

MARCH 2007



BRAZILIAN OVERVIEW

Tarcísio José Massote de Godoy
Brazilian National Treasury Secretary



Brazilian Federal Public Debt

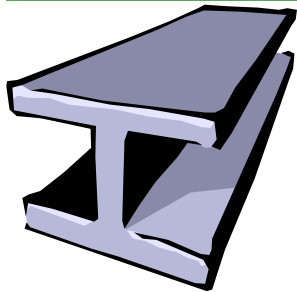
Fiscal Outlook

Public Debt Management

On the path to sustainable growth

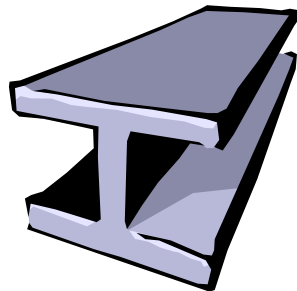
The Economic Policy Mix Provides a Buffer Against External Shocks

Prudent Fiscal Policy



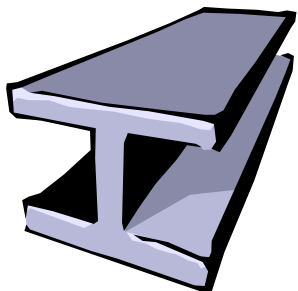
the main pillar of the economic policy

Cautious Monetary Policy



macro stability at the core of economic policies

External Adjustment



robust export growth and strong external accounts

Lead to...

- ✓ Stable inflationary expectations
- ✓ Lower long-term interest rates
- ✓ Improved debt dynamics
- ✓ Greater fiscal flexibility
- ✓ More credit → more jobs

Sustainable Economic Growth & Improving Social Conditions



Reminding key aspects of the Brazilian adjustment

- Back to 1999, the Inflation's Target System was introduced by the Central Bank as an initiative to provide transparency to the monetary policy for the coming years.
- Gradually, market participants were acquiring more information on Central Bank's new framework. Its reputation was built over its serious commitment to the cautious monetary stance and inflation control.
- The flexible FX-rate regime was adopted at that time. Among other factors, this paved the way to the best external trade performance experienced in Brazil, increasing the country's openness.
- Meanwhile, fiscal adjustment was introduced. Brazil managed to create important tools in order to retain its fiscal deficits.
- Debt Management has been very active in the past few years. External exposure was largely mitigated through remarkable improvements in domestic debt profile and external debt indicators.
- Country's risk perception has decreased dramatically.



Consensus 2007-2010

- High priority: Creating conditions for faster growth;
- Investing in infrastructure;
- Decrease current expenditure as % of GDP;
- Face regulatory issues;
- AGENDA:

- Extension of the CPMF;
- DRU - reducing earmarked revenues from the Gov't;
- Tax reform - Broader reform include ICMS and unification of the value added tax. This is broader than what is currently under discussion, but depends on state-governors negotiation. The prospect is to present an to pass these in 2007, but the transition period should be long. Fiscal competition is not desirable among states;
- Political Reform - under discussion: a matter of timing;
- Social Security Forum: set to debate a reform proposal.

} Will be presented in 2007

■ **Government is aware that fiscal credibility can be lost in the overnight and will not carry on initiatives that would risk that.**

Challenges

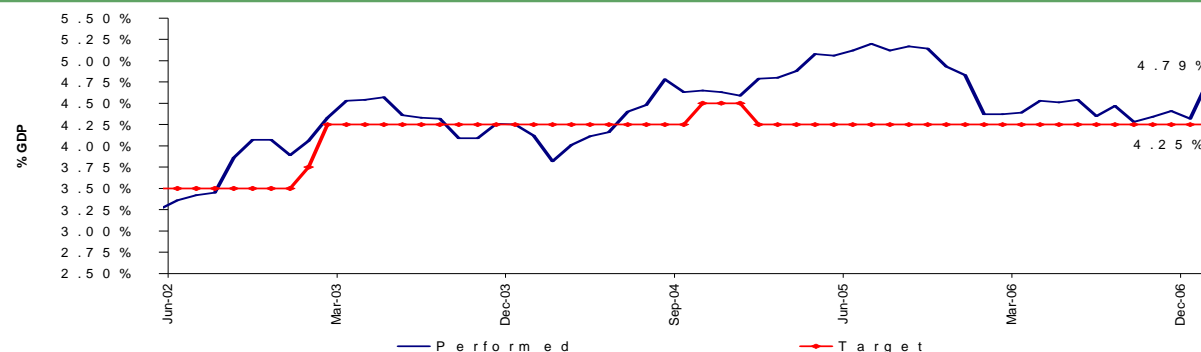
- Tax burden is very high. There is consensus on the need of cutting expenditures in order to extend and deepen the fiscal adjustment. Tax burden growth is unsustainable;
- The more progress is shown in capping expenditures, the more taxes can be cut down, opening room for higher investment and higher growth. The way Brazil pack these is very important, showing people we can benefit from that;
- Primary Surplus and PPI: In 2006, these projects accounted for 0.14% of GDP and the primary is estimated to be above 4.25% of GDP. Project's selection criterion is very rigorous. The gov't will support financially viable projects that would result in very good outcomes in the future;
- GDP growth involves microeconomic aspects, increasing economic openness, stimulating market functioning.



Key reasons why we've always achieved fiscal target

- 1997 - 25 states (out of 27) had its outstanding obligations assumed by the federal gov't renegotiated with a 30-y horizon . They were complied to establish a downward trend in the Financial Debt/Net Real Revenue ratio, which forced them to make adjustments in order to generate primary surpluses;
 - By that contract, the federal gov't can access high-quality guarantees, represented by the constitutional transfers and by tax revenue (ICMS). The states had to present a fiscal plan, on an annual basis, that would track the main sub-national account indicators
 - This framework, allied to state's reduction in financial bank activities¹, has assured the good fiscal performance in local gov'ts, which came from a 0.29% of GDP deficit in 1998 to results higher than 1.10% of GDP in the past few years;
- 2000 - The Fiscal Responsibility Law (LRF) set the conditions to a responsible fiscal management:
 - It limits indebtedness and specific expenditures;
 - Set rules for reaching the primary balance defined in the Budget Guideline Law (BGL);
 - Considered the cornerstone of the Brazilian fiscal adjustment, this law is completing 7 years of existence without any modification, which is particularly important in a democratic environment as found in Brazil.
- 2001 - 180 municipalities (the most indebted ones) also renegotiated its liabilities, under conditions similar to those previously set for states;
- In line with this framework, there is a close follow-up in all levels financing programming, aiming at assuring the primary balance set in the BGL. In case a gov't level doesn't meet its fiscal target, another gov't level must compensate it such that the whole Public Sector is not compromised.

Public Sector Primary Surplus target of 4.25% of GDP will be achieved in 2006



Source: Ministry of Finance ¹ Eliminated an important source of indebtedness used by local state banks at that time.



Measures adopted to improve the sustainability of the social security system

Past Important Modifications

- Constitutional Amendment # 20/1998
 - Constrains retirement by labor tenure, eliminating proportional retirement; imposes, to integral retirement, age limits and contribution tenure instead of labor tenure;
 - To public servants, the retirement cannot exceed the value received by the servant by the time of retirement;
 - Federal and local gov'ts are allowed to set, for pension and benefits provided, the same maximum limit established for the Social Security (once their servants are included in complementary pension scheme);
 - Set upper limits for benefits and contributions for the General Regime Social Security (RGPS) in R\$ 1,200.00.

- Constitutional Amendment # 41/2003
 - Defines social security contributions for retired public servants;
 - Set upper limit for public servants benefits as high as Supreme Court's remuneration;
 - Vanishes the existing parity between active and inactive incoming public servants;
 - Increases the RGPS upper limit to R\$2,400.00. This limit is corrected by the inflation (INPC).



