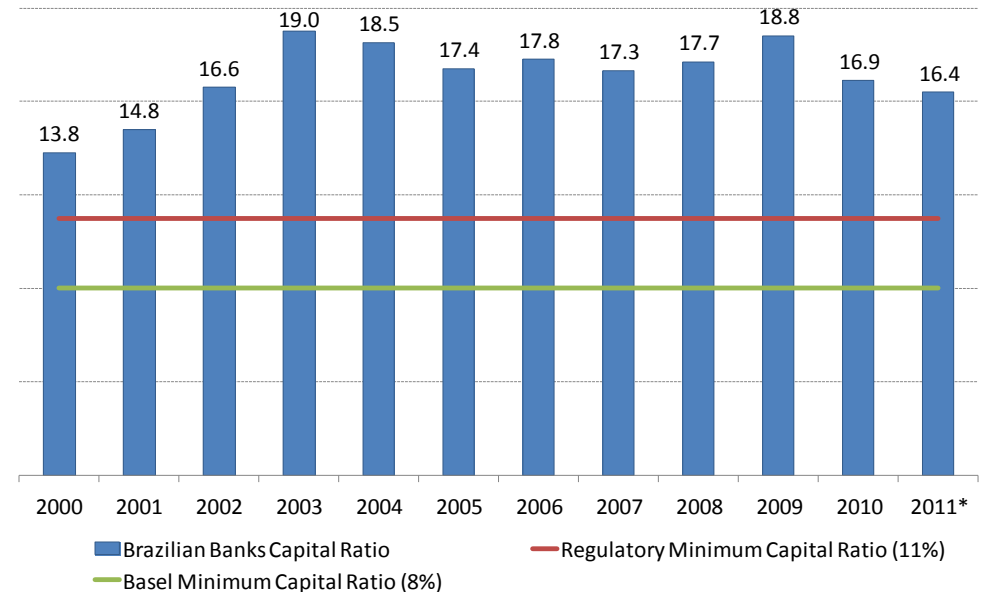
## Sustainable Credit Growth

### Provisions X Default Rate



Source: Central Bank / The default rate includes the total credit overdue for more than 90 days. Provisions for nonperforming loans must be done on a monthly basis .

### Brazilian Banks Capital Ratio



Source: Central Bank

\* July 2011

» The level of provisions has remained comfortably above the default level by about 2 percentage points of the stock of credit since 2002.

» The Central Bank requires to Brazilian Banks a more conservative stance (11%) than Basel ratios (8%), which facilitates their adaptation for new limits on Basel III (13%).

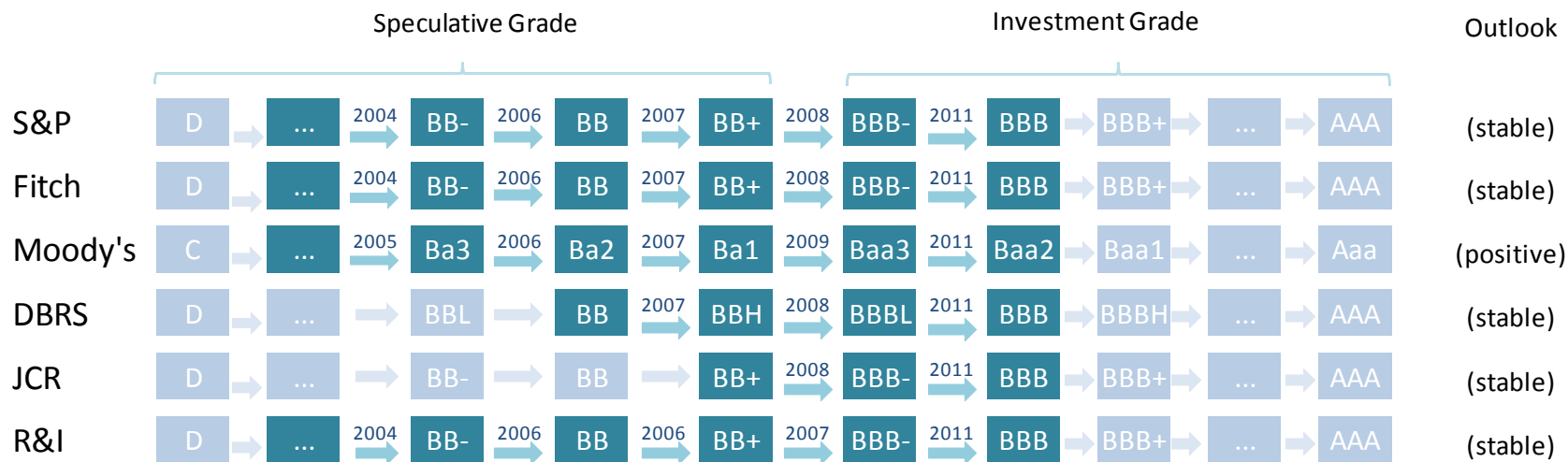
## Market Expectations for 2012-2015

*Median of the Sample Collected by the Brazilian Central Bank*

	Sample Date	2012	2013	2014	2015
Primary Balance (% GDP)	05/14/12	3.10	3.00	2.78	2.80
Current Account Balance (US\$ billion)	05/14/12	-68.20	-73.50	-70.00	-70.00
Exchange Rate Year End (R\$/US\$)	05/14/12	1.85	1.85	1.85	1.90
Inflation (IPCA in %)	05/14/12	5.22	5.53	5.00	5.00
CB Year End Interest Rate - %	05/14/12	8.00	9.75	9.50	9.00
GDP Growth (%)	05/14/12	3.20	4.30	4.35	4.44
Foreign Direct Investment (US\$ billion)	05/14/12	55.74	57.05	57.90	55.20
Net Public Sector Debt (% GDP)	05/14/12	36.00	34.70	33.61	33.00

## Improvement of Rating Evaluation

### Recent Evolution of Brazil's Credit Rating



Source: Rating Agencies

» In contrast with the crisis that split up in the global financial markets in 2011, Brazil's credit rate was raised by the main international Credit Rating agencies.

» The long-term debt in local currency, that represents more than 95% of the DPF, was qualified as A- by S&P.

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Public Debt Management

## Objective and Guidelines of Federal Public Debt Management

The objective of the Federal Public Debt Management is that of efficiently meeting the National Treasury Borrowing Requirements, at the lowest possible long-term financing costs, while ensuring the maintenance of prudent risk levels. Additionally, the aim is to contribute to the smooth operation of the Brazilian government securities market.

To achieve this objective, the guidelines underlying FPD management are as follows:

Increase the average maturity of the outstanding debt

Smooth the maturity profile, with special attention given to short-term maturities

Gradual replacement of floating-rate securities by fixed-rate and inflation-linked instruments

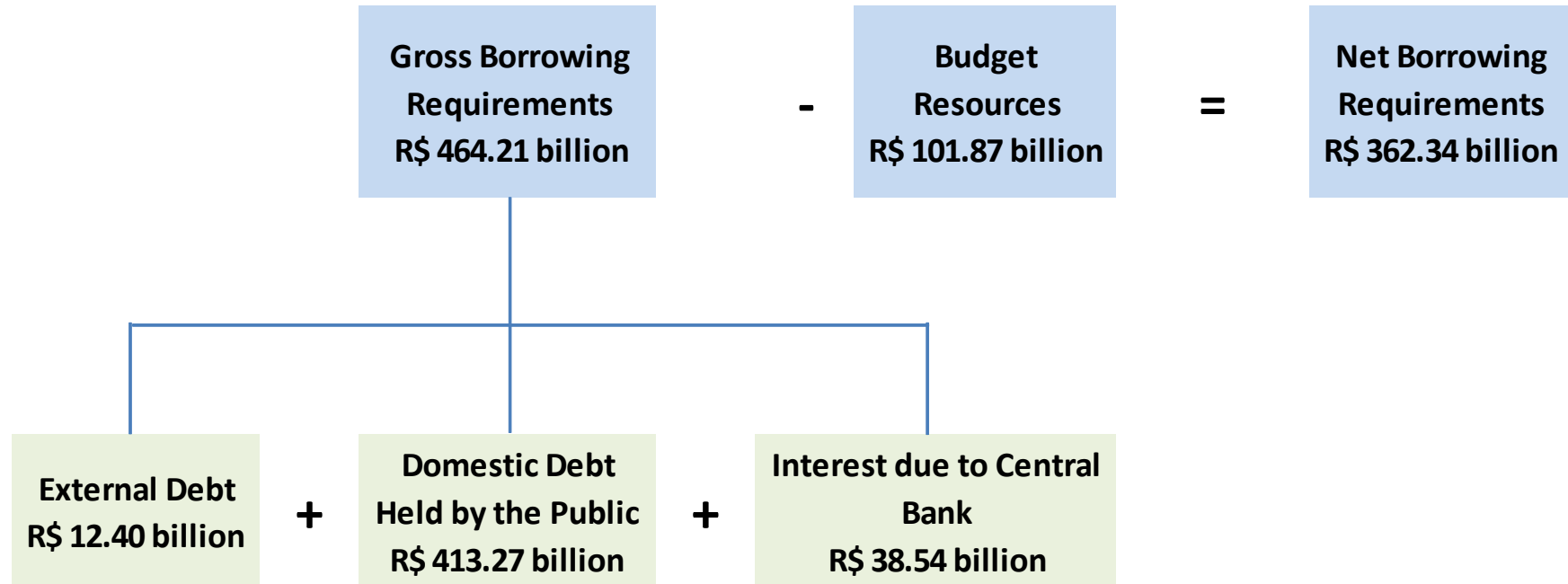
Improvement of the External Federal Public Debt (EFPD) profile through issuance of benchmark securities, buyback program and structured operations

Development of the yield curve on both domestic and external markets and growth in the liquidity of federal government securities on the secondary market

Broadening of the investor base

## Assumptions and Guidelines

### *National Treasury Borrowing Requirements*



The National Treasury has two “liquidity cushions” to manage the Federal Public Debt efficiently:

- » **In foreign currency: US\$ 7.4 billion** already purchased, enough to cover **49%** of the external debt maturing until 2015.
- » **In domestic currency:** a liquidity-cushion equivalent to approximately **six-months** of the Federal Public Debt – FPD service (principal and interest).

