Debt Report
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External Federal Public Debt

INTRODUCTION

Launching of the Brady Plan in the mid-90s not only put an end to the long and arduous process of renegotiating the Brazilian external debt and that of other developing countries hard hit by the sudden and abrupt reduction in international liquidity toward the end of the 1970s, but also created conditions for Brazil to recommence regular international market issuances.

Based on this plan, the country issued nine relatively long-term securities with an overall financial volume of approximately US$ 50 billion and good liquidity to be freely negotiated on the international secondary market. In this way, Brazil managed to create a highly active secondary external debt securities market, with one of the highest trading volumes of all the emerging nations. For example, the C-bond, one of the securities issued by the country in the framework of that plan, had the highest liquidity level among emerging market issuances until it was entirely withdrawn from the market in 2005.

Reinforced by the large volume of FX that entered the country following implementation of the Real Plan in 1994, this scenario allowed for greater flexibility in external market financing, since those responsible for data management had greater freedom in choosing the best combinations of maturity, cost and market for these funding operations. With its newly gained autonomy, Brazil was able to remain active on the external market, even in the midst of the successive international crises (Mexico, Asia, Russia and Argentina) that broke out during those years.

Nonetheless, Brazilian external debt policy only reached full maturity with normalization of the world economic scene. Starting in 2006, significant advances in External Federal Public Debt – EFPD management, backed by continued implementation of a consistent economic policy, made it possible for Brazil to shift the focal point of its external market activity away from public debt financing toward a maturity structure based on the consolidation of benchmarks with enhanced liquidity and lower funding costs, designed to serve as a foundation for the external financing of the Brazilian private sector.

To a great extent, these advances resulted from the National Treasury's decision to adopt the best international debt management practices, a step that produced consolidation of an organizational structure that was, on the one hand, efficient in its use of the management instruments required for steady improvement in external financing conditions, at the same time in which it was capable of instilling transparency into public debt operations, a factor considered indispensable to construction of a broad and diversified investors base.

This report[1] seeks to detail improvements in external debt management directly linked to the management strategy adopted by the National Treasury, together with recent evidence of improvement in the performance of Brazilian assets, considered by market agents as representative of a structural and substantive change that rivals other groups of issuers traditionally considered as low credit risk. The text is organized as follows: section 1 discusses institutional advances, section 2 deals with the instruments used in managing the public debt and section 3 reports on the results obtained.

1 - INSTITUTIONAL ADVANCES

According to the best international practices, transparency and predictability are stimulated mainly by the existence of well-defined legal and institutional frameworks, by opportune providing of information on the activities of institutions (before and after measures are taken) and consistent financing policy procedures, including compliance with predetermined targets. These aspects have been closely observed in Brazil and have achieved consolidation in recent years.

Legal Foundations

As regards the legal framework, one should stress that the Ministry of Finance is charged with Federal Public Debt - FPD management, while the National Treasury Secretariat - STN is the entity within the Ministry responsible for "managing the internal and external public security and contractual debts for which the National Treasury is directly and indirectly responsible".

In the case of the external debt, this definition of responsibility resulted from agreements dealing with debt restructuring in the framework of the Brady Plan in the early 1990s, and is expressed in various decrees that have defined the legal structure of the Ministry of Finance and its secretariats over the years, starting with Decree no. 1,745, dated 12/13/95, up to and including Decree no. 7,050, dated 12/23/2009.

The Central Bank, which had been responsible for external liabilities up to that time, became an agent of the National Treasury in external market security issuances. Following a transition period negotiated between the two institutions and terminated in 2005, the Treasury assumed all activities related to management of the Brazilian external securities debt. Since then, all management of the FPD has been concentrated in a single institution, as is recommended by the best international practices.

In its turn, debt policy is defined on the basis of five legal instruments: the Federal Constitution of Brazil, which sets out general guidelines for the public debt, giving authority to the Federal Senate to authorize external operations of a financial nature of interest to the federal government, states, Federal District, territories and municipalities; the Fiscal Responsibility Act, which defines rules on public finance focused on

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[1] Much of this report was taken from the book "Pubic Debt: The Brazilian Experience", published by the National Treasury Secretariat in 2009 in a partnership with the World Bank. The book is available for consultation through the link: http://www.tesouro.fazenda.gov.br/divida_publica/livro_divida.asp

responsible fiscal management, while also setting down certain limits on the Federal Public Debt; Law no. 10,179/2001, which deals with federal public securities for which the National Treasury is liable; the Budget Guidelines Law - LDO; and the Annual Budget Law - LOA. Aside from this, the general characteristics and issuance systems of federal public securities were consolidated into a single legal instrument (Decree no. 3,540, dated July 11, 2000). In the specific case of the EFPD, mention should also be made of a more recent Federal Senate Resolution (no. 20/2004), which authorized the National Treasury to issue a volume of up to US$ 75 billion in securities and carry out anticipated buyback operations, exchange bonds, as well as utilize derivatives for debt management purposes. Previously, the latter operations had been prohibited to the Republic.

Institutional Organization

With respect to institutional organization, the STN sector charged with public debt management was profoundly altered with the objective of incorporating a Debt Management Office (DMO), that would divide management responsibilities into three distinct areas in line with the best international practices: Front-office, responsible for domestic and external market operations with teams trained to monitor markets and formulate short-term strategies; Middle-office, which takes care of medium and long-term planning and risk management; and Back-Office, charged with accounting records, debt payments and statistics. This structure made it possible to clearly define the responsibilities of each area, while guaranteeing greater integration between the activities of internal and external debt management, segregating departments by functions and eliminating repetition of identical tasks. Furthermore, this structure brought strategic planning and risk management closer together in the daily activities of Brazilian debt management.

From this point of view, it is important to stress the creation of the Investor Relations Management Staff which, in the case of the National Treasury, was given not only the traditional task of communication with the market aimed at reducing information asymmetries and achieving better asset pricing, together with responsibility for expanding and diversifying the investor base. As a consequence of this activity in the framework of medium and long-term debt strategy, management responsibility was allocated institutionally in the middle-office and not in the front-office or as an independent area, as exists in other debt departments.

As a result of this allocation, the area of investor relations focused more on structural questions than on daily communications, as would normally be expected. With this, the framework for these operations was less concentrated on the short-term and more focused on the objectives of Federal Public Debt management guidelines.

Consistency and Transparency of Financing Policy

Efficient providing of information on Treasury activities is well structured, with periodic releases of complementary documents with varied levels of detail. In the case of the external debt, emphasis should be

given to the following: the Annual Borrowing Plan – ABP; the Annual Debt Report – ADR; and Sovereign Issuance Bulletins.

The ABP sets out very clear guidelines, together with the targets to be reached during the course of the year in the area of internal and external public debt management. In 2010, the ABP completed 10 years of existence and is considered by the market as a prospective guide for the National Treasury's management of the Federal Public Debt. The ADR is a rendering of accounts to investors and to society based on a comparison between the guidelines set down in the ABP and the results effectively obtained. In their turn, the bulletins provide information on the characteristics of each external issuance made by the Treasury, accompanied by various types of data on each operation, such as yields and final spreads.

This report is complemented by the National Treasury's efforts to maintain permanent contact with both resident and nonresident investors, financial market entities, and representatives of other countries and multilateral organizations, as well as the specialized media. In this framework, there is a permanent system of presentations for investors, road-shows, conference calls[2], both inside and outside Brazil, designed to maintain an open channel of communication with the various market agents and, at the same time, disseminate precise and updated information on the Brazilian public securities market, while also learning about the difficulties and needs felt by investors.

The advantages of adopting a policy of transparency are reflected in lesser market uncertainties regarding the objectives of debt management policy and the consistency of political decisions taken in relation to these objectives. Evidently, this approach can result in lesser market volatility and risk premiums demanded by investors[3]. When data management policy targets and instruments are known to the public and the authorities are committed to them, the effectiveness of debt management is greatly reinforced.

2 - ACTIVE EXTERNAL DEBT MANAGEMENT

In recent years, the National Treasury has concentrated its efforts on fostering issuances and reopenings of securities with benchmark maturities (10 and 30 years) on the global market, with the objective of developing the Brazilian government bonds yield curve. This strategy is designed to ensure enhanced liquidity to securities that are well received on the secondary market and, in this way, increase efficiency and lower spreads between purchase and sale prices.