New GDP series methodology

Updated data brings more accuracy to economic evolution

- IBGE has just released the updated annual GDP series using a new methodology. These changes should contribute to a clearer diagnosis of aggregate economic activity evolution, including better assessments across the sectors.
- In the last two years, IBGE has been promoting seminars with Government and Market experts, aiming at the transparency of the process.
- In the international scenario, periodic changes occur in the methodology of the National Accounts and series revisions are recommended every ten years¹.
- This change means the adaptation of the System of National Accounts (SNA) to a new underlying economic structure.
- As a result, activities that were previously estimated, such as government consumption and financial intermediation, are now accurately measured.
- Another improvement is that the weight of economic activities was updated, adjusting it to the higher importance of services such as telecommunications and transportation. In historical terms services performance is less volatile than the other sectors, so it is fair to believe that the new series will also present a low standard deviation.

¹ USA and Australia revises every five years; last change in Spain made its GDP increase in 5.0%; in China, greater changes happened, with an increase of more than 10.0% in the GDP

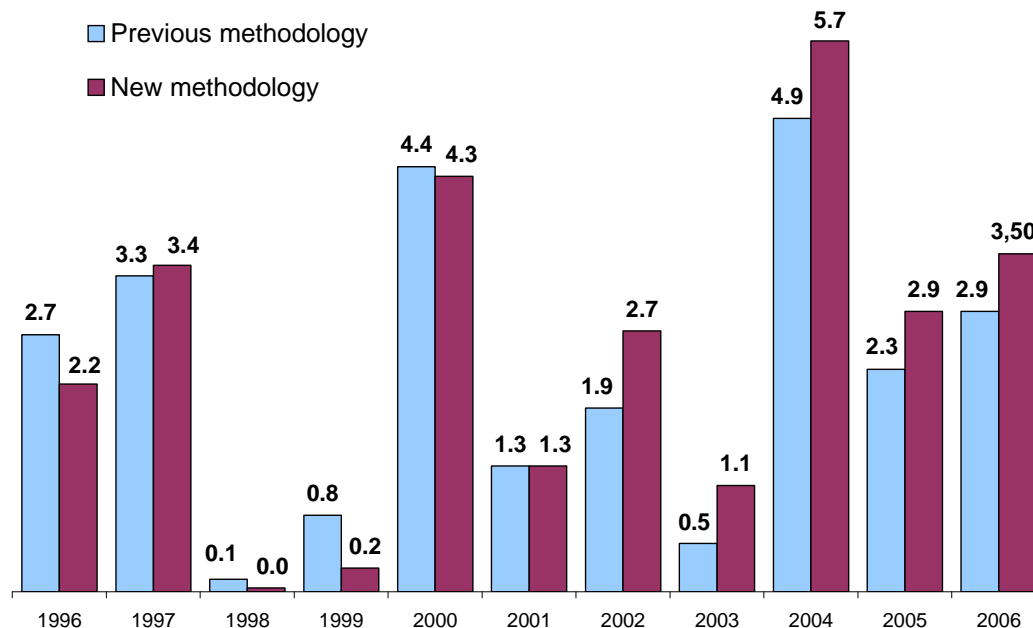


New GDP series methodology

Updated data brings more accuracy to economic evolution

- Turning to supply indicators, the most significant change was the proportion of services: the segment share increased to 66.7% in 2000, from 56.3% in the former series.
- The counterpart was a reduction in the share of agriculture (from 7.7% to 5.6%) and industrial activity (from 36.1% to 27.7%).
- In nominal terms, the Brazilian GDP increased an average of 10.0% over the estimate of the previous methodology.

GDP Growth Rate - 1996-2006



+0.5 in average by year during the period

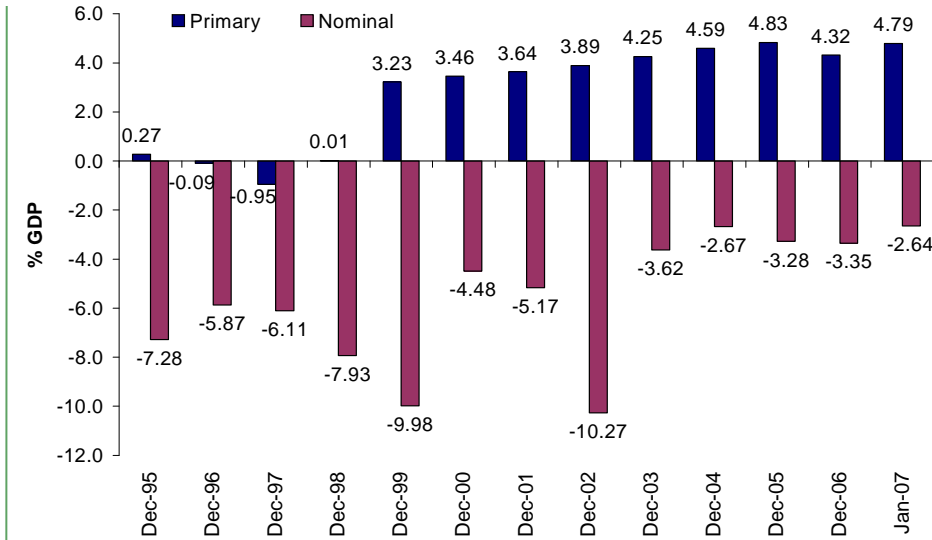
Source: IBGE

(*) Market estimate to 2006 (official data will be released in March 28th, 2007)



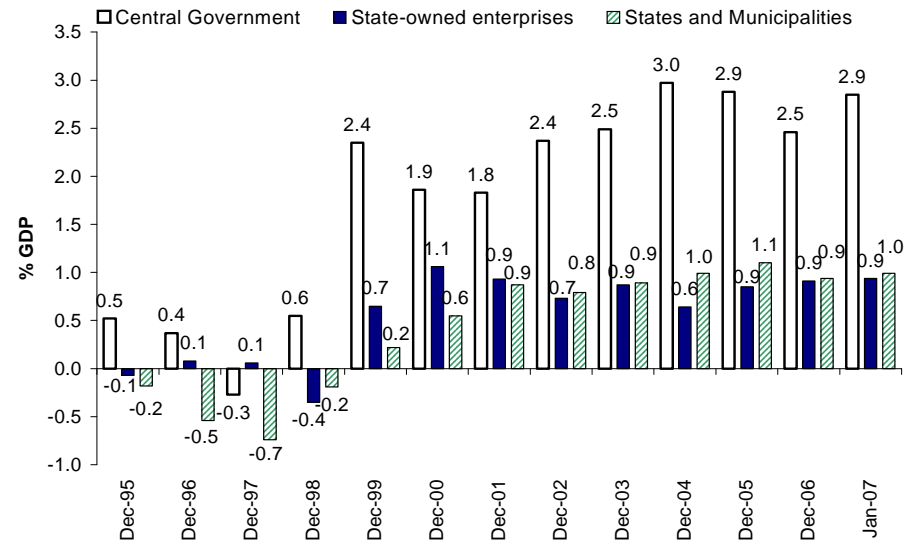
Macroeconomic Overview - Fiscal Commitment

Public Sector Balance (in 12 months)



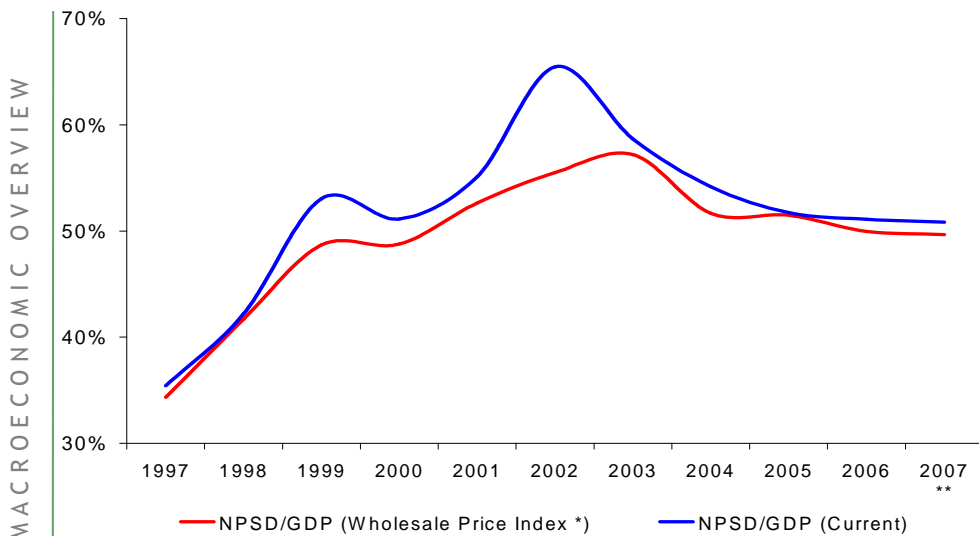
Source: Central Bank

Primary Balance by Government Level (in 12 months)