## Financing Strategy

### *Domestic Federal Public Debt - DFPD*

#### » **Fixed Rate Securities**

- The LTN will have benchmarks of 6, 12, and 24 months, and the NTN-F will have maturities of 5 and 10 years.
- The National Treasury will attempt to distribute outstanding fixed-rate securities in a uniform manner among the four maturity months (January, April, July and October) in each year.

#### » **Inflation Linked Securities**

- The maturities of NTN-B offered throughout 2011 will be 3, 5, 10, 20, 30 and 40 years.

#### » **Floating Rate Securities**

- The new bonds will have maturities in March and September.
- The average issuance maturity will exceed that for FPD (around 3.5 years).

### *External Federal Public Debt - EFPD*

- » Creation and improvement of benchmarks in the external market yield curve through qualitative issuances (10 and 30 year benchmarks).
- » Continuation of the buyback program for securities denominated in Dollars and Euros. Inclusion of securities denominated in Real (BRL) in the buyback program.

## Objective and Guidelines of Federal Public Debt Management

### *Federal Public Debt Optimal Composition*

Composition	Lower Limit	Upper Limit
Fixed Rate	40%	50%
Inflation Linked	30%	35%
Floating Rate	10%	20%
Exchange Rate	5%	10%
Maturity Profile	Lower Limit	Upper Limit
Average Maturity	5 Years	6 Years

» This composition is being pursued gradually, without generating pressures that could result in excessive transition costs and taking in account the guideline of lengthening the average FPD maturity.

## Results and Projections

### Federal Public Debt (FPD) Indicators\*

Indicators	2002	2010	2011	2012**	Limits for 2012	
					Minimum	Maximum
<b>Stock of FPD* held by the public (R\$ Billion)</b>						
	893.3	1,694.0	1,866.4	<b>1,855.9</b>	1,950.0	2,050.0
<b>FPD Profile (%)</b>						
<i>Fixed Rate</i>	1.5%	36.6%	37.2%	<b>37.8%</b>	37.0%	41.0%
<i>Inflation Linked</i>	8.8%	26.6%	28.3%	<b>31.7%</b>	30.0%	34.0%
<i>Floating Rate</i>	42.4%	31.6%	30.1%	<b>26.3%</b>	22.0%	26.0%
<i>Exchange Rate</i>	45.8%	5.1%	4.4%	<b>4.2%</b>	3.0%	5.0%
<b>FPD Maturity Structure</b>						
<i>Average Maturity (years)</i>	3.6	3.5	3.6	<b>3.8</b>	3.6	3.8
<i>Percentage Maturing in 12 Month.</i>	34.6%	23.9%	21.9%	<b>24.2%</b>	22.0%	26.0%

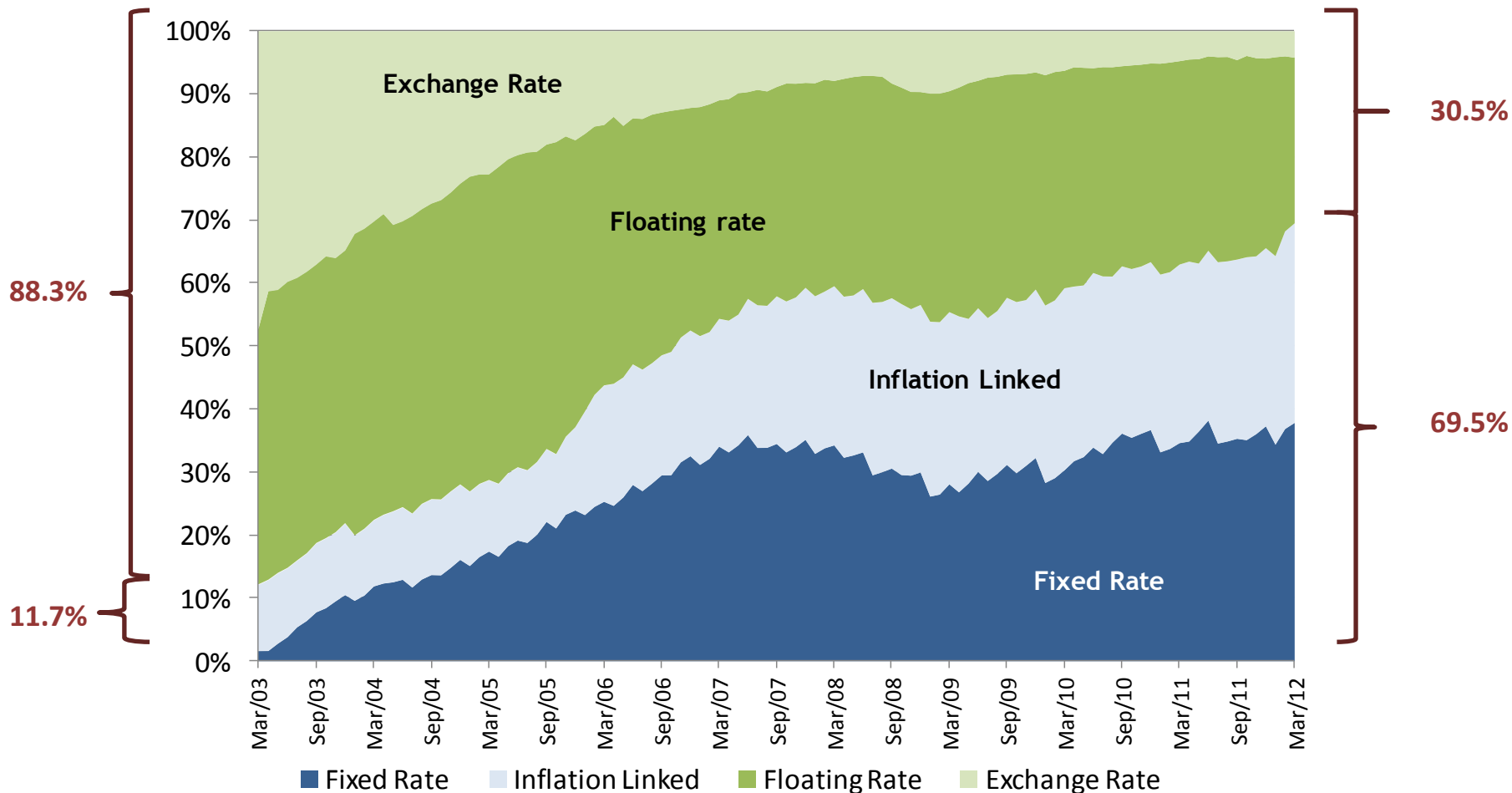
\*It includes domestic debt (R\$ 1,775.9 billion - Mar/12) and external debt (R\$ 80.0 billion - Mar/12) managed by National Treasury.

\*\* February

- » Percentage of fixed rate securities + inflation linked securities above 65% of the outstanding.
- » Percentage maturing in 12 months below 26% and stable average maturity.