This effort has been complemented by liability management operations, making it possible to reduce refinancing risk at specific points on the curve, obtain net gains at current value (NPV savings) or simply increase efficiency in the yield curve, with withdrawal or substitution of securities with high coupons issued

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[2] In 2009, the National Treasury participated in at least 15 international events sponsored by such world renowned institutions as the IDB, LAC DEBT Group, the IMF, the World Bank, Unctad and the OECD, among others.

[3] A great deal of literature is available dealing with the practical effects of transparency on cost reductions. See Bauman and Nier (2004); Mendes-da-Silva and de Lira (2004); Bushman and Smith (2001).

to the market in periods in which financing conditions were not as favorable as now. These operations are effected through tender-offers, exchange-offers, as well as simple buyback operations or together with new issuances.

LM Operations Connected to the External Securities Debt

In Brazil, the LM operations carried out in the last two decades can be divided into three groups. The first was precisely restructuring of the external debt, concluded in 1994 in the framework of the Brady Plan, in which the entire previously existent external debt was restructured into nine securities.

Table 1 - Securities issued in the Brady Plan framework

Debt Restructuring – Brady Plan		
Instrument	Amount Issued (US$ billion)	Maturity Date
BIB or Exit Bond	1.06	9/15/2013
IDU (Interest Due and Unpaid)	7.13	1/1/2001
Discount bond	7.28	4/15/2004
Par bond	8.45	4/15/2004
Flirb (Front-Loaded Interest Reduction Bond)	1.74	4/15/2009
C-Bond	7.41	4/15/2014
DCB (Debt Conversion Bond)	8.49	4/15/2012
New Money Bond	2.24	4/15/2009
EI (Eligible Interest Bond)	5.63	4/15/2006

In contrast to the restructured debt, securities issued after 1994 were part of the so-called sovereign debt. Since Brady-type securities bore the stigma of being the result of a renegotiation process, their rates normally surpassed what is considered a fair curve in which only sovereign securities were included.
This situation provoked a new stage of LM operations, this time with the objective of exchanging the securities that had originated in the renegotiation process for sovereign bonds. Over the course of 2005, the comfortable level of international reserves accumulated at the Central Bank made it possible for the National Treasury to withdraw the entire stock of C-Bonds then on the market. In the month of August, an auction was held to exchange approximately 80% of C-Bonds, or US$ 4.5 billion, for A-Bonds. In October, the remaining stock estimated at US$ 1.1 billion was redeemed through buyback operations foreseen in the respective prospectus.

The National Treasury completed the process of external debt renewal on April 18, 2006, when it exercised its right to call the remaining stock of Brady bonds on the market at par value. Approximately US$ 6.6

billion in securities were redeemed, including US$ 5.8 billion through purchases of reserves. With this operation, the National Treasury not only achieved its objective of improving the external debt profile, but also guaranteed gains of approximately US$ 344 million at Net Present Value.

Once distortions in the curve caused by securities originated in the restructuring process had been eliminated, the third group of LM operations was initiated in 2006 with the aim of reducing the refinancing risk – considered quite high in some years – and increasing the efficiency of the curve.
In this context, it is important to initially highlight the Tender Offer operation, consisting of a public offer to purchase EFPD securities denominated in dollars and euros. The operation made it possible to complete anticipated redemption of approximately US$ 1.3 billion at face value, referring to 20 sovereign bonds scheduled to mature between 2007 and 2030.

After that, an Exchange Offer operation was carried out, consisting of the exchange of external debt securities denominated in dollars and maturing in 2020, 2024, 2027 and 2030, for securities maturing in 2037. In that operation, approximately US$ 500 million in securities at face value were exchanged.

Finally, one should also stress launching of the Buyback Program, involving External Federal Public Debt Securities – DPMFe, which was initially designed to repurchase securities maturing up to 2010, including Globals, Euros and Samurais, and restructured debt securities known as Bradies. Later on, maturities up to 2012 were incorporated into the stock of bonds to be redeemed. In 2006, the repurchased value came to US$ 7.1 billion in financial value (US$6.1 billion at face value), reflecting withdrawal from the market of approximately one-third of the stock of Globals and 15% of the securities denominated in euro and maturing between 2007 and 2012. This program has been implemented by the National Treasury in recent years, as demonstrated by the 2009 result of approximately US$ 19.7 billion at face value.

LM Operations Connected to the External Contractual Debt

One should also emphasize that these LM operations were not restricted to the securities debt. In 2006, the National Treasury followed the example of the Central Bank, which had announced anticipated payment-in-full of its obligations with the IMF in the previous year, and took steps to improve the profile of the Federal External Contractual Public Debt – EFPCD, making anticipated payment of commitments assumed with the Paris Club as a consequence of external debt renegotiation agreements formalized between 1983 and 1992.

Over the course of 2009, the Treasury carried out two other operations of this type: change of characteristics of part of the debt with multilateral organizations (World Bank – IBRD and the Inter-American Development Bank – IDB) in July, coupled with pre-payment of part of the federal government debt with the IBRD in December.

Debt exchange operations resulted in reductions in interest rates and greater predictability in the indexing factors applied to that debt. Renegotiation of operations carried out with the IBRD became possible as a result of a contractual amendment proposed by that institution, suggesting conversion of the interest rates agreed upon in the original contracts into a fixed interest rate. As regards the contracts formalized with the IDB, a similar procedure was adopted. That institution also suggested the possibility of a contractual amendment, which would make it possible to convert the agreed-upon interest rates into fixed rates and, when applicable, conversion of principal into United States dollars.

Once it had been decided that renegotiation based on the aforementioned model was opportune, the National Treasury opted for conversion of the contracts, making it possible to achieve a considerable reduction in the costs built into the current value of those instruments, coupled with lessening of the market risk of these operations, resulting in enhanced predictability and transparency in these loans. Taken together, the operations generated an interest savings estimated at US$ 77.56 million.

With regard to pre-payment of part of the federal government debt with the IBRD, the choice of contracts gave consideration to average maturities, the financial risks of the contractual modalities and financial gains for the Republic. The contracts selected were those that generated positive financial results at pre-payment with lesser average maturities, considering the objectives of lengthening public debt maturities and reducing refinancing risk. The contracts chosen for pre-payment totaled approximately US$ 870 million, including contracts with fixed margins, variable margins and baskets of currencies. Pre-payment of part of the debt with the World Bank not only reduced refinancing risk, since new issuances had longer average maturities than pre-paid securities, thus representing a savings of US$ 16.3 million in interest payments.

These gains became possible by the fact that the National Treasury possessed a dedicated team charged with permanently monitoring the market and evaluating opportunities for gains at lesser cost and risk, through utilization of structured operations aligned with the guidelines defined for EFPD management.

External Issuances in BRLs

Aside from consolidation of debt benchmarks in American dollars, the National Treasury took advantage of the enhanced synergy between internal and external debt management and opted to create a yield curve in BRL on the external market, which would be complementary to the fixed domestic market curve.

In September 2005, when the fixed rate security with the longest maturity issued on the domestic market was seven years (NTN-F 2012), the Treasury issued the Global BRL 2016 bond on the international market. This was the first security based on the yield curve in BRL on the external market. Later on, two more issuances in BRL were made, Global BRL 2022 and 2028, in 2006 and 2007, respectively.

Aside from demonstrating the credibility of national economic policy, financing in local currency reduces debt volatility when facing external shocks, since it is devoid of FX risk. Up to that time, Brazilian external

issuances always bore the weight of what is commonly called “original sin”, since they were carried out exclusively in foreign currency and, consequently, their costs increased sharply in moments of financial turbulence, when international liquidity was low, national currency was subject to sharp devaluation and investors had shown themselves to be more resistant to high-risk applications, particularly in emerging countries.