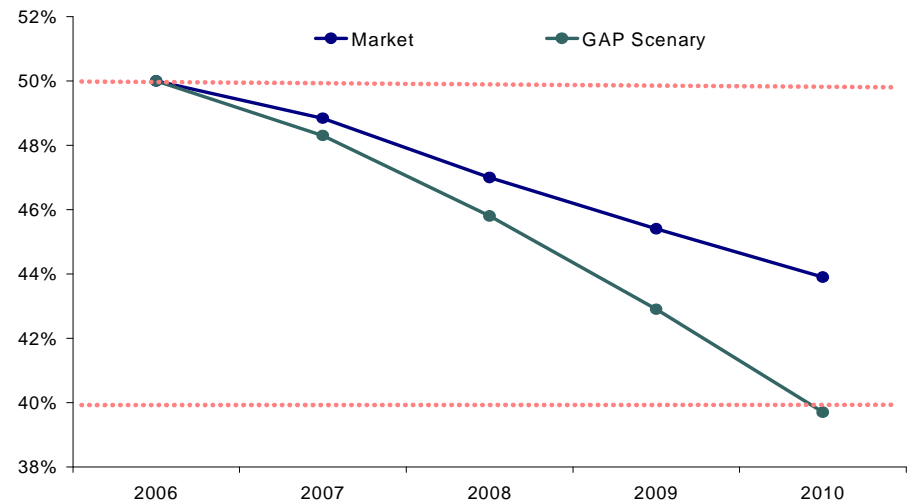
Source: Central Bank

Net Public Sector Debt / GDP



* Data of Central Bank - IGP-DI (wholesale price index) 'modified' ** January

Net Debt/GDP scenarios based on the market expectations*

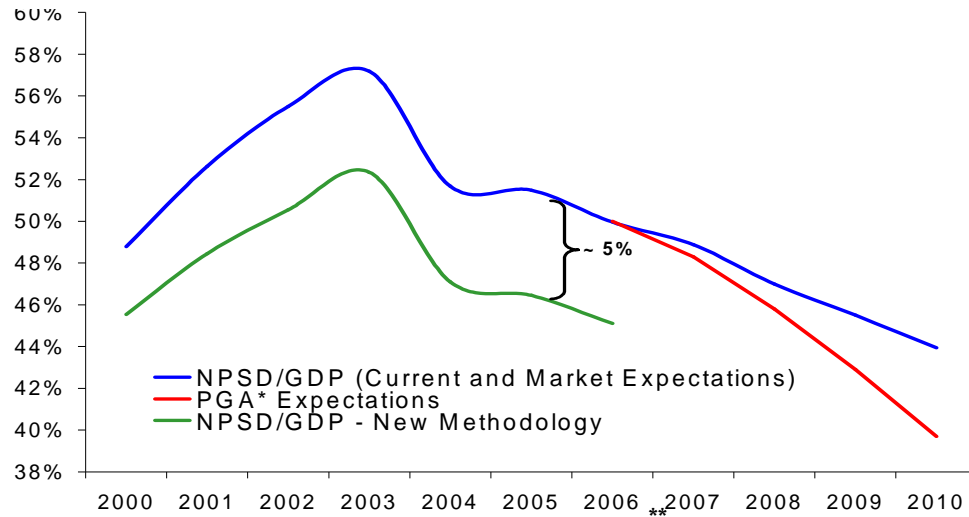


* FOCUS - 03/09/2007 Source: Central Bank and National Treasury



Policy Fiscal under new methodology

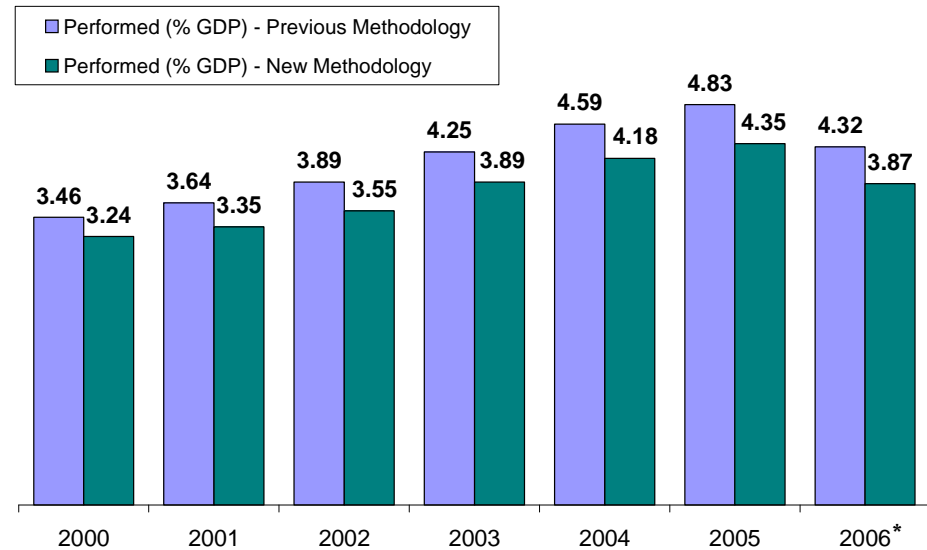
Net Public Sector Debt / GDP



* Program of Growth Acceleration

** Market estimate to 2006 (new methodology)

Public Sector Primary Balance as % of GDP

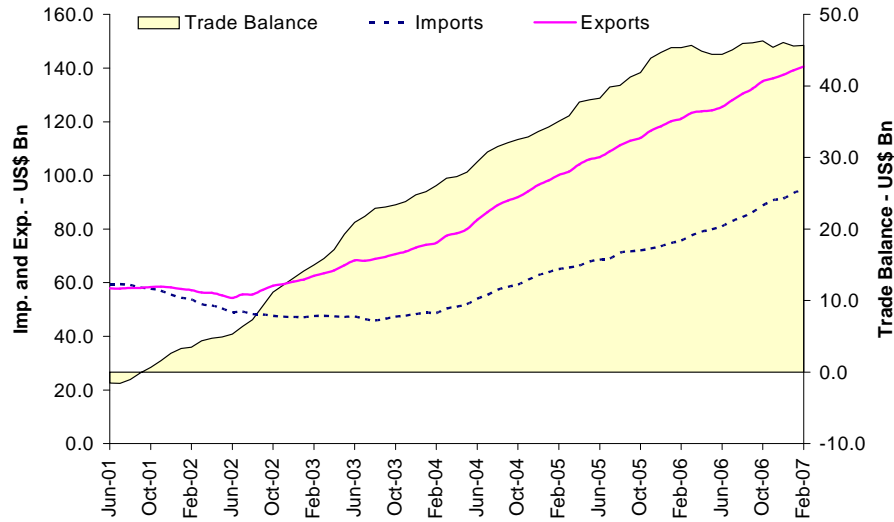


* The GDP growth for 2006 considers market expectations (3,5%) based on the new IBGE methodology.