## Guideline: Improving Public Debt Composition

*Replacement of floating-rate securities by fixed-rate and inflation-linked*



## Guideline: Improving Public Debt Composition and Reducing Risks

### *Stress scenario impact over NPSD\* (% GDP)*

Type of Index	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Interest Rate	1.81%	2.11%	1.86%	1.84%	1.52%	1.61%	1.73%	2.09%	1.90%	1.92%
Exchange Rate	14.99%	11.39%	1.86%	2.08%	-0.93%	-4.57%	-5.29%	-5.02%	-5.15%	-7.15%
<b>Total</b>	<b>16.80%</b>	<b>13.51%</b>	<b>3.73%</b>	<b>3.92%</b>	<b>0.59%</b>	<b>-2.96%</b>	<b>-3.56%</b>	<b>-2.92%</b>	<b>-3.26%</b>	<b>-5.22%</b>

Source: National Treasury

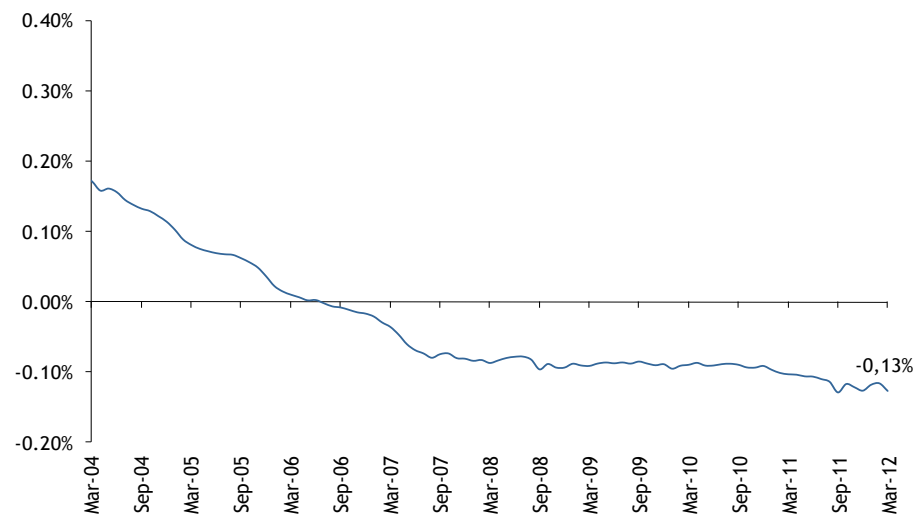
Note: Stress scenario considered of 3 standard deviations over the medium interest and exchange rate observed at 2002, equivalent of an overshooting of 56.6% on exchange rate and an increase of 7.8 on the Selic rate.

\*Net Public Sector Debt

» In particular, the protection created by the fact that the Government has more FX assets than liabilities compensates the interest rate risk, shielding the NPSD.

» The impact of a stress scenario of exchange and interest rates over the Net Public Sector Debt (NPSD) outstanding was reduced in **22 pp** of GDP between 2002 and 2011, due to changes at the Public Debt composition.

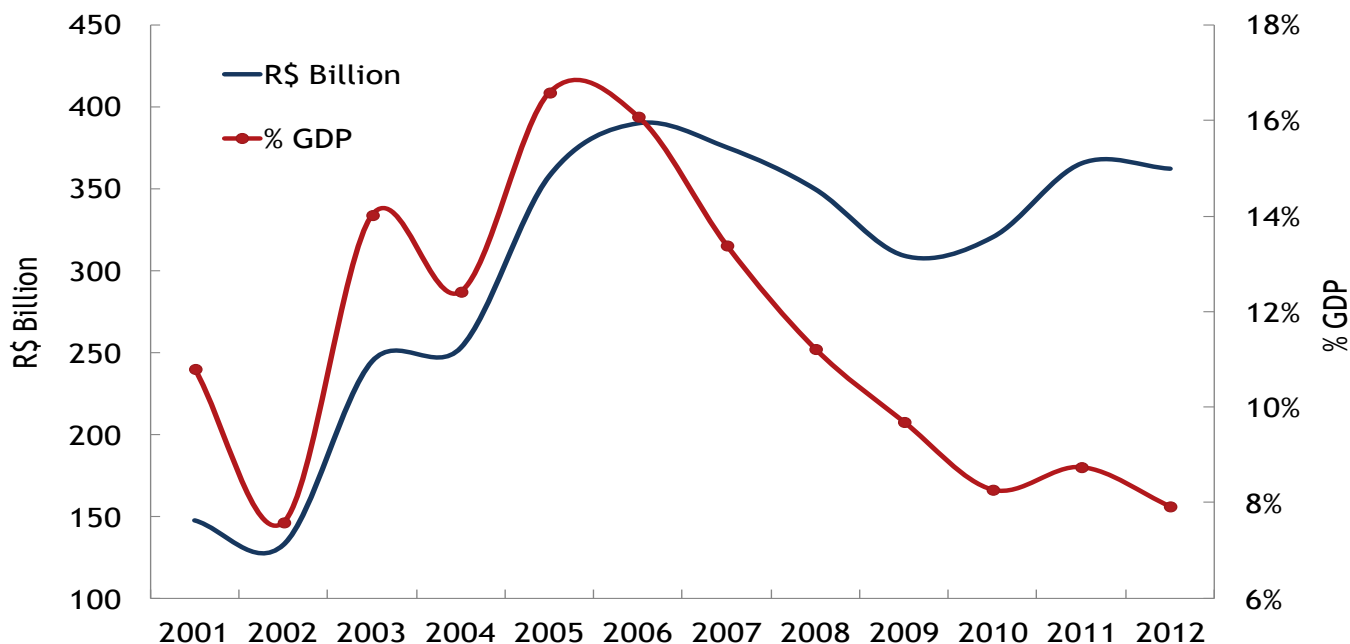
### *Impact of 1% FX devaluation on NPSD/GDP*



Source: Central Bank

## Guideline: Reducing Borrowing Requirements

### *National Treasury's Net Financial Needs*



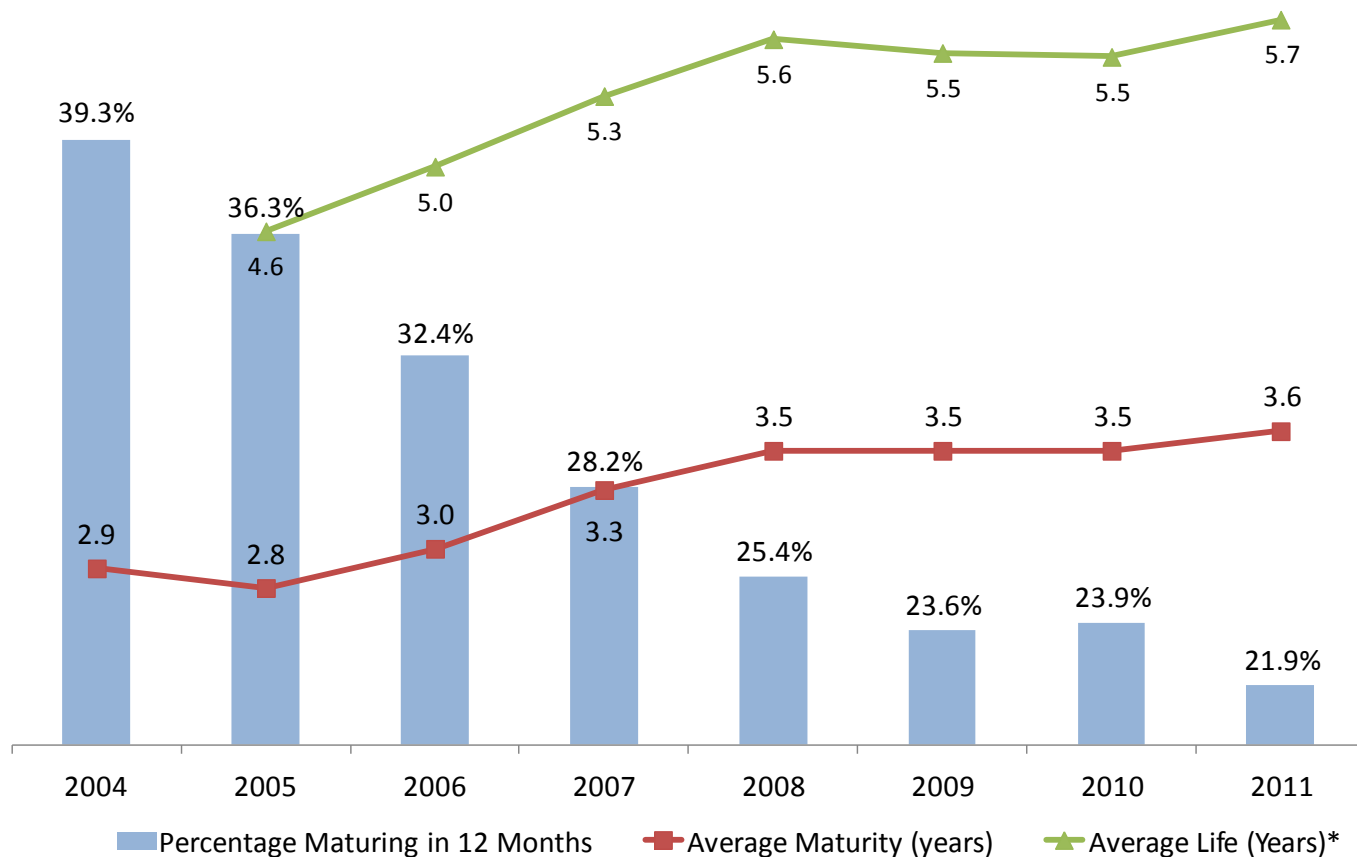
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» **In foreign currency:** **US\$ 7.4 billion** already purchased, enough to cover **49%** of the external debt maturing until 2015.

