

APRIL 2005



## BRAZIL: continuing the good work

*Joaquim Vieira Ferreira Levy*

National Treasury Secretary

# A matter of accountability: what was said a year ago?



MINISTÉRIO DA FAZENDA  
Secretaria do Tesouro Nacional



## *Turning Point to Brazil*



Joaquim Vieira Ferreira Levy  
Secretário do Tesouro Nacional -

New York, April 27, 2004



Cost of (external) adjustment fading

Jobs are the lagging variable

Improved debt structure

Changing the trend in the public debt level

**Will the country grow?**

### *Challenges ahead:*

*Fiscal Discipline is a long-term commitment*

*A glimpse on Social Security issues*

*Other "strategic" considerations*

➤ *How to be competitive in world markets?*

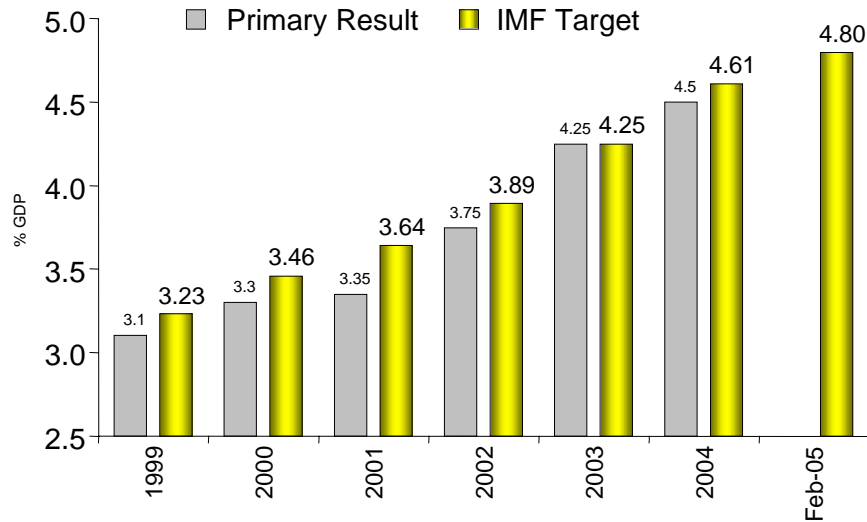
➤ *How to address the challenge of investment in infra structure?*

That was then...

... What is it now?

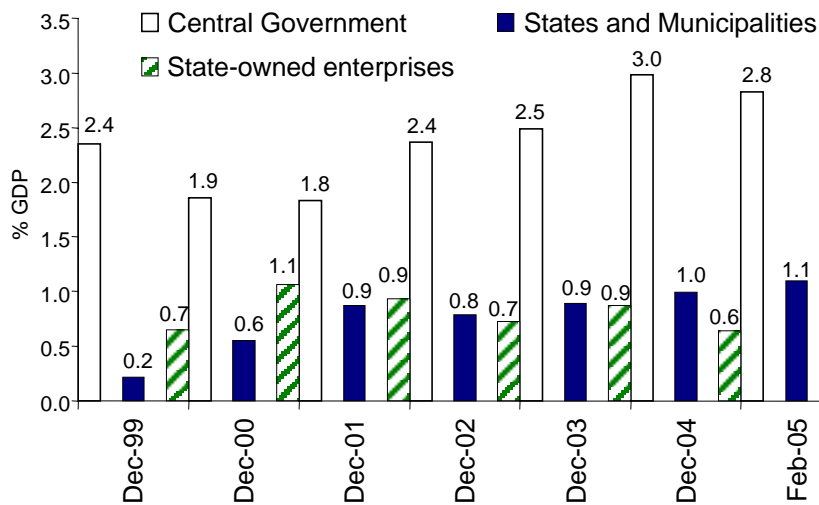
# Fiscal Commitment: the cornerstone of the economic policy