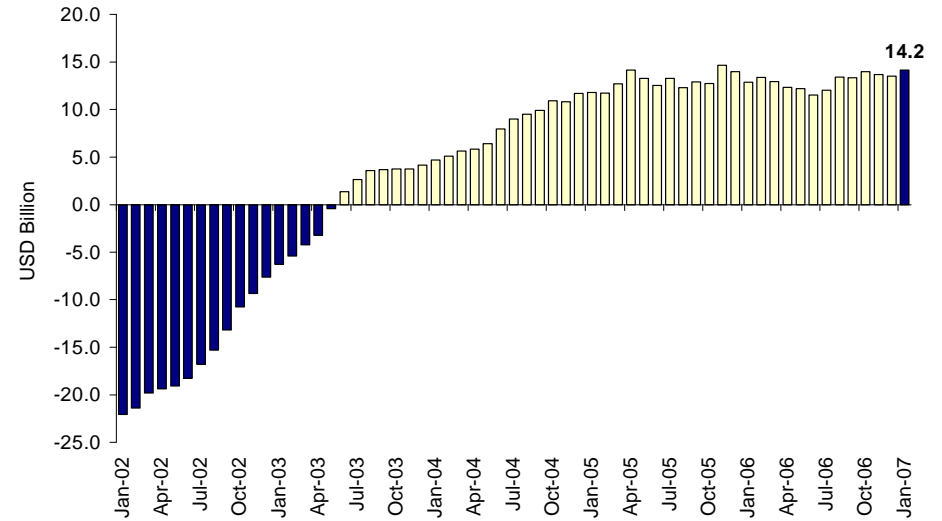
Macroeconomic Overview - Reduction in the External Vulnerability

Trade Balance



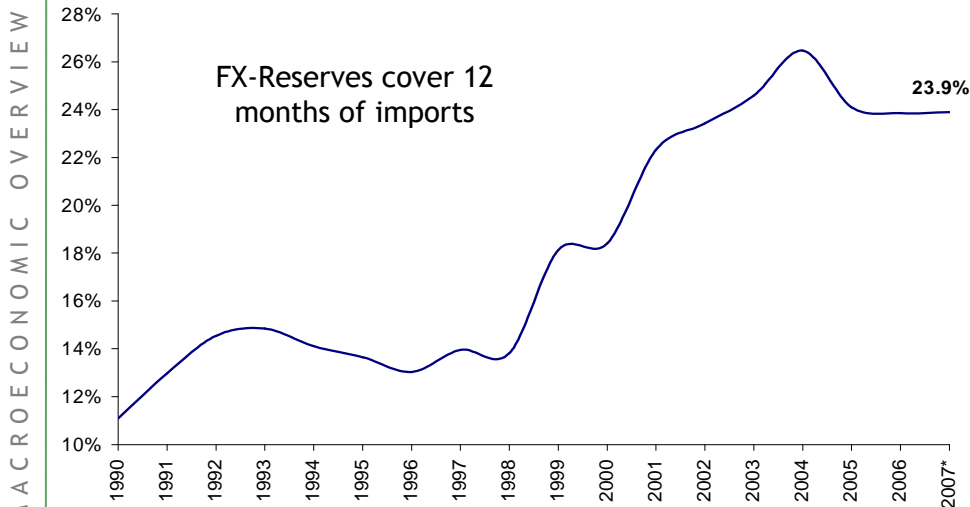
Source: MDIC - SECEX

Current account (12 months accumulated - US\$ bn)



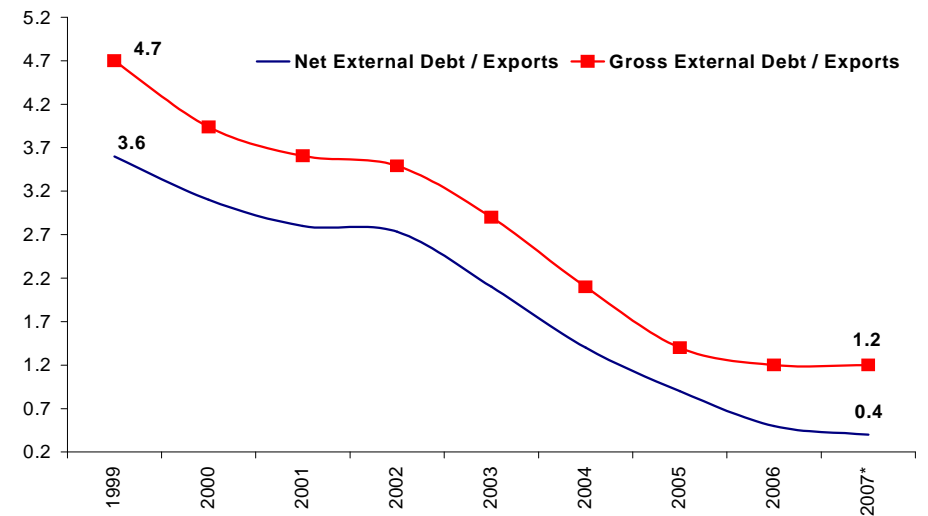
Source: Central Bank

External Trade (Exports + Imports) of GDP (%)



* Until January, 2007
Source: MDIC - SECEX and Central Bank

Net External Debt/Exports accumulated in 12 months**

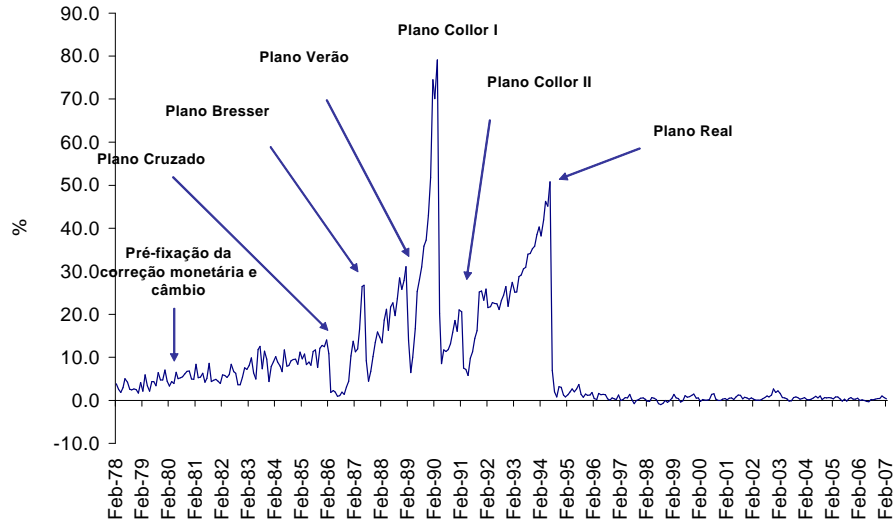


Source: Central Bank. * Until January, 2007 **Public Debt and Private Debt as a share of export accumulated in 12 months



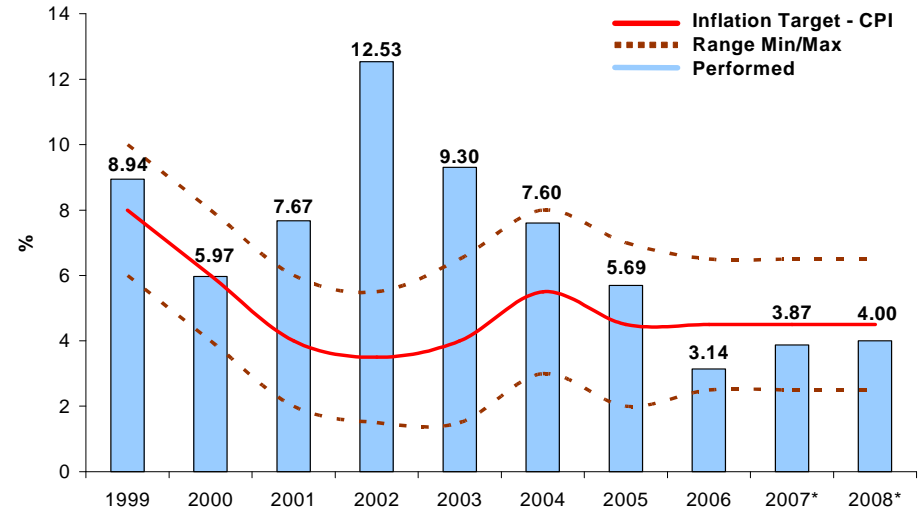
Macroeconomic Overview - Inflation under control and the economy stability