» **In domestic currency:** a liquidity-cushion equivalent to approximately **five-months** of the Federal Public Debt – FPD service (principal and interest). Given the current structure of the FPD, the Treasury considers comfortable to maintain a liquidity-cushion equivalent to, at least, 3 months of payments.

## Guideline: Improving Public Debt Maturity Profile

*Lengthening and Smoothing the Maturity Profile*

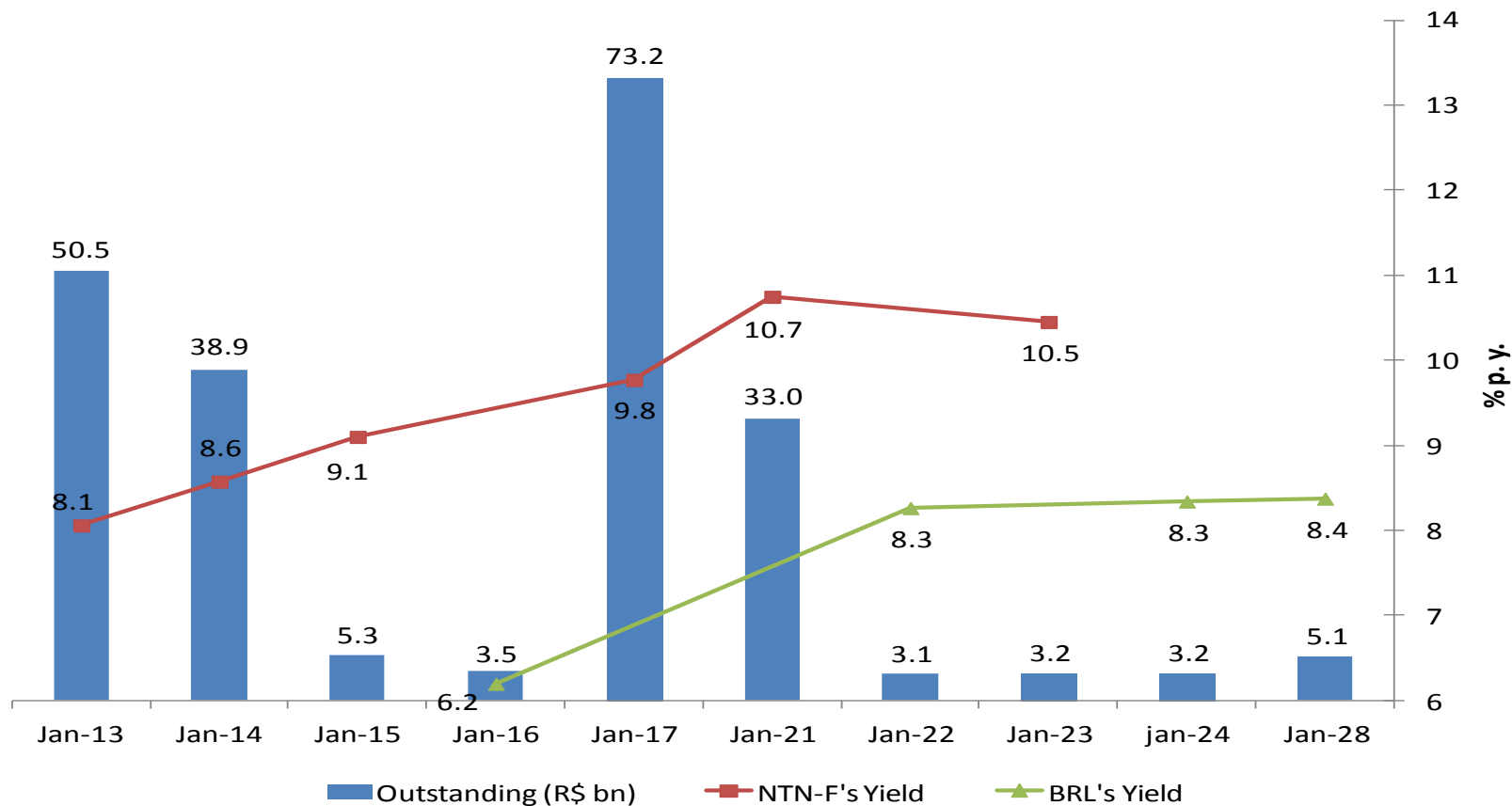


Source: Brazilian National Treasury

\*Average Life is different from the Average Maturity indicator because it does not consider intermediate coupon payments.

## Guideline: Developing the Domestic Yield Curve

### NTN-F and BRL - Outstanding and Yields (5/11/12)



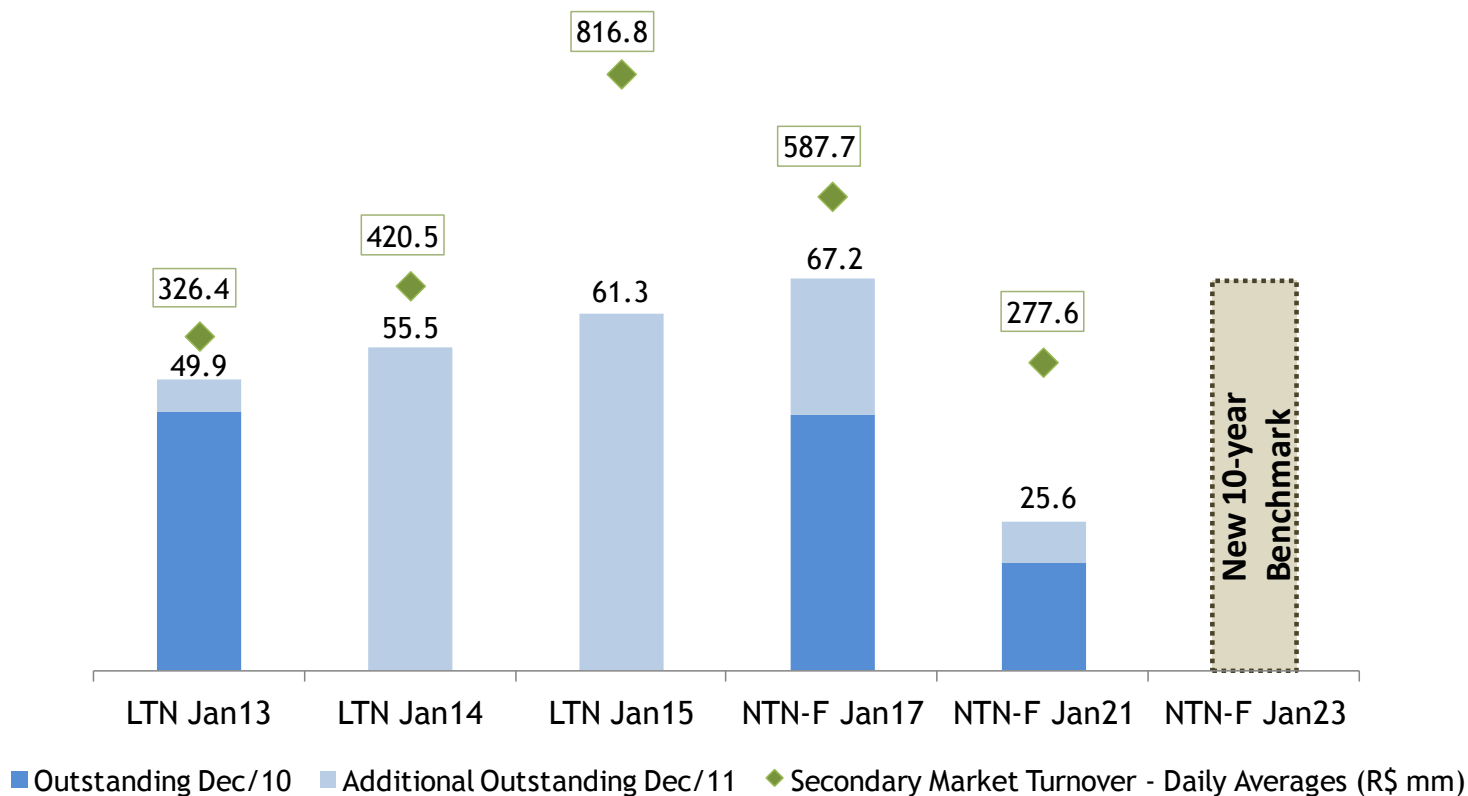
Source: Bloomberg, Andima (Yields) and National Treasury (Outstanding)

Note 1: Currently, only the NTN-F Jan/18 and Jan/23 are issued.

Note 2.: The yield of the NTN-F is based on the 252-d standard while the yield of the BRL is based on the 360-d standard.