## Public Sector Primary Balance (in 12 months)



Source: Central Bank

## Primary Balance by Government Level

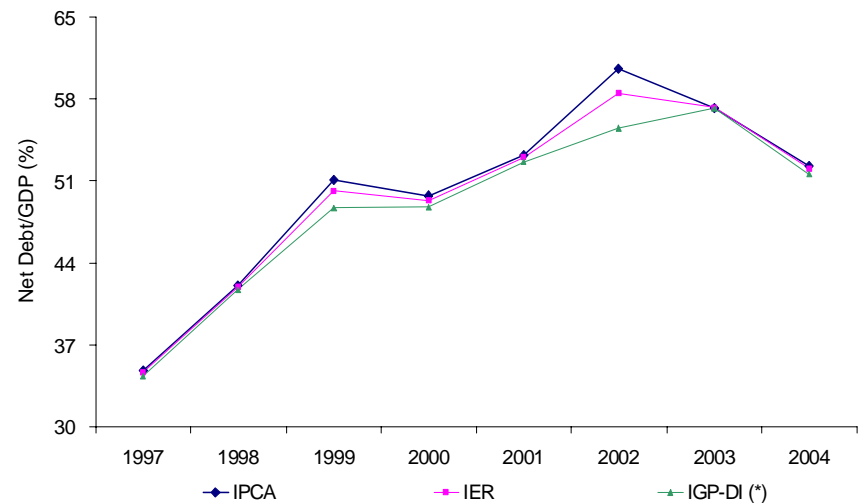


Source: Central Bank

## Improving the Governance of Social Security

- Social Security is the largest budget at the federal level
- Its governance has not progress on par with that of other sectors in the Federal Government
- Creation of “*Secretaria da Receita Previdenciaria*” to organize the collection of employer contribution
- Effort to check records, comparing with information from other sources (Labor Ministry, CPF, etc.)
- Efforts to strengthen data management and functioning of services for the public
- **Review of illness and disability benefits;**
- The Social Security is a major treasury of Society

## Net Public Sector Debt/GDP

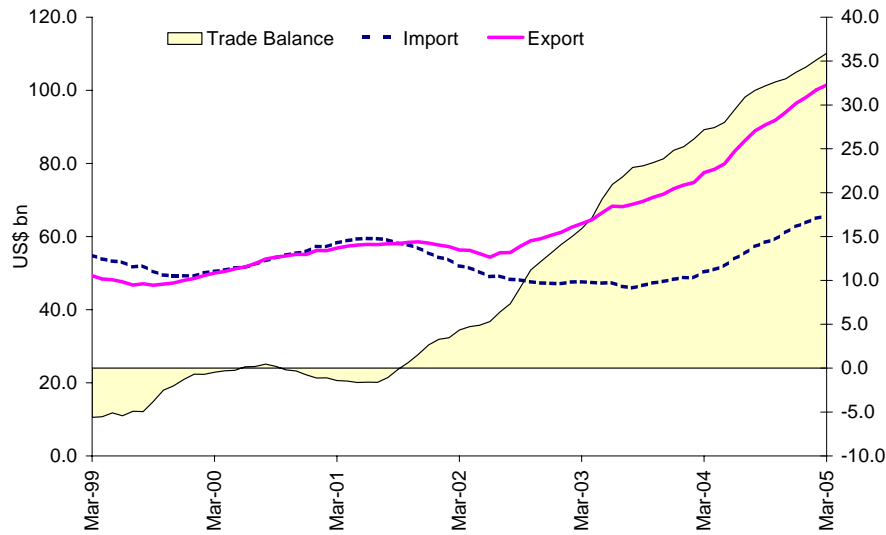


Source: Central Bank



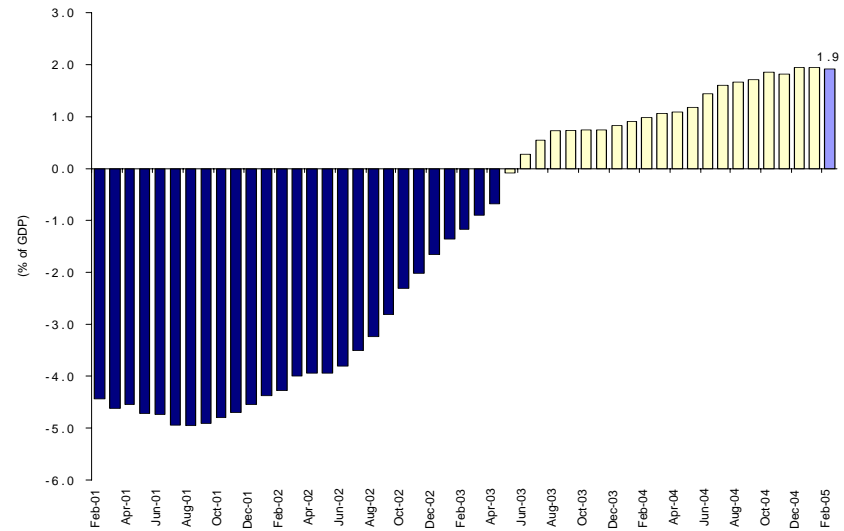
# The big swing in External Accounts continues on the strength of exports