Inflation 1976/2006 - CPI* - Monthly (%)



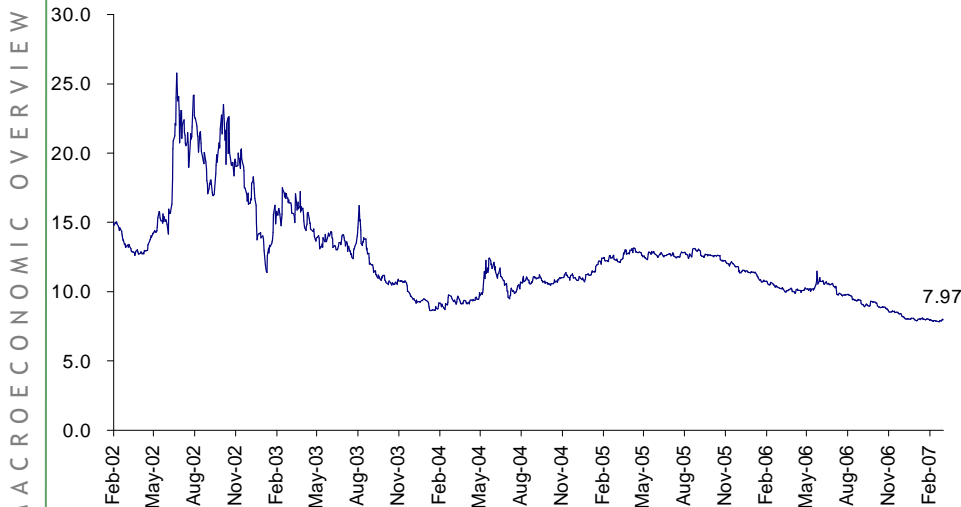
Source: IPEADATA. * Consumer Price Index - IPC (FIPE)

Annual Inflation - Target and Performed



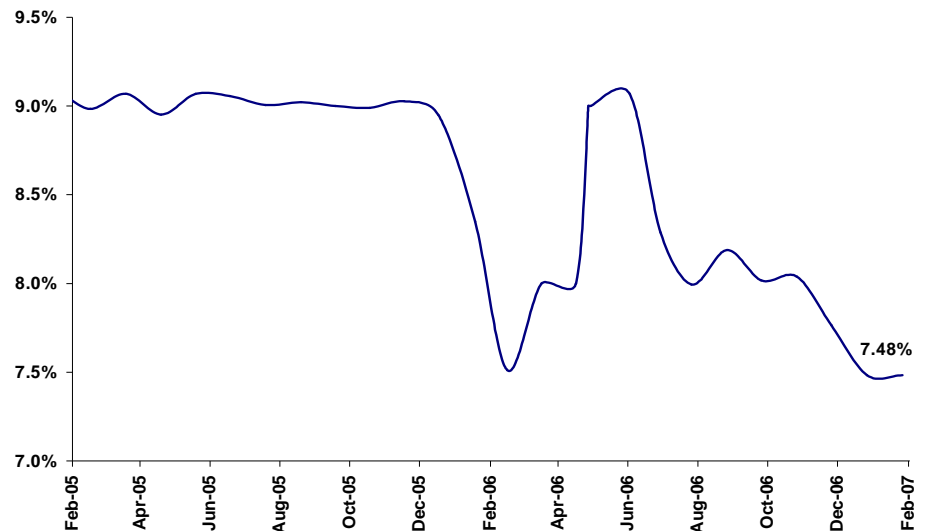
Source: Central Bank * Market Expectation - Central Bank/FOCUS - 03/09/07

Real Interest Rate (Swap 360 vs 12-month CPI forecast)



Source: Central Bank and Bloomberg

Medium and Long Term Real Interest Rate on inflation linked bonds* - Average rate of auctions



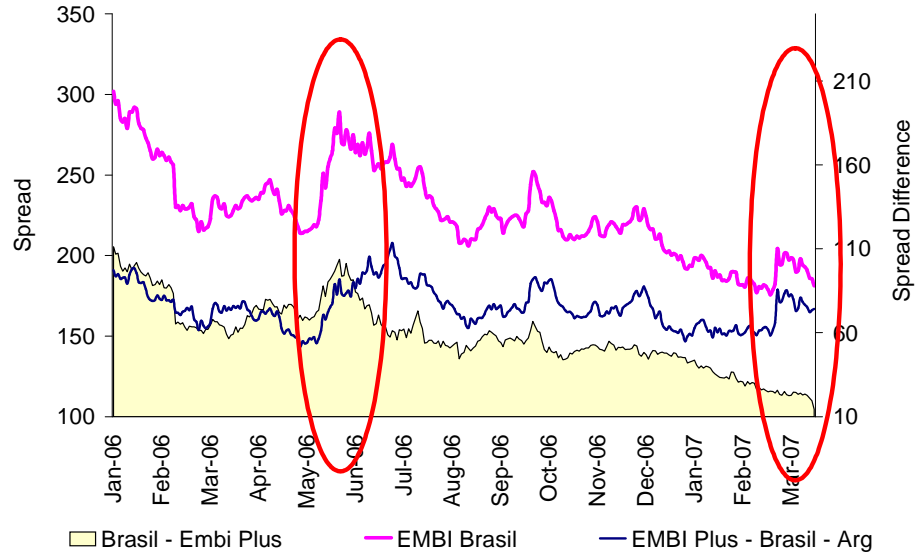
Source: National Treasury

* NTN-B: CPI indexed bonds, maturing in 2024, 2035 and 2045.



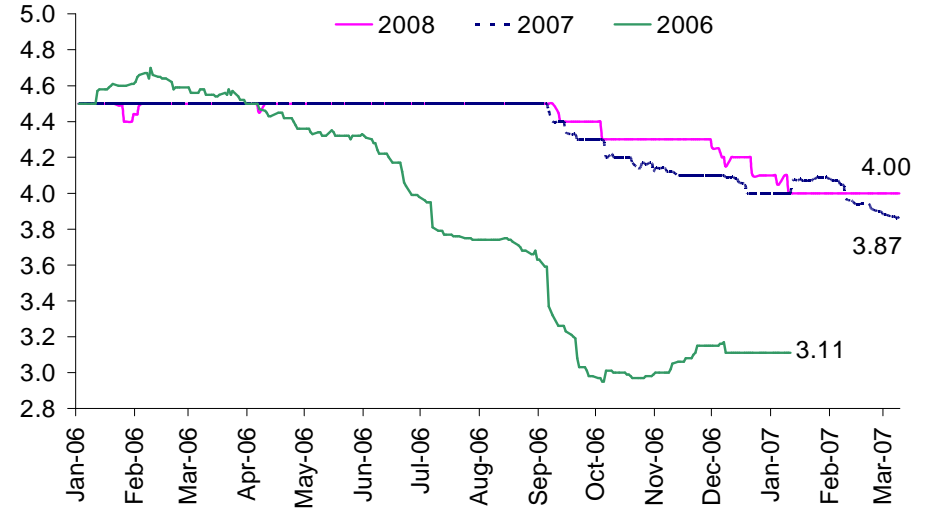
Market Expectations for 2007-2008

Spread Performance - Brazil and Emerging Markets



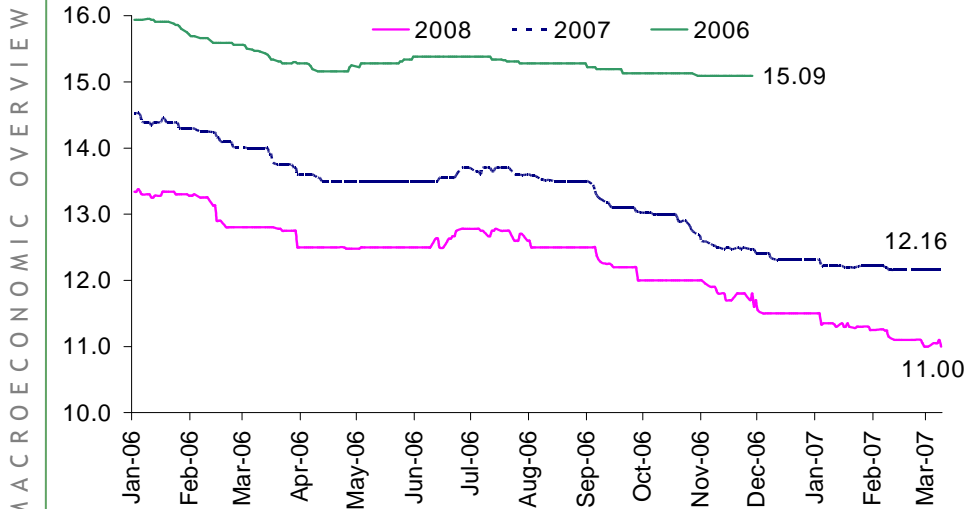
Source: JP Morgan

Inflation - CPI (%)