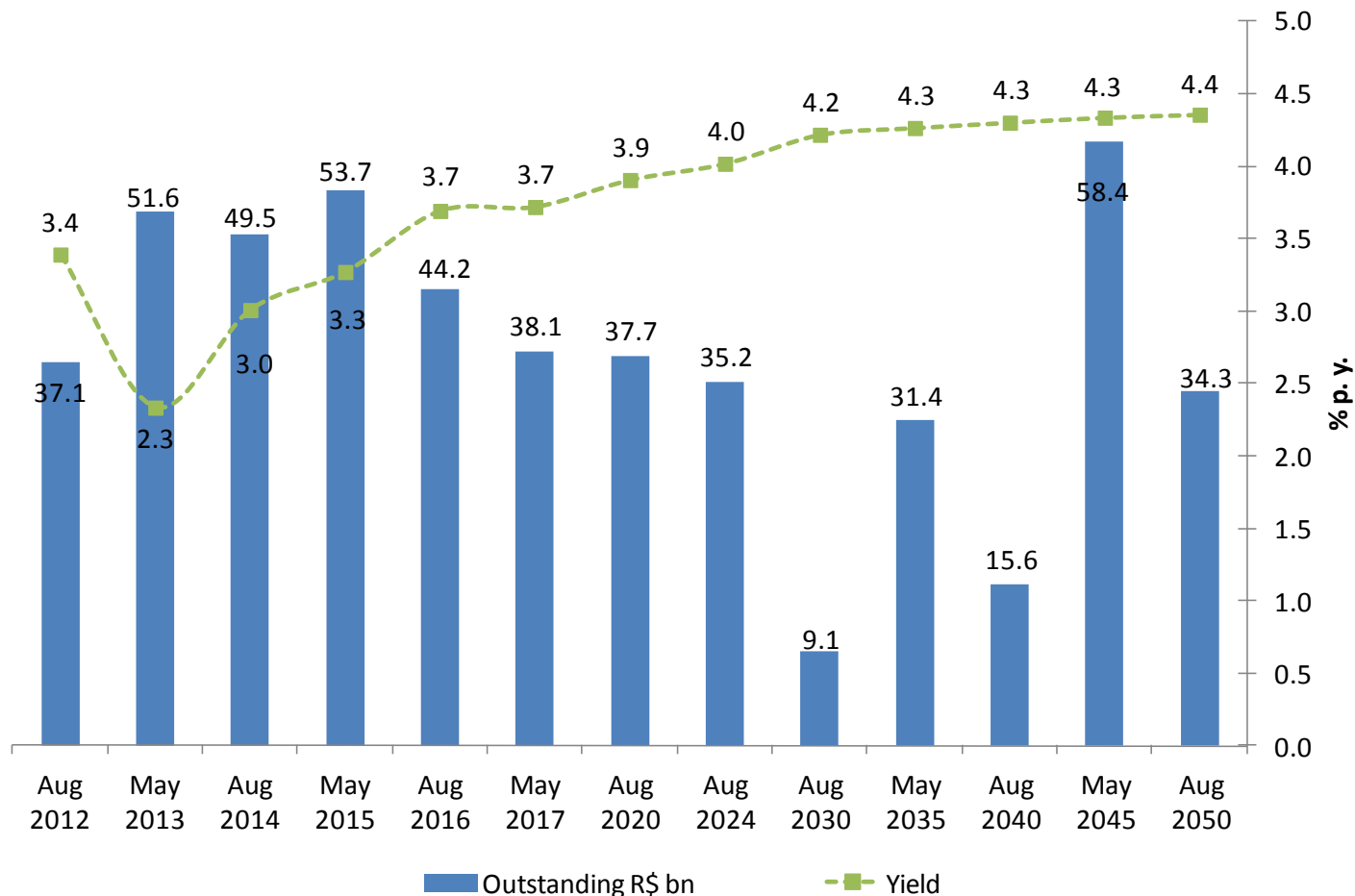
## Guideline: Developing the Domestic Yield Curve

*Fixed Rate Bonds: Outstanding (R\$ bn) and Secondary Market Turnover 2011 (R\$ mm)*



## Guideline: Developing the Domestic Yield Curve

### *Inflation linked bonds (NTN-B) - Outstanding and yields (as of 5/11/12)*



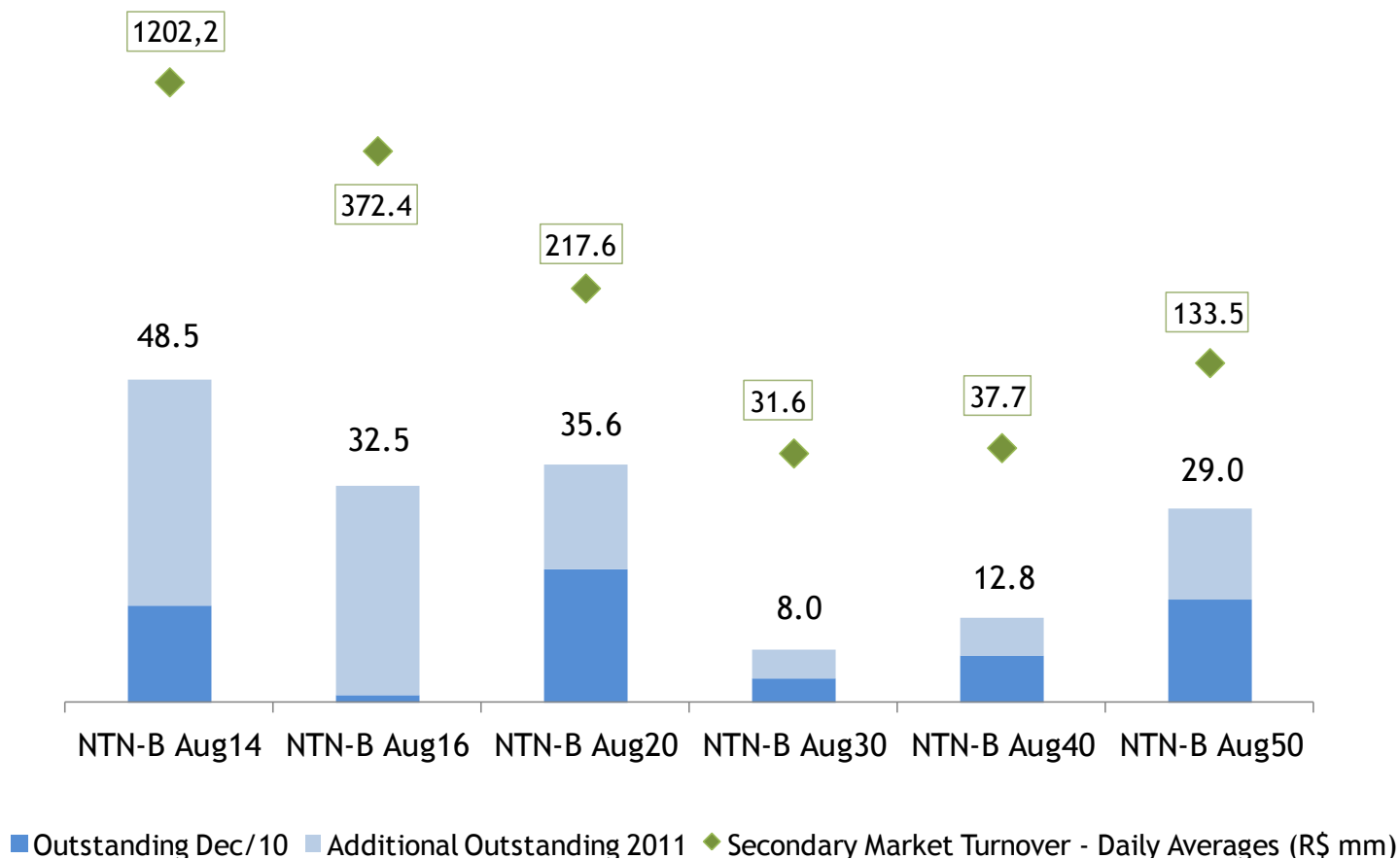
Source: ANDIMA (Yields) and National Treasury (Outstanding)

Note 1: Currently, only the NTN-B Aug/16, Ago/18, Aug/22, Aug/30, Aug/40 and Aug/50 are issued.

Note 2: There are NTN-Bs with other maturities.