## Trade Balance - (US\$ billion)



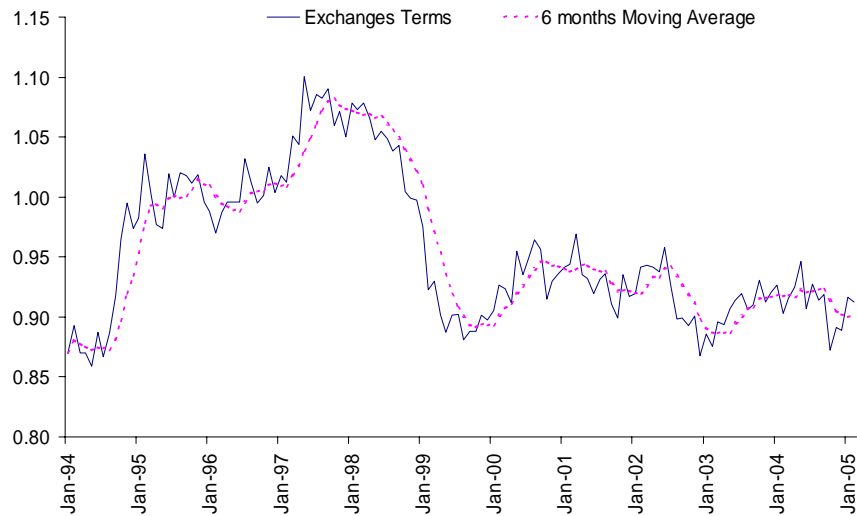
Source: Central Bank

## Current Account (12 months cumulated - % of GDP)



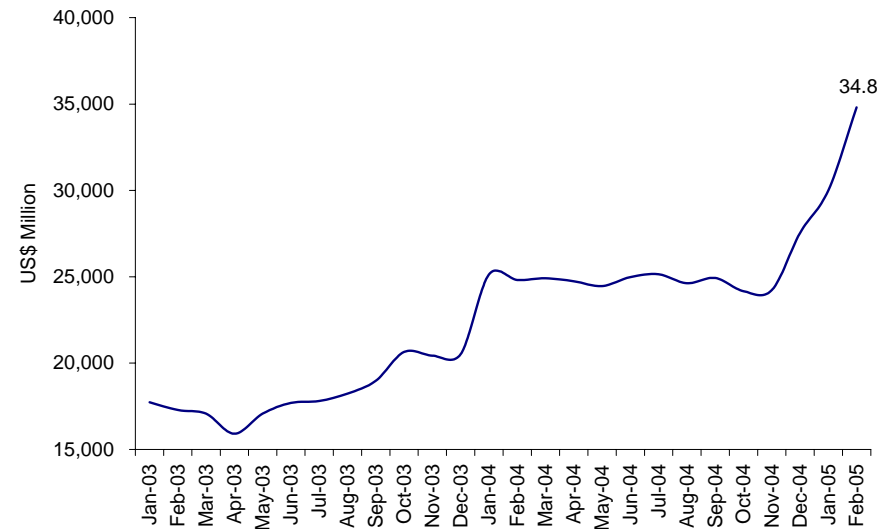
Source: Central Bank

## Terms of Trade



Higher number means more favorable terms; source:Tendencias

## Net Reserves - Excluding IMF

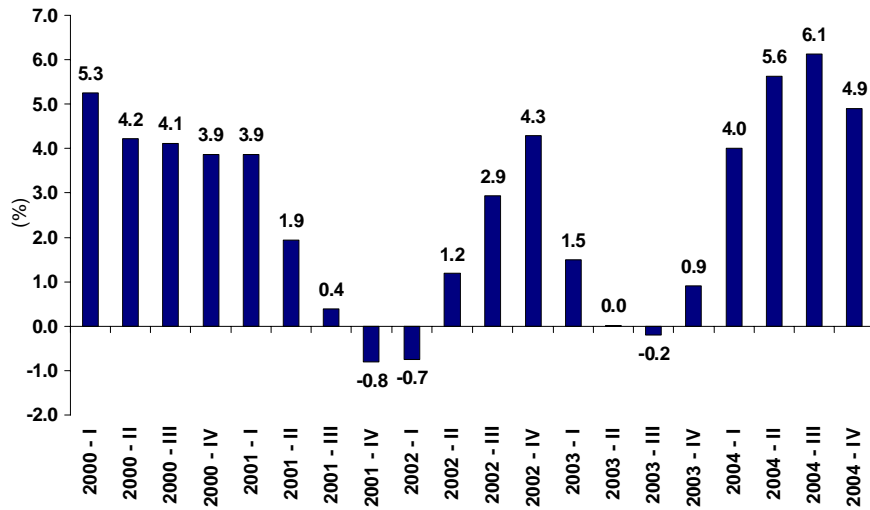


Source: Central Bank



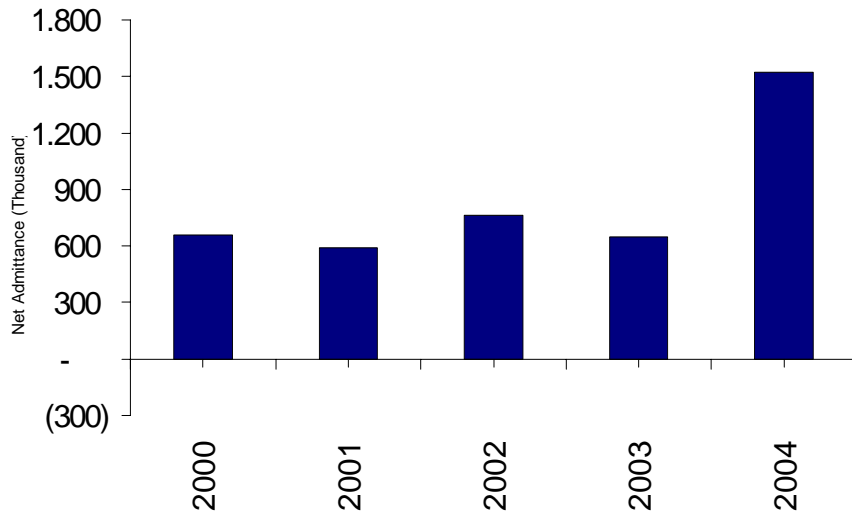
# Economic recovery with a pick up in investment and new jobs