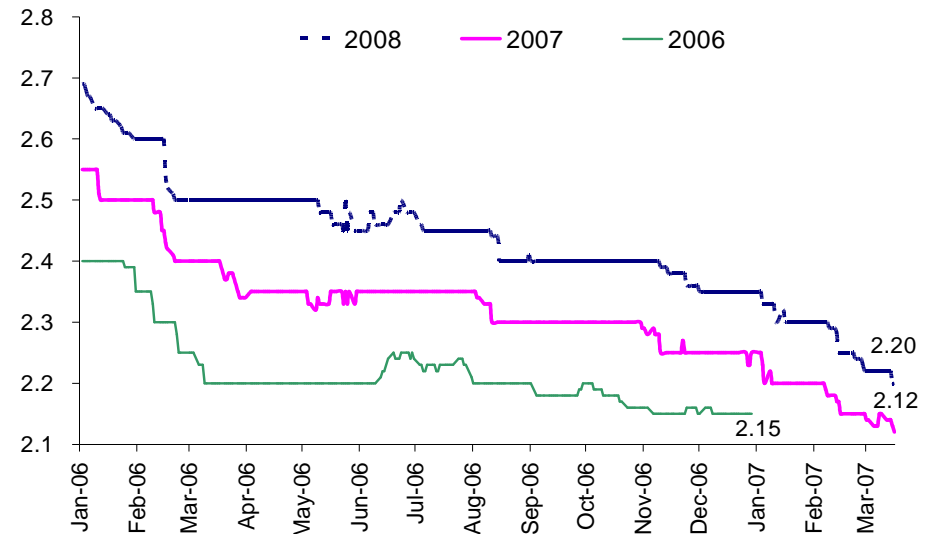
Source: Central Bank/Focus (03/16/07)

Nominal Interest Rate - Selic (%)*



Source: Central Bank/Focus (03/16/07) *End of the year rate

Exchange Rate Year End (R\$/US\$)



Source: Central Bank/Focus (03/16/07)



Search for the sustainable growth

Program of Growth Acceleration - PGA

- Compatibility with the short term target, with public investment growth in infrastructure and the private investment stimulation;
- Long term financing and credit stimulation, with emphasis on habitation and infrastructure;
- Improving the investment feasibility: environmental question, regulatory framework (gas, regulatory agencies and others), market competition defense and stimulate the regional development;
- Prior on energy sector: enhancing of environmental regulation, financing (via BNDES) to infrastructure projects with better conditions, besides cutting down taxes regarding FI-IE;
- Cut down taxes and enhance the tributary system (cut down taxes on investment and civil construction);
- Focus on social security question: measures to improve the social security management and establishment of a National Forum to discuss the enhancement of the Social Security Model; and
- Long term fiscal measures focused on fiscal sustainability: definition of a new policy for the minimum wage, personal expenses and discussion of a new tributary structure.



Program of Growth Acceleration: 2007-2010

Investment in Infra-Structure

Sector	US\$ billion	as % of GDP
Logistic	27.3	0.58%
Federal Budget	15.4	0.33%
Government Enterprises and Other Sources	11.8	0.25%
Energy	128.6	2.71%
Federal Budget	-	-
Government Enterprises and Other Sources	128.6	2.71%
Social and Urban Infra-Structure	79.9	1.69%
Federal Budget	16.3	0.34%
Government Enterprises and Other Sources	63.6	1.34%
Total	235.8	4.97%
Federal Budget	31.7	0.67%
Government Enterprises and Other Sources	204.1	4.30%



Program of Growth Acceleration: 2007-2010

Investment- Federal Budget

	2007		2008-2010		Total	
	US\$ billion	as % of GDP	US\$ billion	as % of GDP	US\$ billion	as % of GDP
PGA - Infrastructure	7,4	0,71%	24,4	0,66%	31,7	0,67%
PPI funds	5,3	0,51%	19,3	0,52%	24,6	0,52%
Other funds	2,1	0,20%	5,1	0,14%	7,2	0,15%
Other investments	4,1	0,39%	17,5	0,47%	21,5	0,45%
Total	11,4	1,10%	41,8	1,13%	53,3	1,12%



Tax Measures: Improving Equilibrium and Balance

Complementary Law for Micro and Small Enterprises : Main Framework

Complementary Law 123, December 2006

- **Unification of the legislation:** SIMPLES Law (Law 9.137/1996) and Statute of Micro and Small Enterprises (Law 9.841/1999)
- **Creation of Micro and Small Enterprises Committee** (almost 80% of all Brazilian companies);
- **Simplify procedures of inscription and closure:** unification and standardization of legal proceedings among Federal, States and Municipalities - *This will provide flexibility and agility in opening and shutting business.*
- **Tax System - creation of NEW SIMPLES :**
 - **All taxes are condensed in a single form.** It facilitates monitoring in all government levels, deeply avoiding tax evasion.
 - **Simplify procedures and facilitate tax compliance:** unification of federal (IRPJ, IPI, CSLL, Pis/Pasep), states (ICMS) and municipalities tributes (ISS);
 - **Tax cuts to stimulate the growth and formalization of micro and small enterprises.**
 - **Fiscal impact:** R\$ 2,5 billion in 2007 and R\$ 4,9 billion in 2008;
 - **Foster governmental purchase;** simplifies labor duties; civil rules and access to Justice;
 - **Incentive to the technological innovation.**



Tax Measures: Improving Equilibrium and Balance

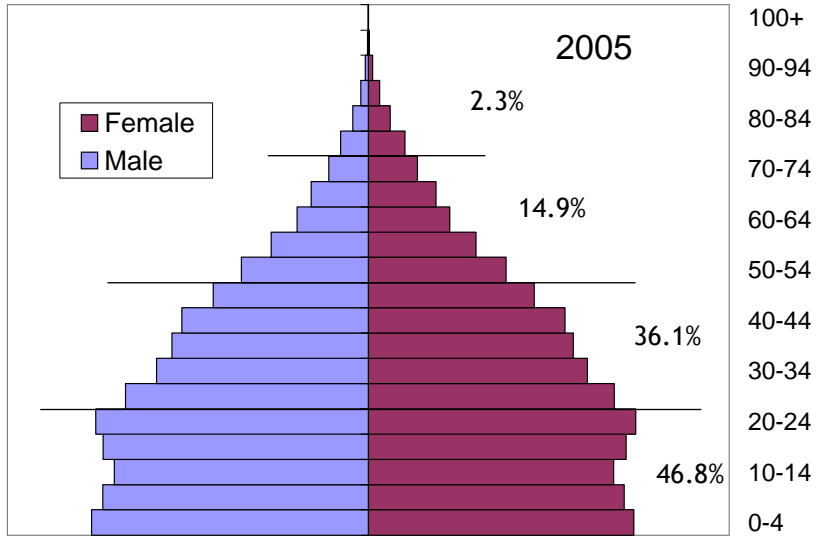
Electronic TAX Invoice System - SPED

- Changes the current system of issuing tax invoices, allowing traditional fiscal books to be substituted by electronic invoices with digital certification;
- Generates significant operational costs reduction;
- Promotes fiscal balance;
- Contributes to enhance Brazilian competitiveness which will eventually lead to a higher GDP growth rate;
- Allows data integration among the three government levels;
- Facilitates data access and provides a very important tool in order to devise tax reform proposals.