At the same time, one could cite the fact that the benefits obtained by the National Treasury were not limited to the public sector, since sovereign operations create price and volume references for private corporate issuances. This can be demonstrated through data on issuances made by the private sector both before and after the Republic began operating on the international market in BRL in September 2005. From December 2004 through July 2005, private issuances in BRL posted an average of only about R$ 180 million and were restricted to the banking sector. From September 2005 to July 2007, these operations reached an average volume in the range of R$ 364 million and had the participation of companies from other sectors of the economy, including CESP, AMBEV and RBS[4].

Anticipated Foreign Currency Purchases

Finally, among the debt management tools adopted by the National Treasury, it is important to highlight the policy of anticipated purchases of foreign resources. The Treasury normally utilizes its prerogative of anticipated acquisition of the volume of foreign currency required to make all external debt payments forecast for a given year in order to avoid the volatility inherent to the exchange market, while fleeing from the need for acquiring exchange in the midst of turbulence when costs will certainly be higher[5]. The case of 2009 is a good example, as the Treasury acquired approximately US$ 5.6 billion, enough to pay approximately 73% of the entire external debt due to mature in 2010.

3 - RESULTS

Backed by the macroeconomic equilibrium achieved by the country in recent years, efforts made to improve management have generated significant advances in EFPD indicators. These improvements range from a broader and more diversified investor base, to a more efficient external debt profile and reductions in the costs and spreads of new issuances.

Investor Base

Diversification of the investor base makes sense not only from the point of view of risk management and portfolio diversification, but also as an instrument for achieving a balanced allocation of debts among the various types of investors. If, on the one hand, the participation of long-term investors, such as dedicated

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[4] Source: bondradar.com

[5] In March 2010, the central bank issued Circular no. 3,493, expanding the period allowed for settling exchange operations formalized by the National Treasury Secretariat from 360 to 750 days.

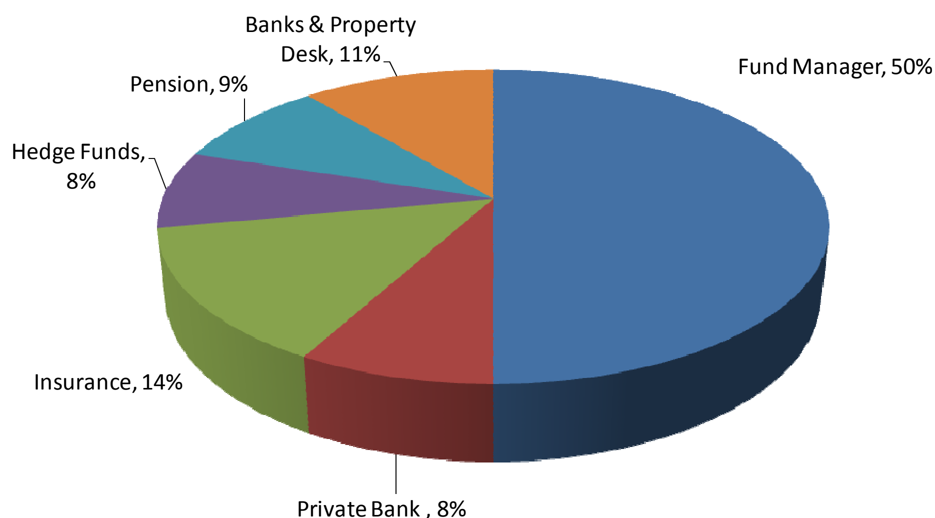
funds and insurance companies, contributes to lesser secondary market volatility, thus benefiting performance, the participation of investors with a short-term profile, on the other hand, such as hedge funds, contributes to liquidity.

Thus, a more diversified investor base guarantees that securities will have a more appropriate combination of liquidity and performance. Aside from this, it also clearly contributes to cost reductions and market demand stability. A heterogeneous base, with various maturity horizons, risk preferences and motivations generates both market activity and liquidity. Even liquid markets can temporarily suffer from stress, when abrupt movements occur in certain market segments and are not offset by other investor groups[6].

Soon after renegotiation of the external debt was concluded in 1994, Brazil sought to diversify its base by issuing securities in a variety of currencies (Japanese yen, German mark, Portuguese escudos, Dutch florins, Austrian shillings, Italian lira and American dollars). Currently, the country achieves this objective through issuances of its benchmarks on the global market in local currency and in American dollars, and on the euro market.

The most recent Brazilian issuance abroad – opening the Global 2019 Bond last April – clearly illustrates this new phase of Brazilian issuances. This operation was marked by a good investor profile, both in relation to its area of impact, and in geographic terms, as shown in the following graphs.

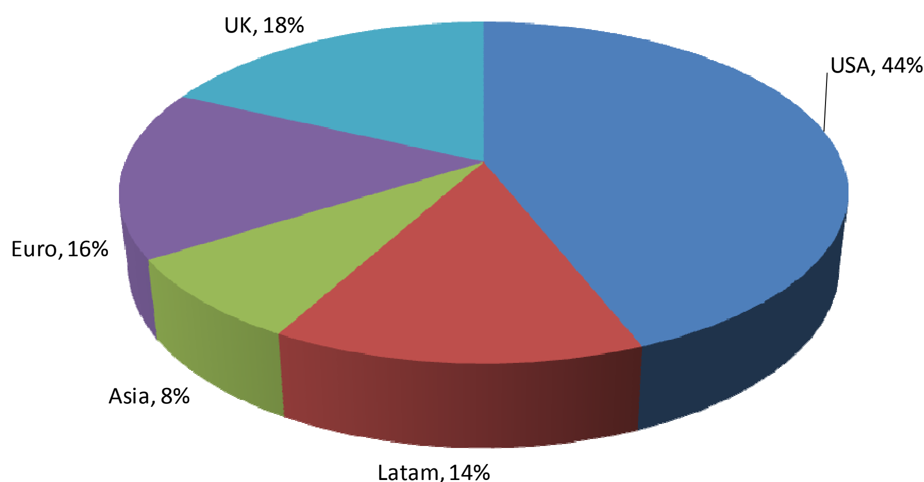
Graph 1 –Global 2021 Opening
Allocation per Investor's Type – Apr/2010



[6] For greater detail, see World Bank in the IMF (2001) – Developing Government Bonds Market – Handbook.

Graph 2 –Global 2021 Opening

Geographic Allocation – Apr/2010



A major step in this process occurred when the largest international risk rating agencies granted an investment grade rating to Brazil, since this allow investors with longer-term profiles, such as pension funds and sovereign funds, to include Brazilian securities in their portfolios. It is worth mentioning that part of the market had already anticipated the impact of this event and broadened its interest in Brazilian assets.

From the viewpoint of geographic diversity, one should highlight the increased participation of countries from the East, such as Singapore, Japan, China and Hong Kong, and from the Persian Gulf region, such as Dubai and Kuwait, which are considered more conservative. Besides that, a significant European and US based investors, originally dedicated to high grade, increased their presence in the Republic´s operations.

On the one hand, this occurred as a result of the investor relations policies adopted by the national Treasury, which had made a concentrated effort to disseminate information in those markets on the characteristics and conditions of the country since 2004. On the other hand, starting in 2006, the change in the mechanism for making these issuances became particularly important, since it was aimed at expanding the investor base in Asia. Given the difference in time zones between the American, European and Asian markets, Brazil has announced issuances at the opening of the New York market, reserving the right to reopen the security later on when the Asian market comes on line. The reopening is limited to a volume equivalent to a maximum of 10% of the original issuance. This is known as the Green Shoe strategy and has been quite successful, as evinced by consistent growth of Asian investors in primary market operations.

It is important to stress that some of these investors create positions in Brazilian external debt as the first step in investing their resources on the domestic market, which has considerable liquidity and volume in the fixed rate and inflation-linked segments[7].

External Debt Profile

Following a strategy of adjusting the external borrowing interest curve, with withdrawal of inefficient securities from the market (above the curve) in the benefit of those considered as benchmarks, coupled with renegotiation and anticipated payment of the contractual debt, liability management operations provoked significant improvement in the EFPD profile.

Since 2005, when the National Treasury assumed full responsibility for external debt operations, the institution has operated intensively on the market, as is revealed in the chart below. The operations related to the Brady Bonds were deemed to withdraw the securities related to the distant and troubled past on the external debt side during the 80´s and 90´s.