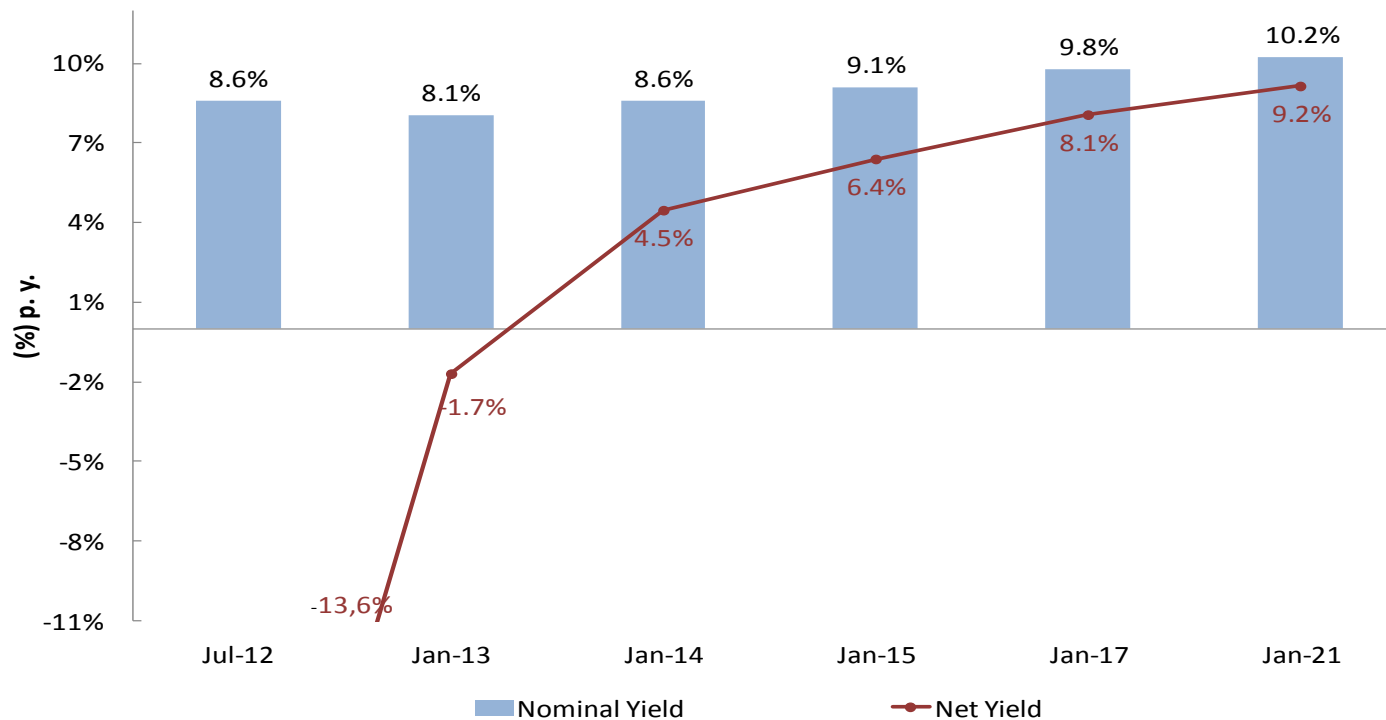
## Guideline: Developing the Domestic Yield Curve

*Inflation Linked Bonds: Outstanding (R\$ bn) and Secondary Market Turnover 2011 (R\$ mm)*



## Impact of IOF on the yield of fixed rate securities

*LTN and NTN-F - Yields (5/11/12)*

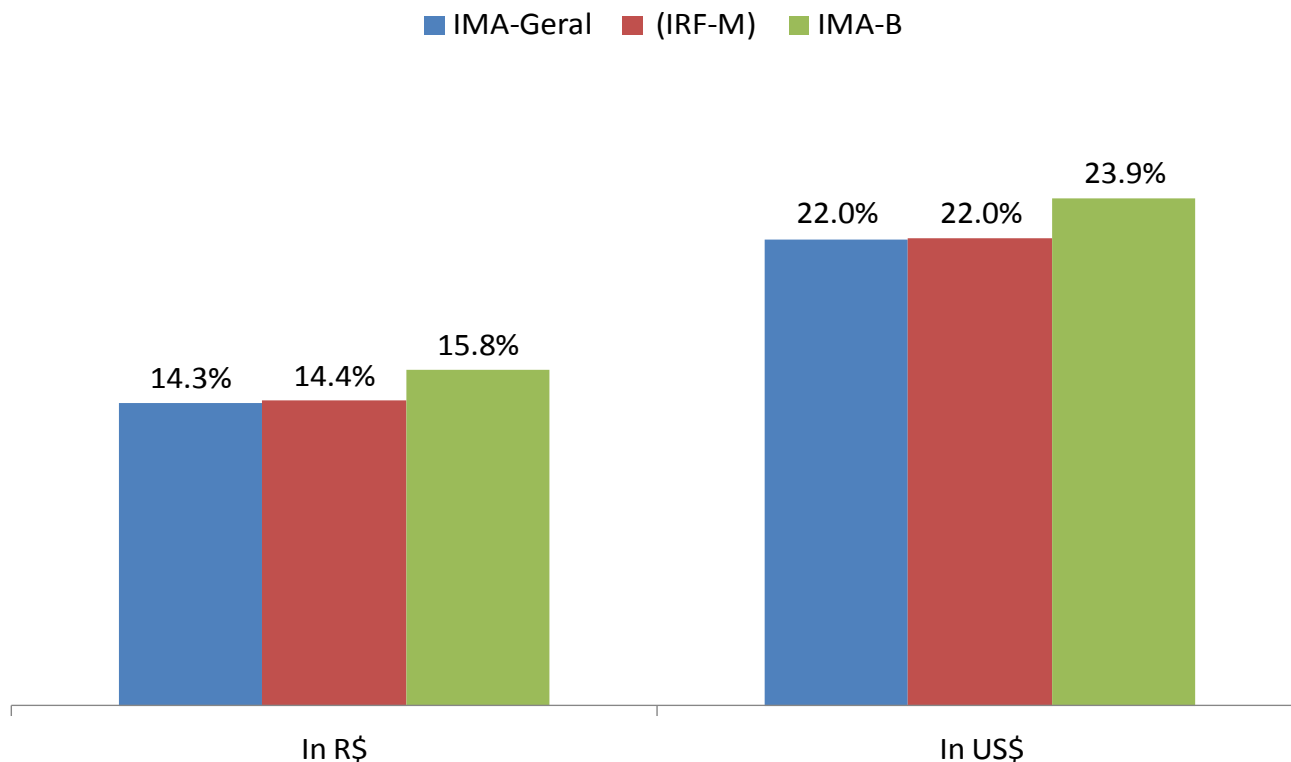


Source: Brazilian National Treasury

» The IOF tax itself is an important step in generating long-term growth and stability in the market, which is a fundamental factor behind the interest rate in the Brazilian markets. The longer the maturity of a bond the lower the impact of IOF in the final net return.

## National Treasury Performance - opportunities merge in the domestic market

*Average Return of Public Bonds between 2005 and 2011 – ANBIMA Market Index (IMA)*

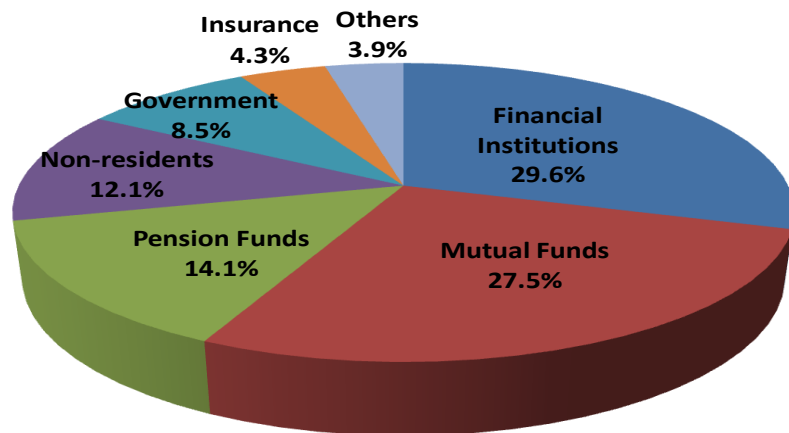


Source: ANBIMA

Obs.: IRF-M considers all fixed rate bonds outstanding (LTN and NTN-F). IMA-B considers all inflation linked bonds outstanding (NTN-B). IMA-Geral is the most comprehensive index and is the sum of IRF-M, IMA-S (floating rate index), IMA-C (NTN-C) and IMA-B.

## Domestic Federal Public Debt (DFPD) - Holders

*Holder* (March 2012)



Source: National Treasury

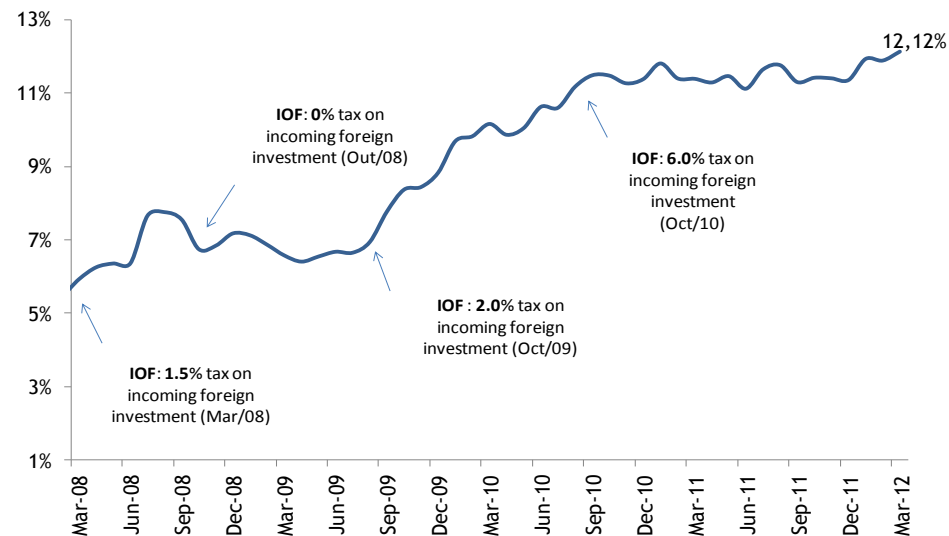
“Pension Funds” includes both open and closed pension funds.