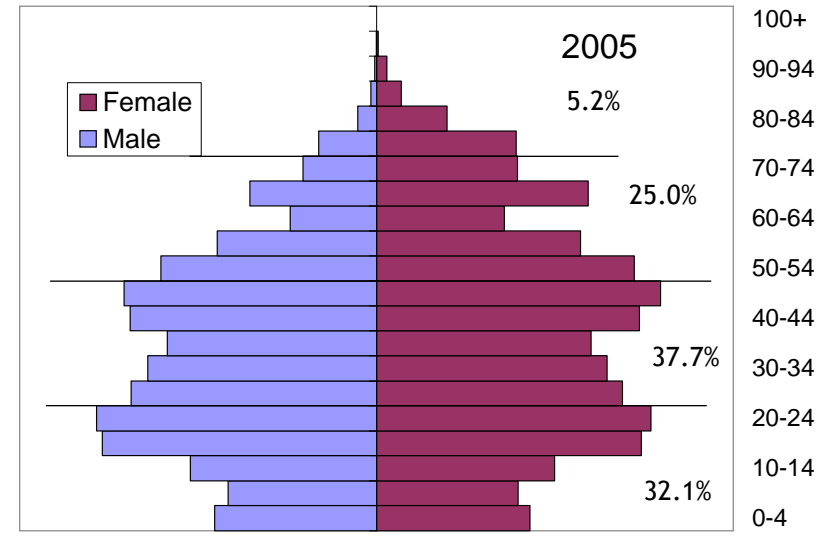
Demographic Structure of BRIC countries - 2005

Brazil



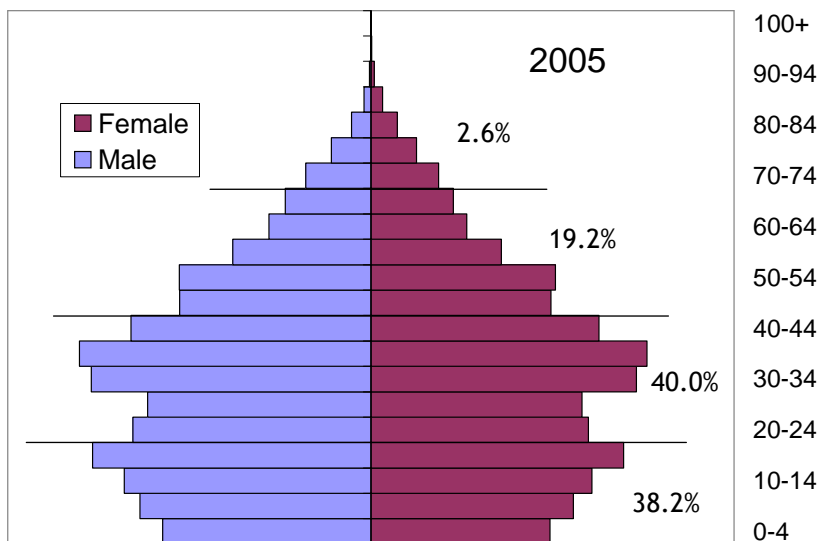
Source: United Nations

Russian Federation



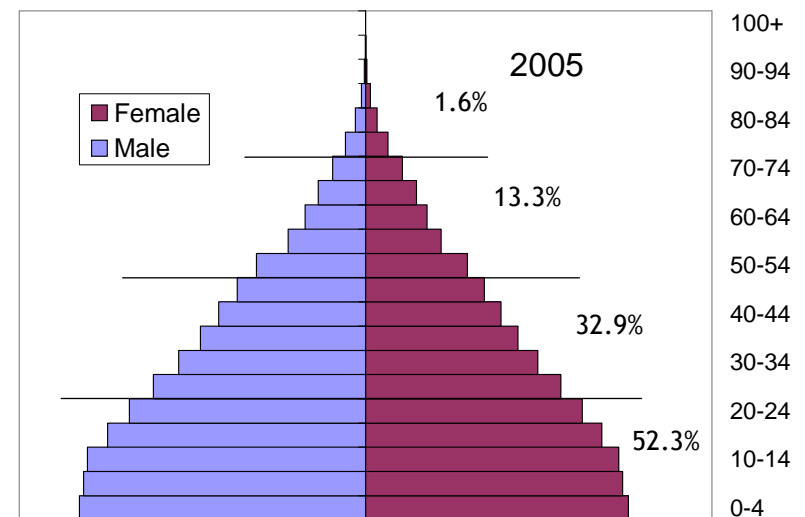
Source: United Nations

China



Source: United Nations

India

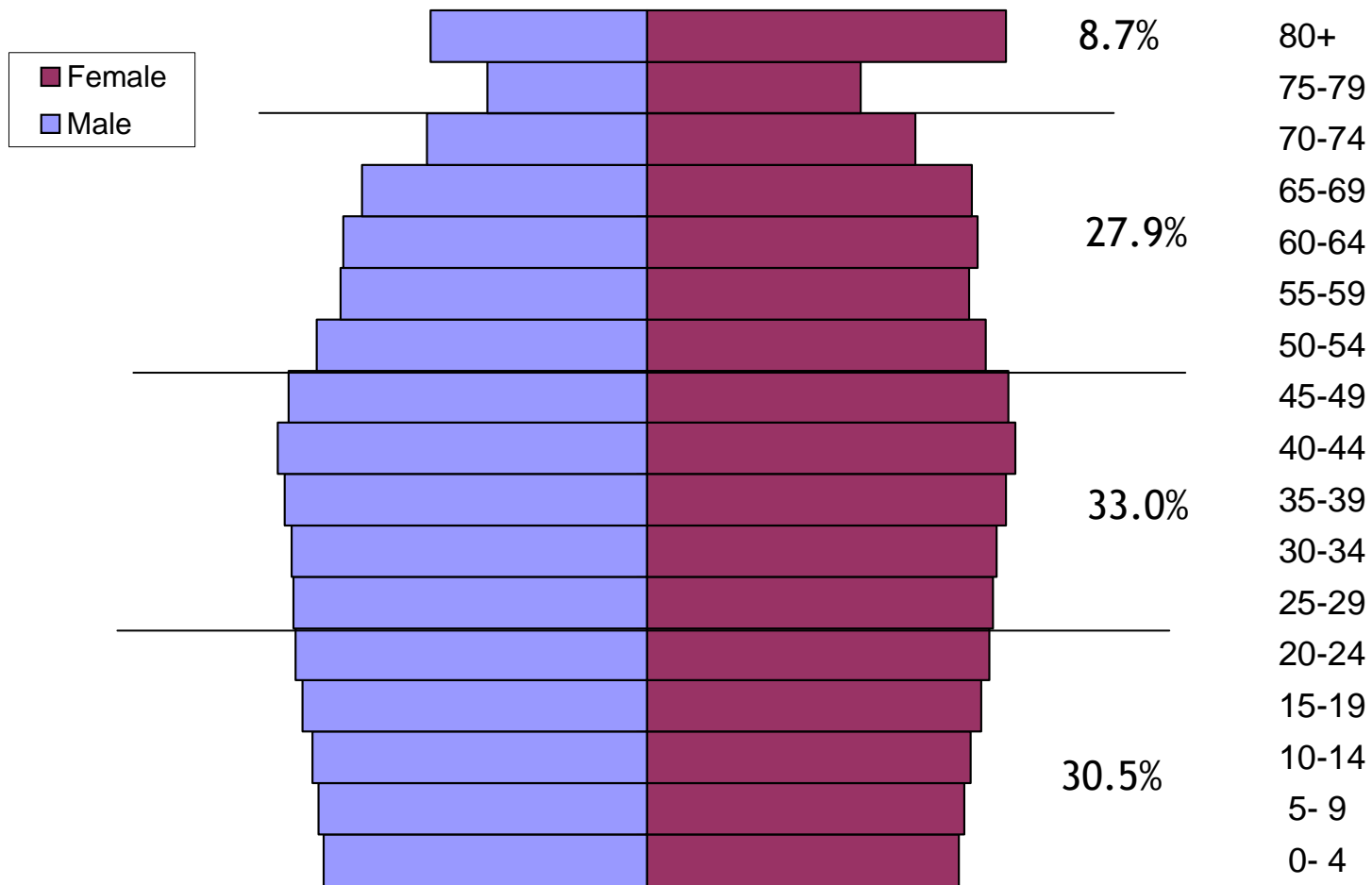


Source: United Nations



Demographic Bonus*

Demographic Structure of Brazil - 2050



Source: IBGE

* Period of time in a nation's demographic evolution when the proportion of population of working age group is particularly prominent.