Table 2 – Liability Management Operations

LIABILITY MANAGEMENT OPERATIONS - 2005 / 2006	**US$ Billion**
C-Bond Call (Oct-2005)	1.1
Buyback Program (Jan to Dec 2006)	6.1
Brady Bonds Call (Apr-2006)	6.5
Tender Offer (Jun-2006)	1.3
Contractual Debt	**1.7**
Payment to Paris Club (Jan-06)	1.7

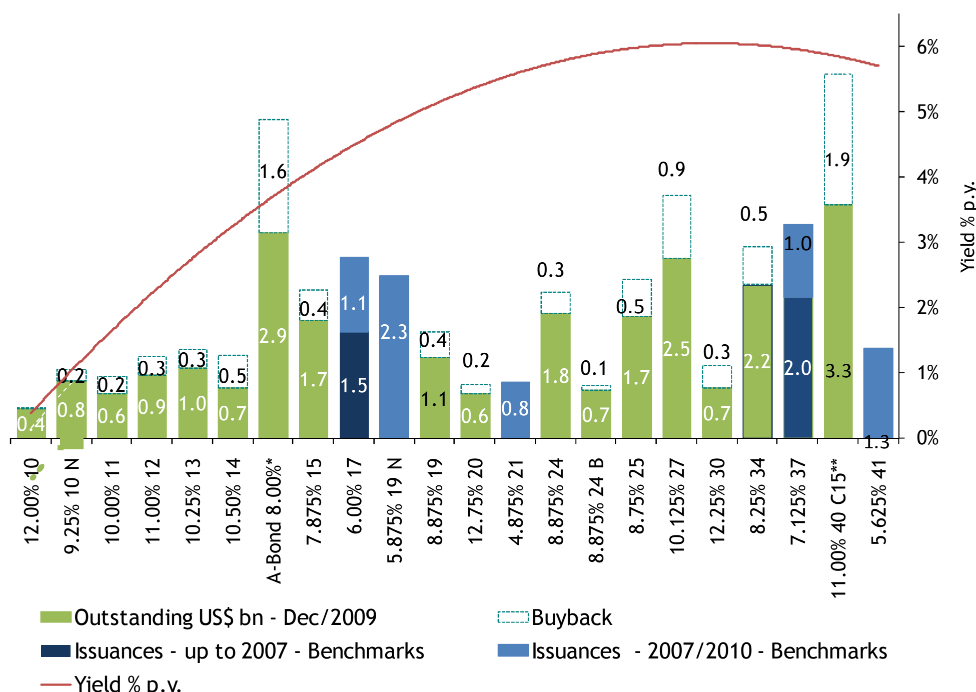
When added to the anticipated payments made to the IMF by the Central Bank in 2005, these operations represented a reduction of US$ 37.1 billion in the outstanding Brazilian external debt.

In the period extending between 2007 and 2009, this process continued with repurchase of approximately US$ 13.6 billion at face value involving securities not considered as benchmarks. More specifically, in 2009 the overall volume repurchased came to US$ 1.075 billion at face value (US$ 1.377 in financial value).

Considering only repurchases since January 2007, the reduction in the flow of interest to be paid by 2041 came to a total of US$ 16.67 billion at current values. The impact of the Buyback Program on outstanding EFSD(external Federal Public Securities Debt) since 2007 is shown below, together with concentration of issuances at benchmarks:

[7] The domestic debt (known as the Domestic Federal Public Debt – DFPD) accounts for approximately 92% of the total public debt.

Graph 3 – Result of the Strategy Adopted for the External Securities Debt between 2007 and 2010

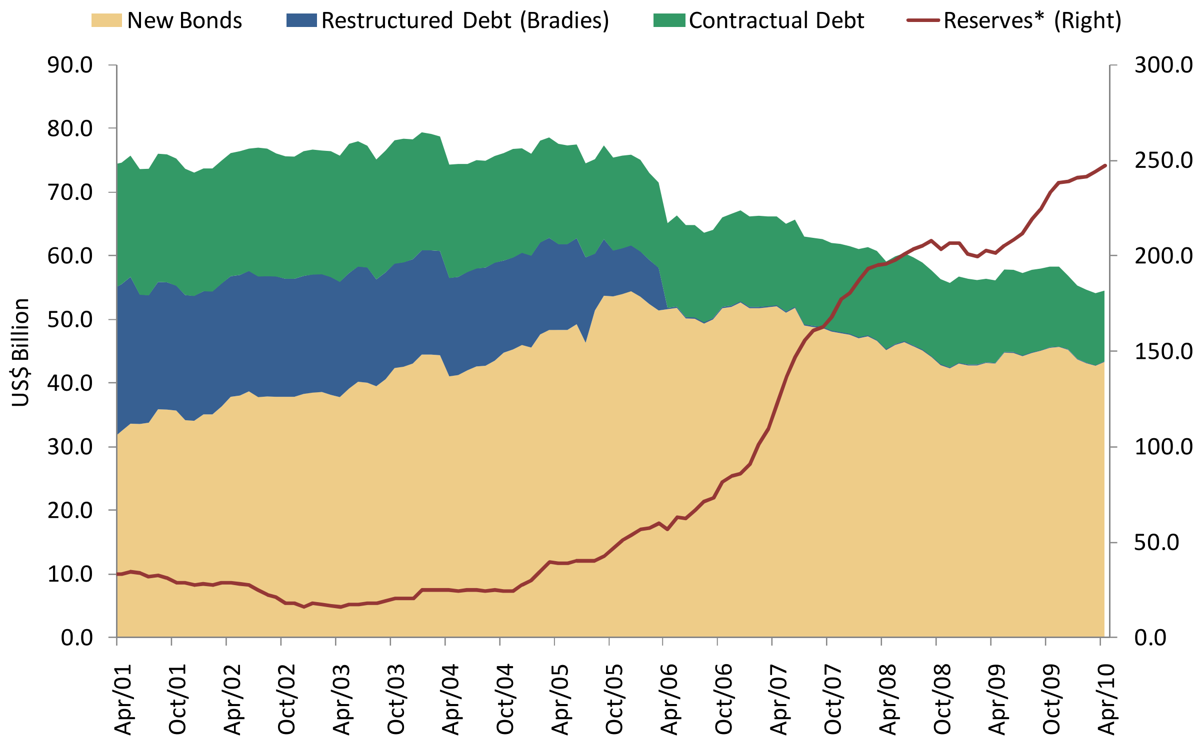


The Buyback Program aids in obtaining a more efficient interest rate structure representative of gains in economic fundamentals and the public debt profile, while allowing for withdrawal from the market of securities issued at adverse moments.

Clear definition of the benchmarks, in turn, not only increases the liquidity of these securities, but also facilitates access on the part of Brazilian companies to the international market, since it creates maturity and cost benchmarks for their own issuances.

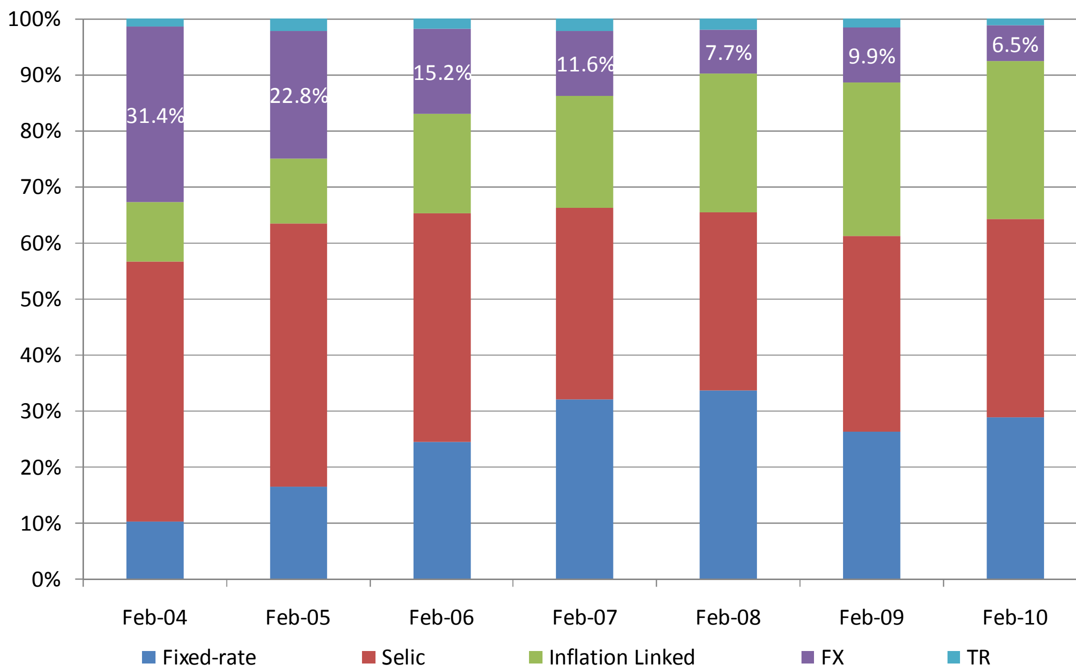
Parallel to this, one should mention that reductions in outstanding EFPD reduce refinancing risk, as a result of lesser exchange exposure and cutbacks in the share of the debt scheduled to mature over the short term. This strategy accompanied by the Central Bank's policy of accumulating reserves made it possible for Brazil to raise its reserve position to a level sufficient to pay off the totality of the EFPD held by the public as early as 2006 (see following graph).