## GDP Growth quarter on quarter (%)



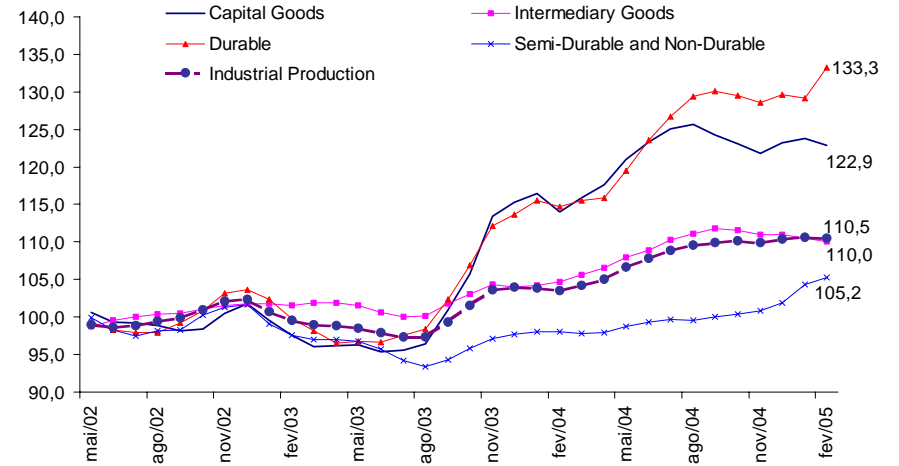
Source: IBGE

## Job Creation in the formal market (thousands)



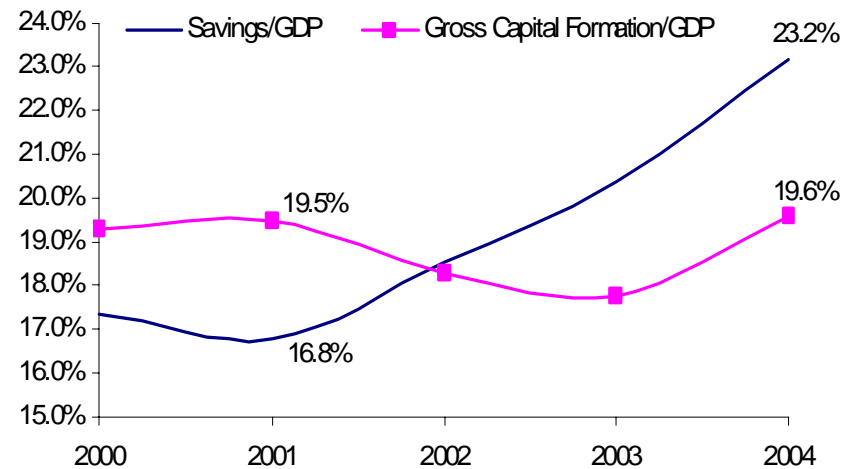
Source: IBGE  
Note: Average 1990=100

## Industrial Production by Category (Quarterly Moving Average)



Source: IBGE

## Savings (as % GDP) and Gross Capital Formation (as % GDP)



Source: IPEA and IBGE



# A wide range of macroeconomic and microeconomic reforms

## Status of Key Reforms

Reform/measure	Type of measure	Approved/issued	Status	
			Approved/issued	Work in progress
Social Security Reform (Public Sector Scheme)	EMC #41 Constit. Amendment	2003	✓	The deficit of this scheme amounts of 3% of GDP. The reform will help reduce it in the short, medium and long-term (by taxing high pension funds and creating a complementary pre-funded scheme, in addition to change the number of years of contributions and
Transformation of COFINS in a VAT	Draft Law 474/01	ongoing	✓	This tax raises more than 5% of GDP and loopholes were closed regarding local regulation discrepancies, harmonizing tax schedule and inter-state trade distortions.
Elimination of PIS/Cofins on Financial Receipts	Decree #5,164	2004	✓	
Real Estate Sector Reform Law	Law # 10,931	2004	✓	