Brazilian Federal Public Debt

Macroeconomic Overview

Public Debt Management



Great advances in the debt management

Recent advances

■ Improvement in Federal Public Debt indicators

- The share of fixed rate plus inflation-linked bonds, which was 20% in 2003, reached more than 51% in January 2007.
- The share of FX linked (external and domestic debt) plus floating rate decreased from almost 80%, in 2003, to 46.6% in January 2007.
- Percentage due in 12 months will be reduced in 8 p.p. from 2004 to 2007 (from almost 39% to less than 31%).

■ Enhancement in the external debt profile

- Improvement in the external debt profile: Bradies' call, anticipated payment of IMF and Paris Club debt.
- Buyback program, redeeming “high coupon bonds” and consolidating benchmarks.

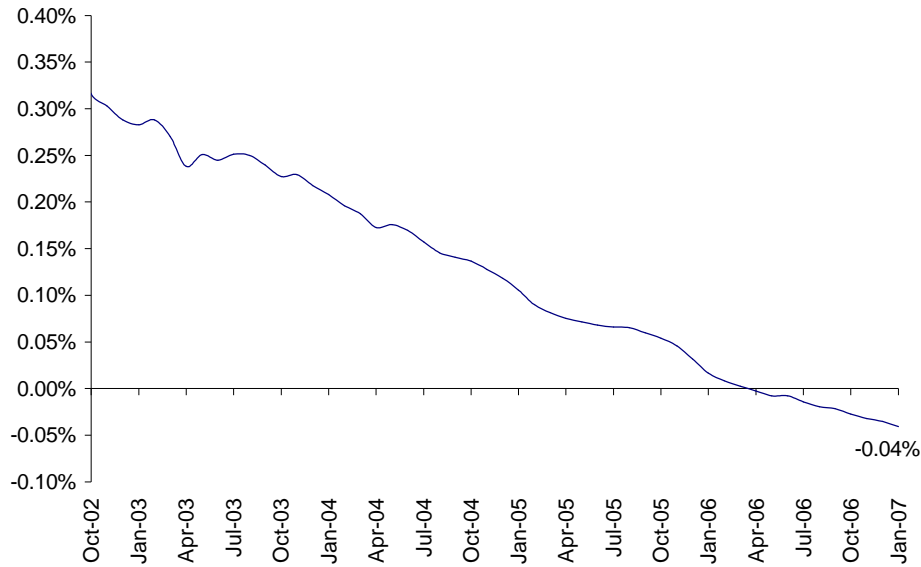
■ Reduction in the risk exposition

- Improvement in the debt composition reduced the market risks: exchange rate and floating rate risks
- Reduction in the refinancing risk



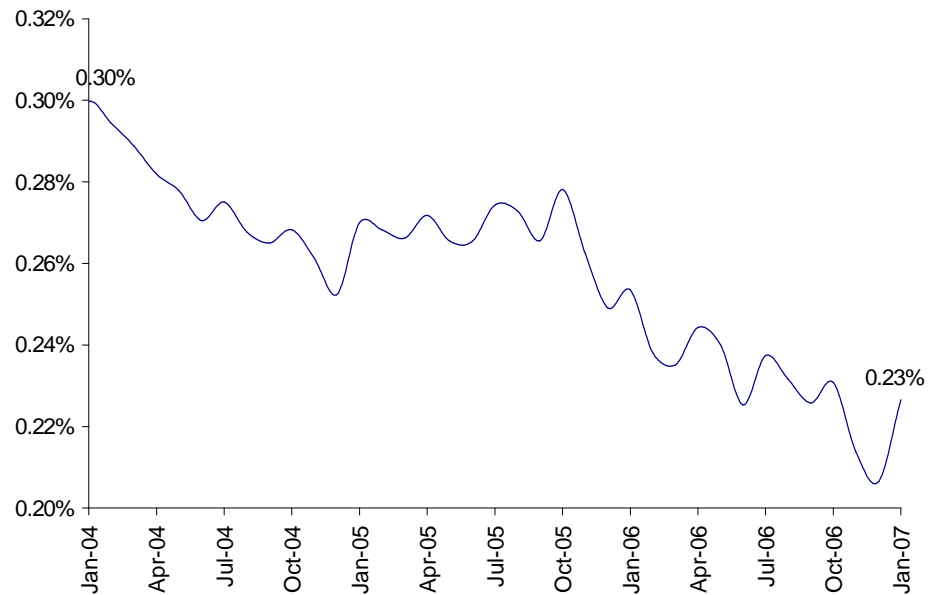
The improvement on the Public Debt composition has reduced the exchange rate and floating rate risks

Impact of 1% FX devaluation on Net PS Debt/GDP



Source: National Treasury

Impact of 1% SELIC change on Net PS Debt/GDP*



Source: National Treasury

*In 12 months



Risk Management

Stress Test over Interest and FX-Rate

Indicators	Share of DPF (%)						Stress Impact (R\$ billion)					
	2002	2003	2004	2005	2006	2007*	2002	2003	2004	2005	2006	2007
Floating Rate	42.4	46.5	45.7	43.9	33.4	29.0	52.7 (3.3%)	57.8 (3.6%)	56.8 (3.1%)	54.6 (2.8%)	41.5 (2.0%)	36.1 (1.6%)
Exchange Rate	45.8	32.4	24.2	17.6	12.7	11.0	299.4 (18.9%)	211.9 (13.3%)	158.2 (8.5%)	115.0 (5.9%)	83.0 (3.9%)	71.9 (3.1%)
Total	88.2	78.9	69.9	61.5	46.1	40.0	352.1 (22.2%)	269.7 (16.9%)	215.0 (11.6%)	169.6 (8.7%)	124.5 (5.9%)	108.0 (4.7%)

Note: Stress tests consider 3-standard deviation shocks on the interest rate (7,8 percentage points) and *Real* devaluation (56,6%), persisting for a year.

- The stress analysis demonstrates that the impact in the Federal Public Debt - DPF of a shock of extreme ratios and substantial persistence (i.e., at least one year) in the interest rates and exchange rates would be only 4.7% of the GDP;
- If the DPF structure were the same as in 2002, this impact would be of 22.2% of the GDP. This represents a reduction of almost 80% of the impact in the DPF between 2002 and 2007;
- If we take into account that, since mid 2006, the level of international reserves is superior to the Federal Government total debt indexed to exchange rate, one can say that the foreign exchange risk is null. In this case, the total impact would be merely 1.6% of the GDP.



Brazil - the first country that satisfied all the investor relations best practice criteria in Institute of International Finance (IIF) report

Investors Relations: An approach to Effective Communication and enhanced transparency

- Assessment of 30 key borrowing countries in Investor Relations and Data Transparency Practices.
- **First Release (Dec-05)** - Brazilian's Government reached 37 out of 38 in prioritized terms.
- Measures:
 - Staff reachable through website
 - Reciprocal links between government agencies
 - Investors able to register for website subscription
 - Investor conference call
 - Regular self-assessment of investor relations activities.
- **Second Release (Sep-06)**: Based on the combined score (Gerin, operated by the Central Bank of Brazil, and Investor Relations Office of the National Treasury), Brazil has become the first country to score 38 out of 38 in prioritized terms.



**For additional information access
Brazilian National Treasury site :**

www.tesouro.fazenda.gov.br

Or contact Institutional Relations area:

brazildebt@fazenda.gov.br

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