Graph 4 – Evolution of Outstanding EFPD x International Reserves



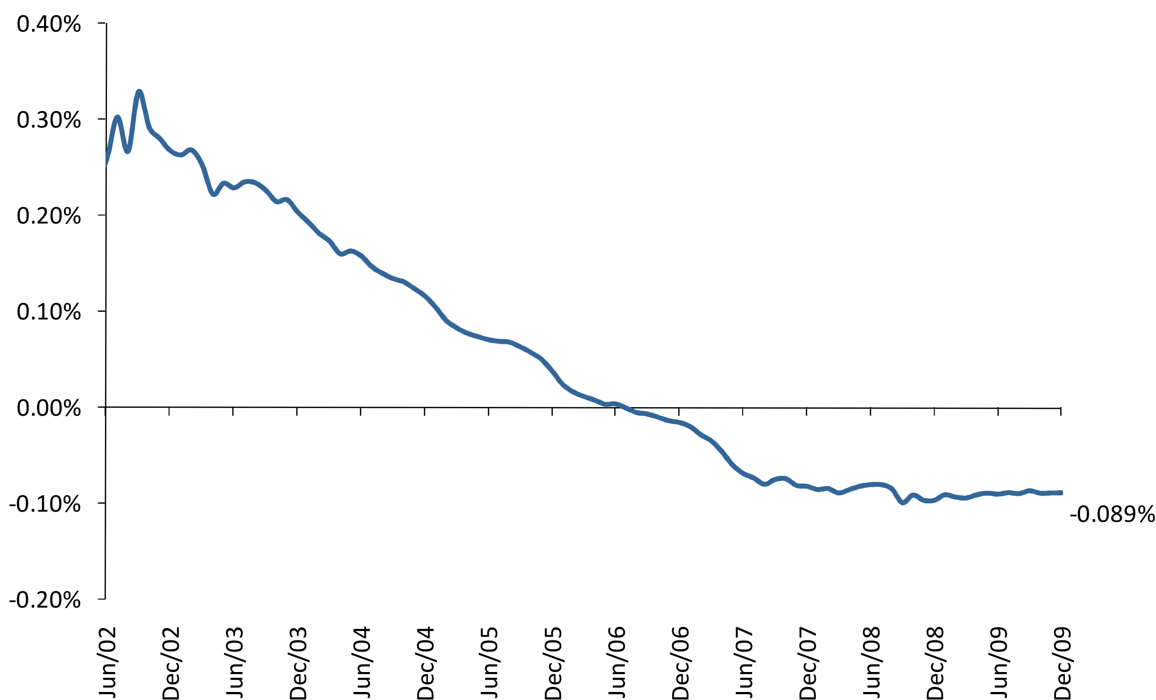
This advance can also be corroborated on observing the evolution of the FPD profile, as shown in the following graph. The share of the FX-linked debt, which stood at more than 30% in 2004, now corresponds to less than 6.5% of the total.

Graph 5 - Evolution of the DPS Profile



With this, public debt FX risk no longer stood as a hindrance to sustainable economic growth, since exchange devaluations that had previously forced the government to adopt restrictive measures to be able to meet its obligations, now generate a positive impact on the nation's indebtedness.

Graph 6 – Impact of 1% Exchange Devaluation on NPSD/GDP

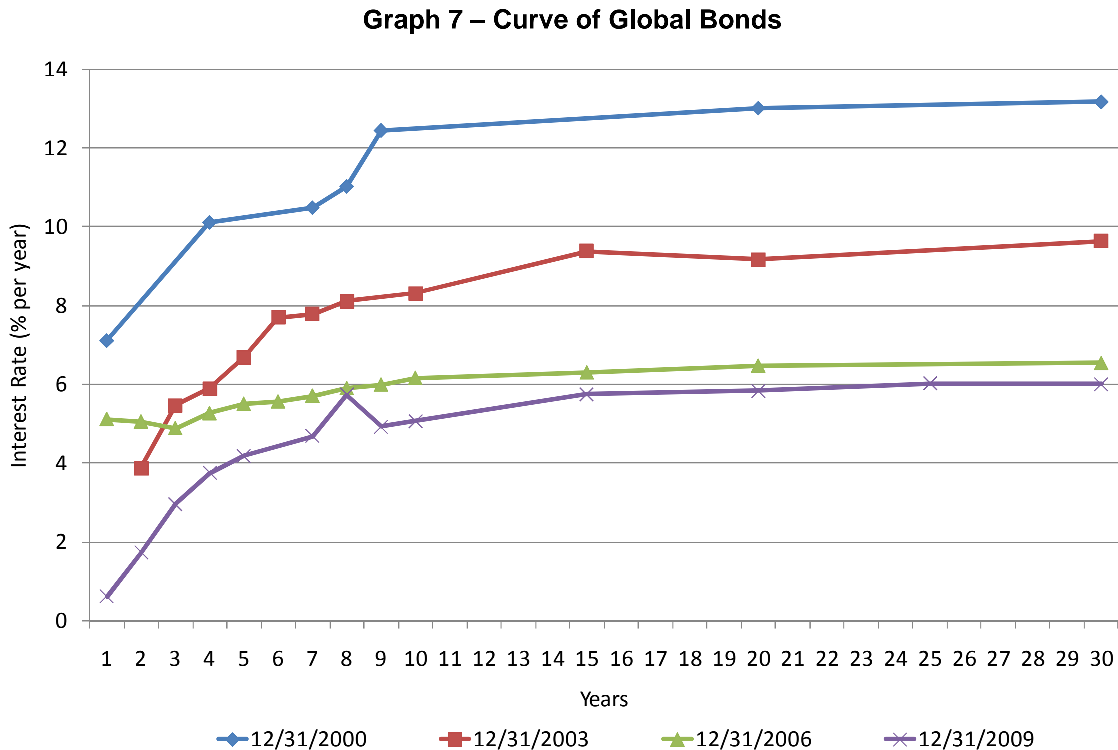


Taken together, these measures contribute to reducing country risk, as reflected in better financing conditions, maturities and costs, for both the public and private sectors.

Costs and Spreads

Demonstrating what was stated in the previous item, the forward structure of the Brazilian external debt has shown undeniable evolution, with reduction of the rates charged by investors at all points along the curve in recent years.