“Government” comprises funds that are managed by the public sector, including those whose assets are not public.

» The share of Non Residents in Domestic Federal Public Debt has been kept stable.

» This is the result of a strategy adopted by the National Treasury aimed at diversifying the investor base.

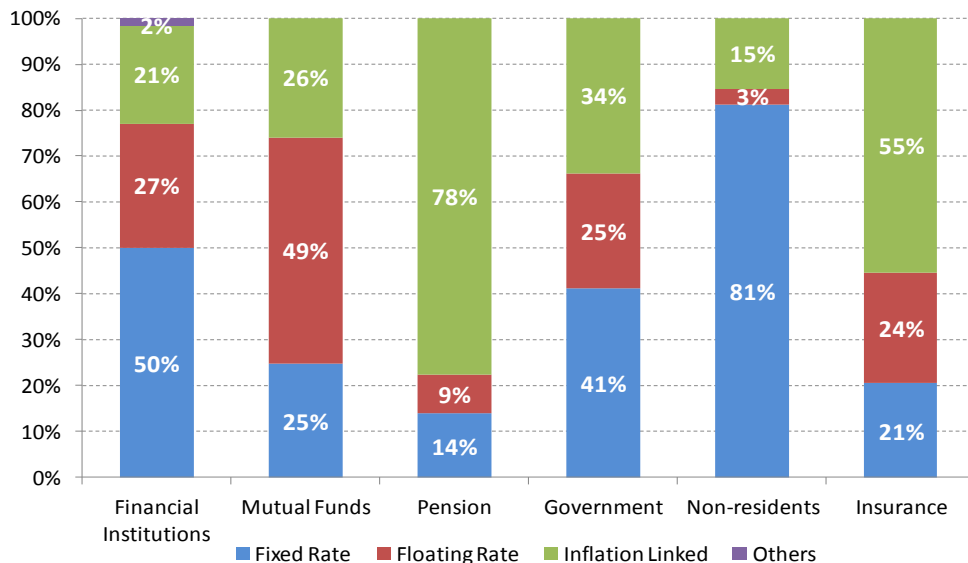
### Share of Non Residents



Source: National Treasury

## Holder's Domestic Public Debt Portfolio

### By security type (March 2012)

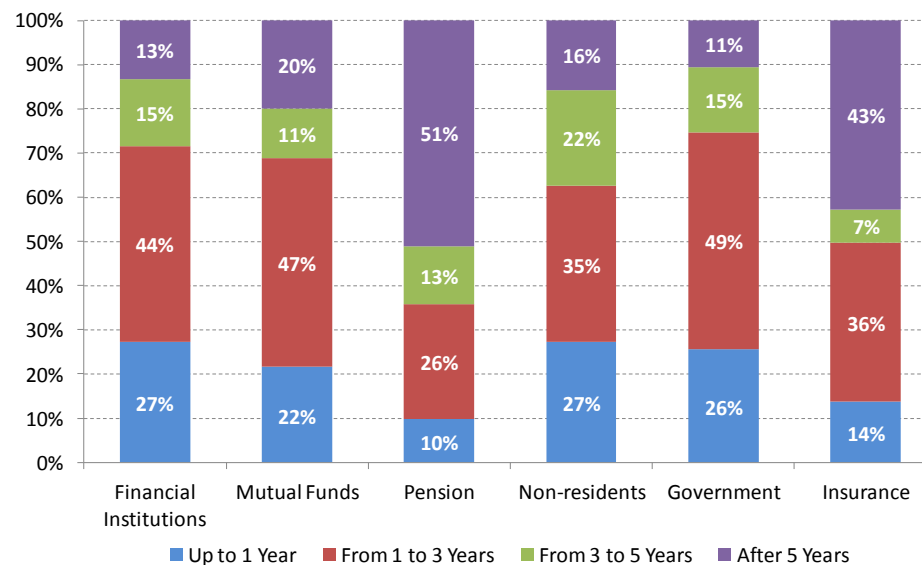


Source: National Treasury

» Regarding maturities, Pension Fund portfolio's have longest duration.

» As regards the debt by type, 50% of bank holdings are fixed rate bonds, while 49% of Mutual Fund's portfolio is in floating rate bonds. Inflation-linked bonds are 78% of Pension Fund holdings.

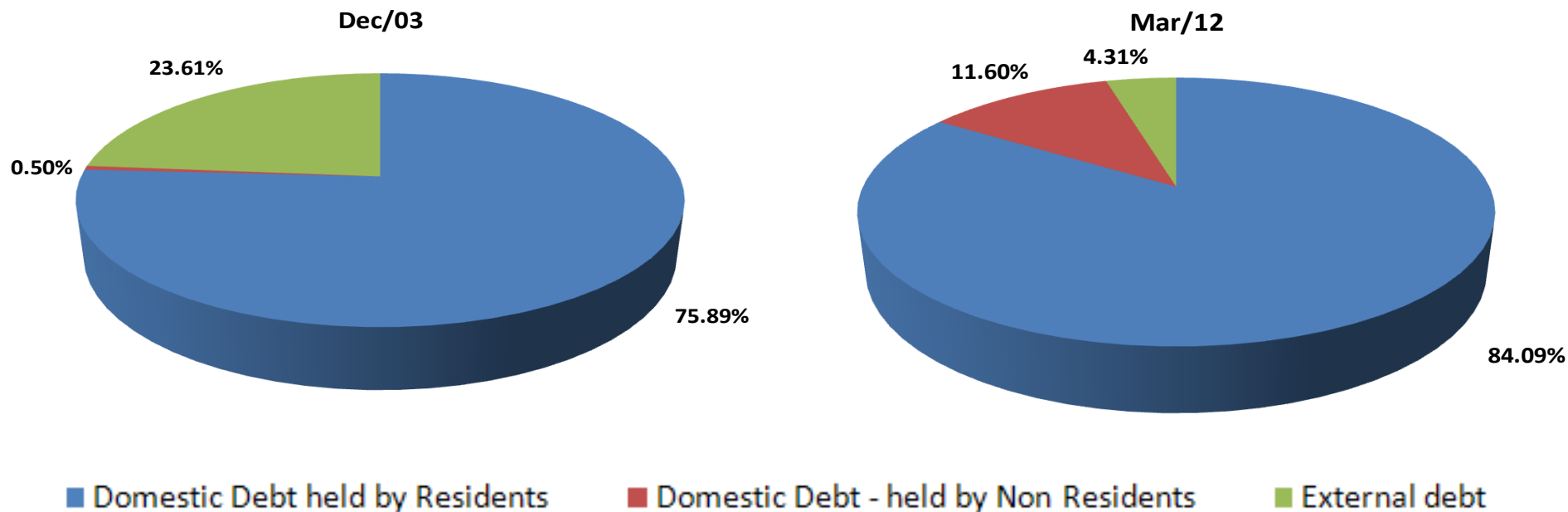
### By maturity (March 2012)