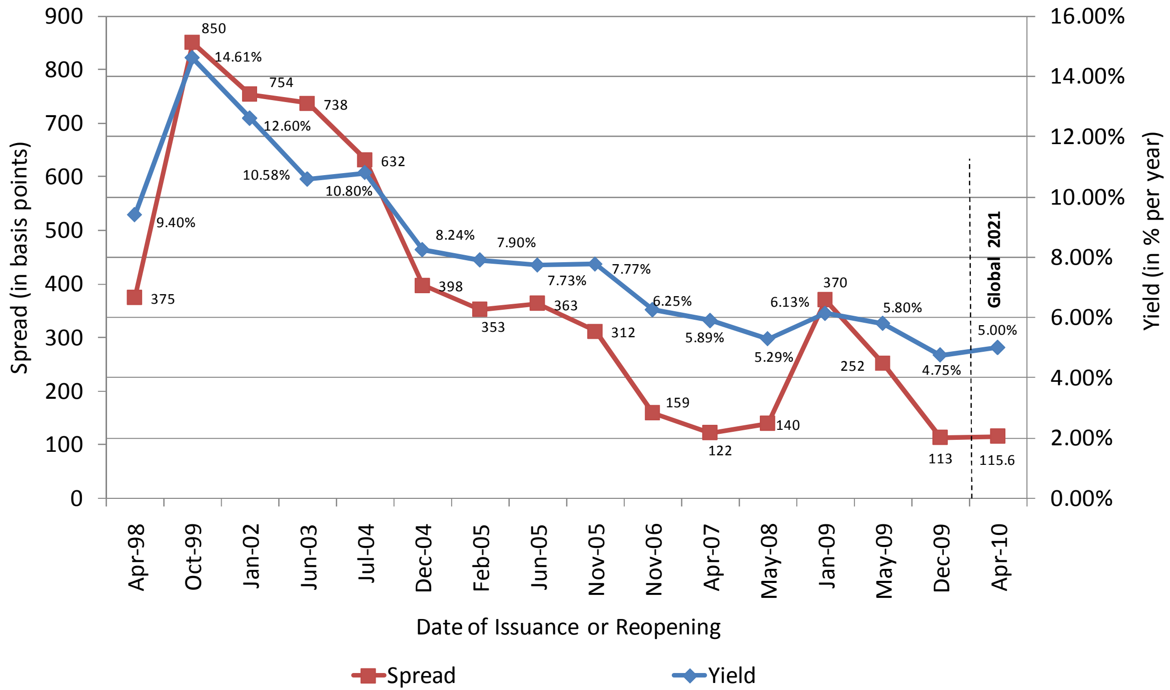
Graph 7 – Curve of Global Bonds



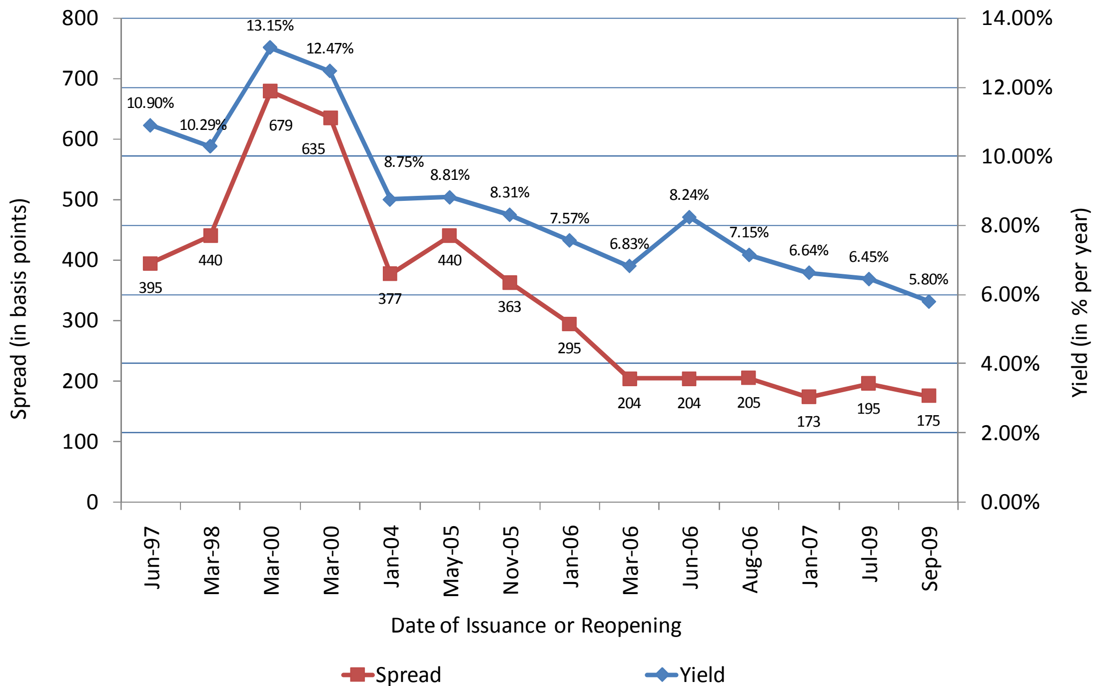
Focusing the analysis on securities used as 10 and 30-year Global Bond benchmarks, the following two graphs indicate a clearly downward trend in their funding costs, represented by the values of their spreads[8] and yields registered at issuance. One should note that more recent issuances of these two benchmarks obtained the lowest interest rates ever paid for Brazilian securities with corresponding maturities. The recent launch of the new 10y benchmark (GBL 2021) was as clear sign of the new Brazilian financing conditions as that security embedded the lowest coupon rate ever for the Republic.

[8] Spreads on American Treasury bonds (Treasuries) with identical maturities.

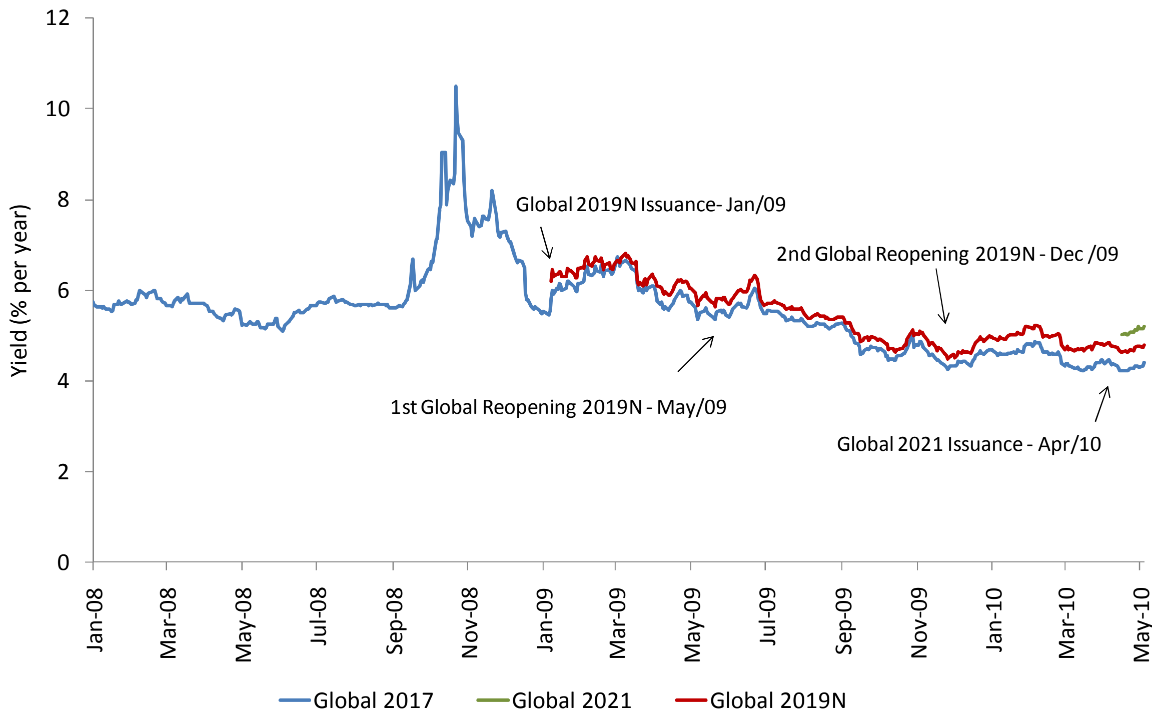
Graph 8 – Global 10 years –Spreads and Yields



Graph 9 – Global 30 years – Spreads and Yields



Considering the secondary market for these securities, the following graphs show that the turbulence registered at the apex of the 2008 crisis was rapidly overcome, as interest rates returned to their normal levels in 2009.



It is important to stress that the accentuated movements shown in the two graphs in the second half of 2008 where not restricted to Brazilian assets. All over the world, a spectacular process of leverage reductions and dismounting of investment positions occurred in various classes of assets, including fixed yield and

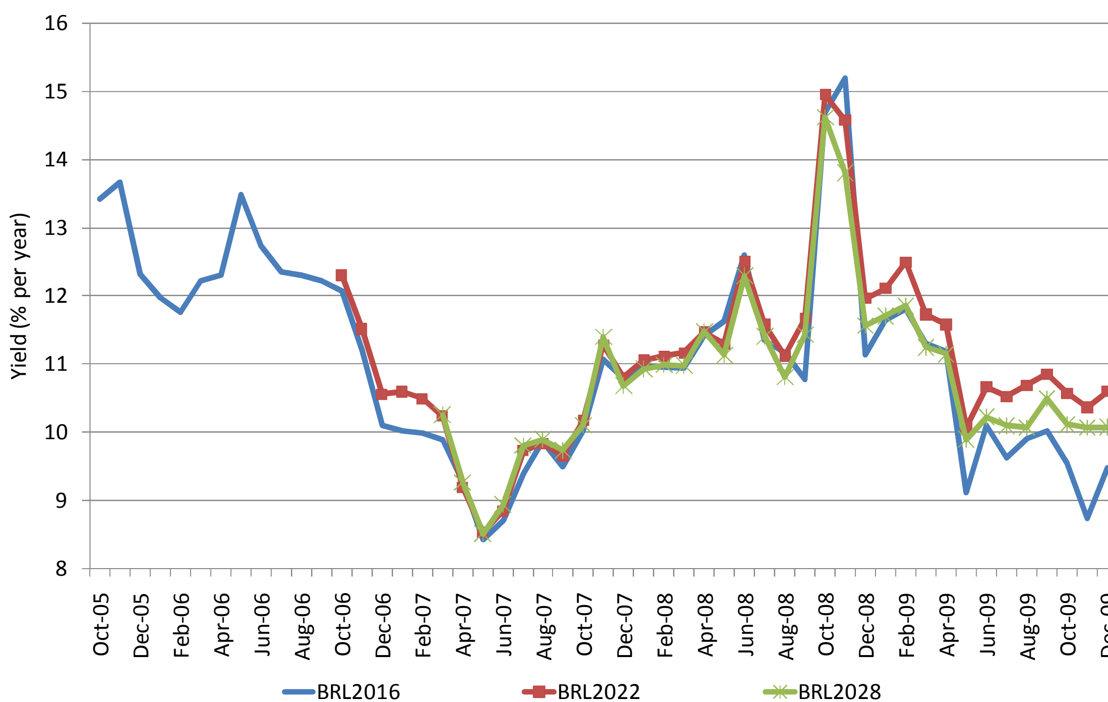
variable yield instruments, as well as in currency positions, mainly as a consequence of events following in the wake of the Lehman Brothers bankruptcy in the United States.

Analysis of variations in 5-year CDS - Credit Default Swap[9] - of various emerging economies, as shown in the next item of this report under Graph 13, demonstrates not only the generalized impact of the crisis, but also makes it clear that the impact on Brazilian securities was relatively less severe.

Issuances in BRL

In much the same way as securities issued in dollars, the Global BRL also recovered sharply in the wake of the crisis and continued being negotiated at rates below those registered when they were issued:

Graph 12 - Global BRL Yields



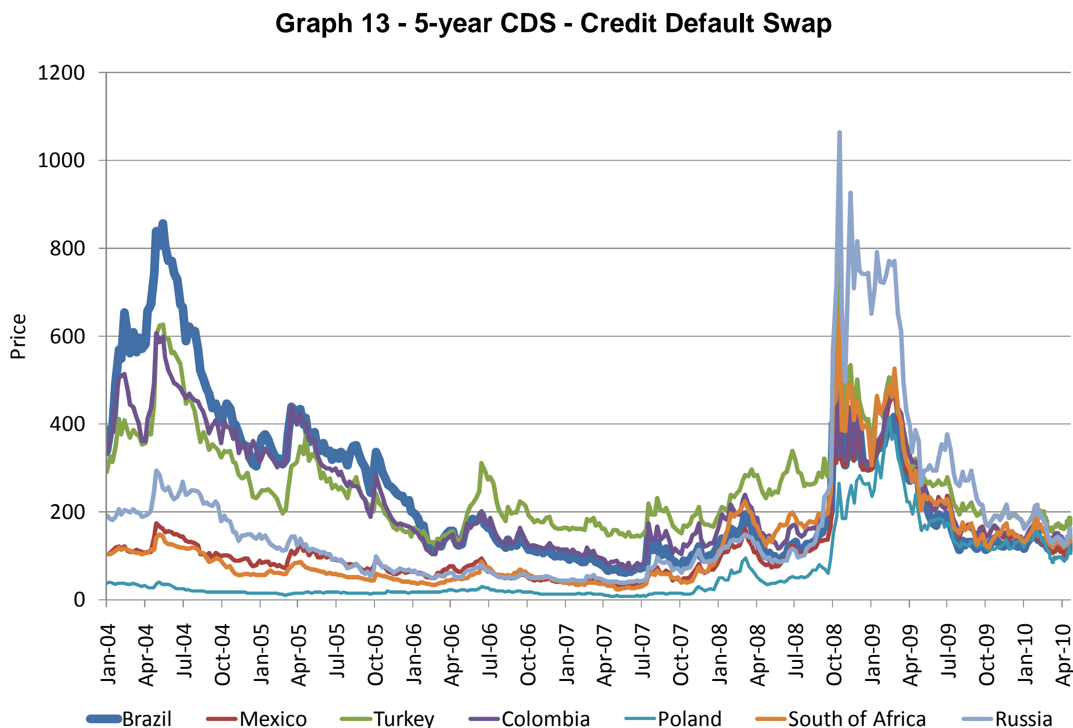
[9] CDS are derivatives commonly used to express investor perceptions of security risk and function as a type of insurance against possible default on the part of issuers. The CDS rate would correspond to the insurance premium charged by the market, in such a way that the greater the risk associated to the issuer, the higher will be the rates charged for these derivatives.

Relative Position

Compared to the country's own history, the evolution evinced in its macroeconomic fundamentals and external debt indicators can be corroborated when compared to other countries at similar stages of development.

Considering the already mentioned analysis of 5-year CDS, the following graph shows that Brazil occupies a privileged position, clearly leaving behind the high risk position that had marked mid-2004, to become the issuing country with the lowest risk perception among the countries analyzed[10]:

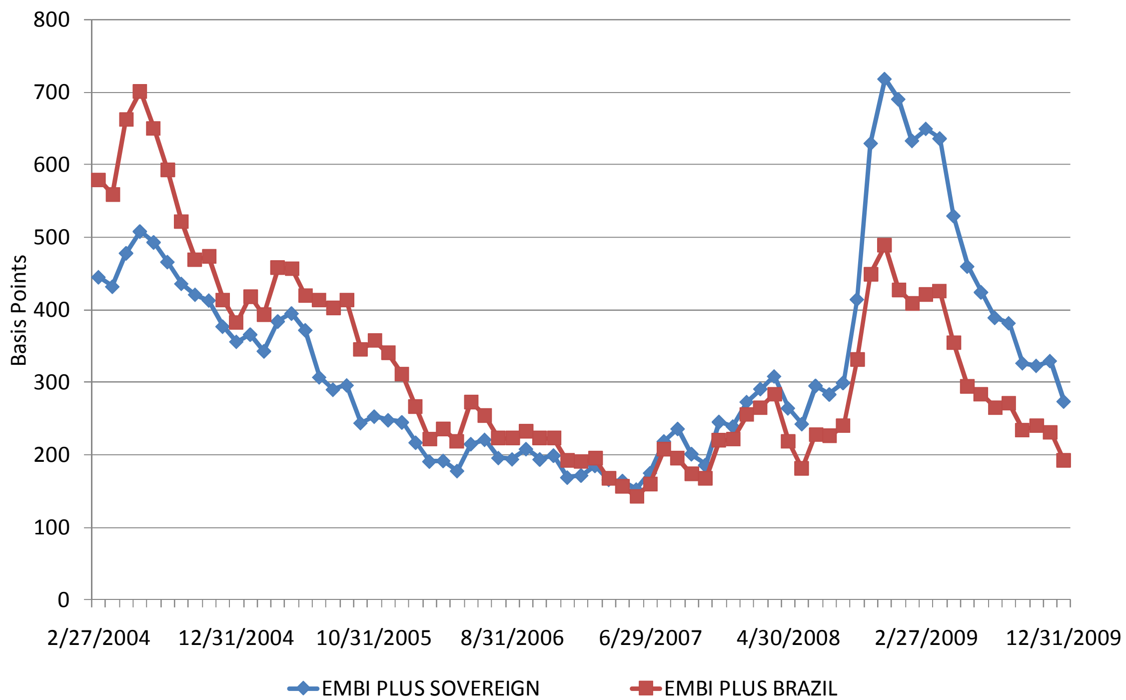
Graph 13 - 5-year CDS - Credit Default Swap