Source: National Treasury

## Non-Resident Share in Overall Public Debt

*Recent Evolution (as % of FPD)*

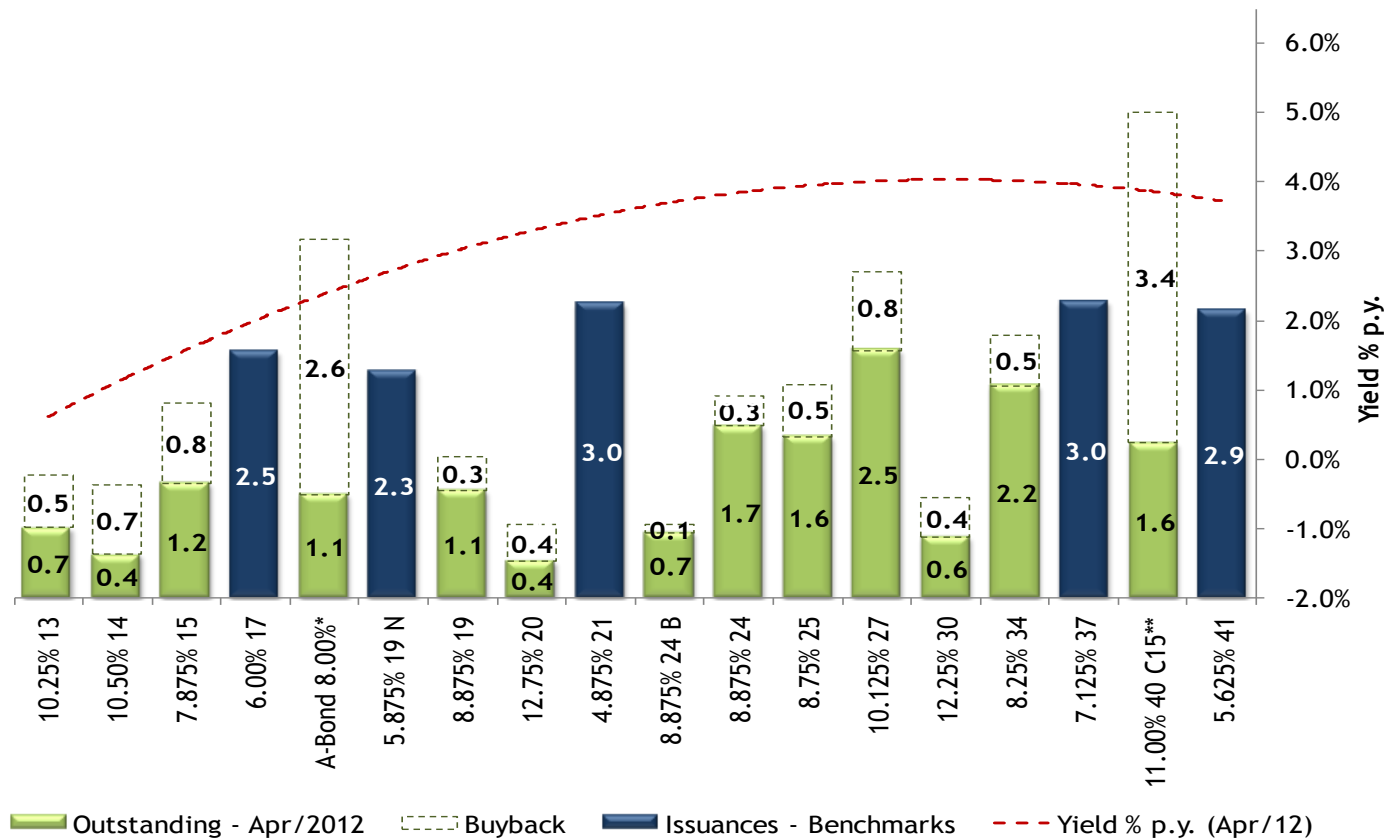


» The external debt as a share of FPD has reduced from 23.6% (US\$ 78.0 billion) in Dec/03 to 4.3% (US\$ 43.9 billion) in Mar/12. During this period the share of non residents in the domestic debt has increased considerably from 0.5% to 11.6%.

» In 2005, Brazilian National Treasury initiated the issuance of external debt denominated in *reais*, which amounts US\$ 6.4 billion in Mar/12.

## Achieved Results

*Result of the Strategy adopted for the External Federal Public Debt*

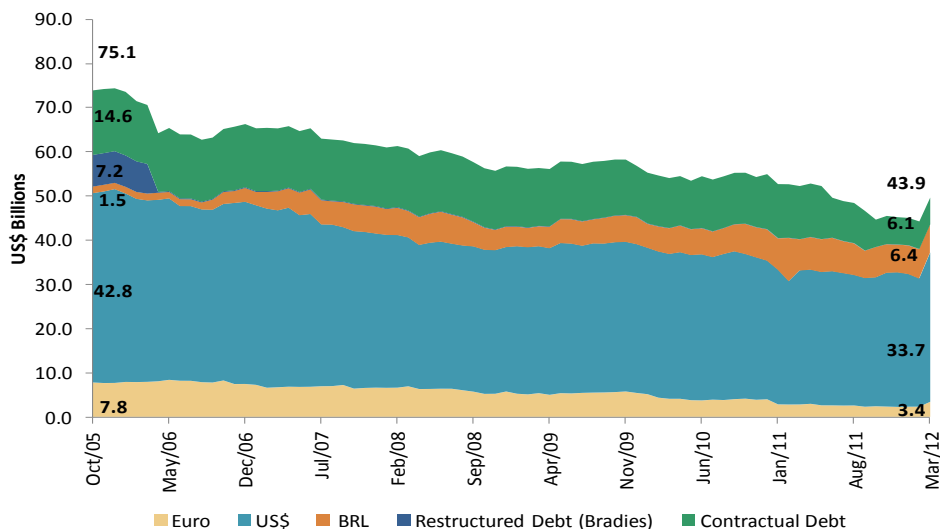


Source: National Treasury

Note: This amount includes the exchange of approximately US\$ 676 million of external debt securities for domestic debt bonds in the Central Bank's portfolio. As for the A-Bond (BR 8,00 15/01/2018), the reduction in the outstanding value includes not only the amount repurchased through the Buyback Program but also US\$ 184.5 million of amortization.

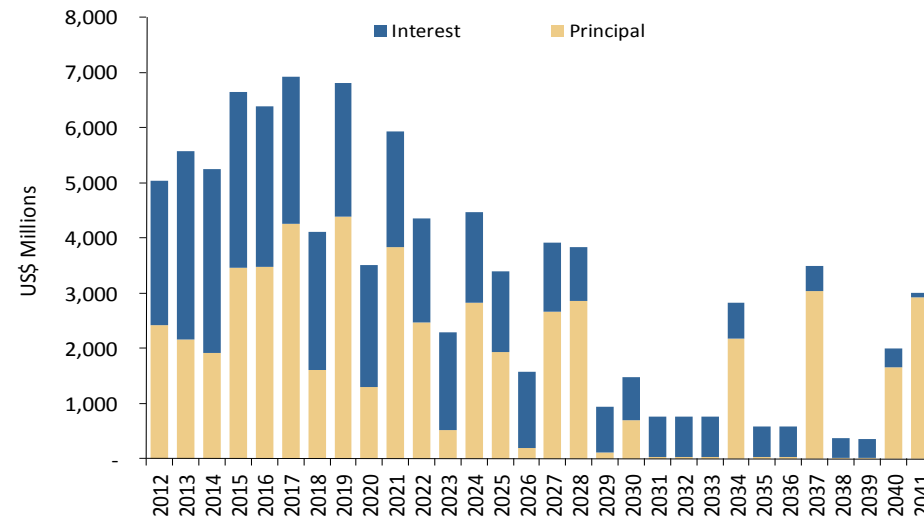
## External Public Debt

### Outstanding



Source: National Treasury

### Maturity Profile – February/2012



Source: National Treasury

» As a result of a successful strategy adopted by the National Treasury throughout the last years, the outstanding EFPD has been systematically shrinking in the past years, reaching US\$ 44.4 bn in 2011 (in contrast with US\$ 55.0 bn, in 2010) and representing only 4.4% of total FPD.

## Brazil stands out in Investor Relations Best Practices

### *IIF Report - Investor Relations: An Approach to Effective Communication and Enhanced Transparency*

- » Brazil was the first country to satisfy all the investor relations best practice criteria of the Institute of International Finance (IIF).
  
- » Assessment of 38 key borrowing countries in Investor Relations and Data Transparency Practices in 2011.
  - Brazil, a top-ranked IR leader since the first IIF report in 2005
  
  - In 2008, Brazil became the first country to score 38 out of 38 in the IIF's prioritized criteria for IR practices, based on the combined scores of both its IROs (Gerin, operated by the Central Bank of Brazil, and Investor Relations Office of the National Treasury)
  
  - In 2011, both Brazilian IROs scored 38 points on the IIF prioritized criteria, continuing Brazil's leadership in this area
  
  - The quality of Brazil's practices is well-regarded by investors. Regarding these practices, it can be highlighted: Staff reachable through website, reciprocal links between government agencies and investors able to register for website subscription

*For additional information access the National Treasury website:*

[www.tesouro.fazenda.gov.br](http://www.tesouro.fazenda.gov.br)

*Or contact Institutional Relations area:*

[brazildebt@fazenda.gov.br](mailto:brazildebt@fazenda.gov.br)

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# ANNEX

## Fiscal Agenda in Congress

### *Law Proposals*

- » Gradual reduction in value-added tax (ICMS) over imported goods to 2% until 2015, opening space to a commensurate increase in the rate on where the good is consumed. This would materially reduce Brazil's so-called "fiscal war".
- » Regulation of Constitutional Amendment nº 29, which would impose a minimum limit for health expenditure to Central Government, States and Municipalities.

## A steady level of public external debt with improved profile

### *Impact of the “Cleaning Up” on the Federal Government External Debt*

	(US\$ bn)
Operations	Face Value <sup>1</sup>
<b>External Public Debt in Bonds</b>	<b>28.1</b>
C-Bond call (Oct-05)	1.1
Brady Bonds call (Apr-06)	6.5
Tender Offer (Jun-06)	1.3
Buyback Program <sup>2</sup>	19.2
2006	6.0
2007	5.4
2008	1.2
2009	1.1
2010	3.2
2011	2.3
<b>Contractual Debt</b>	<b>28.8</b>
IMF early payment I (Jul-05)	4.9
IMF early payment II (Dec-05)	15.5
Paris Club early payment (Jan-06 <sup>3</sup> )	1.7
IDB early payment (Dec-09)	0.87
World Bank early payment (Jun/Oct - 11)	5.9
<b>Total</b>	<b>56.9</b>

<sup>1</sup> Captures the impact of the operations on the outstanding public debt.

<sup>2</sup> The Program started in 2006. Between 2006 and 2011, R\$ 19.2 billion in securities were repurchased, at face value.

<sup>3</sup> Announcement