Another index commonly used to compare the rate of return charged on the sovereign bonds of emerging countries is the EMBI+. As shown in the following graph, since 2007 Brazilian securities have been negotiated at lower rates compared to the average of the emerging economies, at the same time in which the country's economy showed considerably less volatility at the high point of the financial crisis.

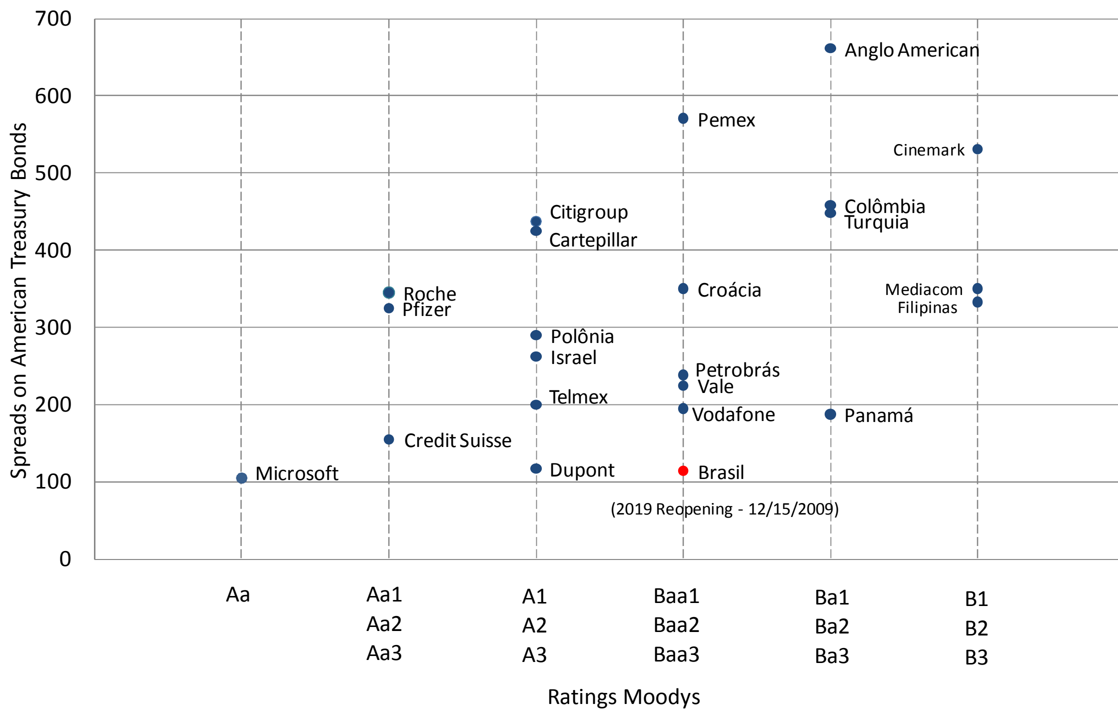
[10] For this analysis, emerging countries from different regions of the world were selected. These countries are usually compared to Brazil in a variety of international statistics.

Graph 14 – Spread Performance – Brazil and Emerging Economies

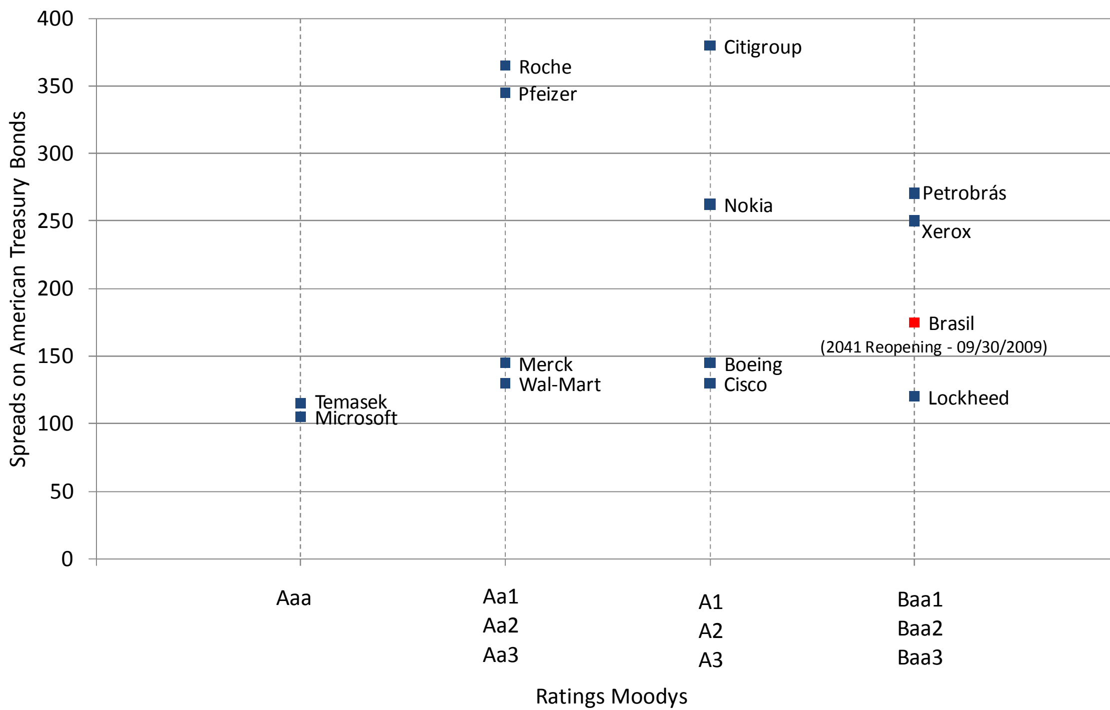


This relative improvement can also be perceived when observing that the prices of the most recent Brazilian issuances abroad (opening of the Global 2021, in April 2010, and tapping the 2041, in September 2009) were much closer to the yields generated by American Treasury bonds with similar maturities than to the yields generated by issuances effected by countries and companies with ratings higher than those of Brazil (see following graphs).

Graph 15 – Spread on Issuances in 2009 – 10 years Bond



Graph 16 – Spread on Issuances in 2009 – 30 years Bond



Source: Bondradar.com

CONCLUSION

Continued implementation of an economic policy based on inflation control and backed by the target system adopted in 1999 and by fiscal responsibility, as reflected in significant consecutive annual primary surpluses, coupled with a high level of sophistication and commitment in external debt management, as is clear in the measures discussed in this report, has produced significant progress in Brazil's financing conditions abroad.

Thirty years ago, the sharp decline in international liquidity that followed upon the second oil shock and spiraling interest rates in the United States jeopardized Brazil's capacity to honor its external commitments, at the same time in which it left the country mired in a long period of economic stagnation.

Today, however, following the worst financial crisis since the Great Depression, Brazil is focused on pursuit of a new and lasting growth cycle, in the position of net external creditor with a long-term external debt classified as investment grade. If, in the past, EFPD managers faced hardness in financing the external debt and experiences volatility in the balance of payment flows, after a period of external liabilities reduction and macroeconomic adjustment, the National Treasury is in position to take advantage of the positive market sentiment and increased demand for its securities, at historical lowest costs, launched in the external market for qualitative purposes in managing the Brazilian external debt.

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