Loans guaranteed by Payroll	Law # 10,820	2003	✓	
Securitization of Bank Credits ( <i>Cédulas de Créditos Bancários</i> )	Law # 10,931	2004	✓	
Private rural insurance	Law # 10,820	2004	✓	
Agribusiness Deposit Certificate	Law # 11,076	2004	✓	
Agribusiness call option	Law # 11,076	2004	✓	
Investment Account Law	Law #10.892	2004	✓	Eliminates effect of CPMF on portfolio adjustments and help boost competition in the financial sector
REPORTO	Law # 11,033	2004	✓	Creates incentives to ports modernization and application

## ... reforms that continue to happen

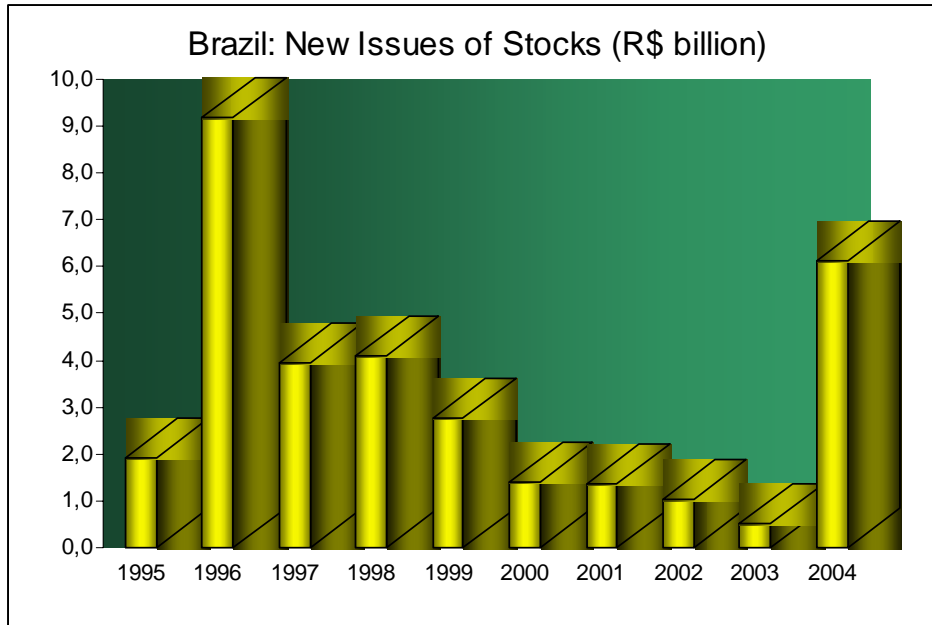
### Status of Key Reforms

em 14/04/2005

Reform/measure	Type of measure	Approved/issued	Status	
			Work in progress	
Bankruptcy Law	Law # 11,101	2005	✓	
Energy Sector Framework		2004	✓	Market-base framework already tested in real auctions
Tax incentives for long-term investment	Law #11,033 and 11,053	2004	✓	
Private-Public Partnership Law	Law # 11.079	2004	✓	
Industrial Development Agency Act	Law # 10,093	2004	✓	
Research and Development Incentives	Law # 10,973 and #11,077	2004	✓	
Technological Innovation Law	Law # 11,080	2004	✓	
Judicial Reform		2004	✓	Key articles approved in 12/08/2004. The " Súmula Vinculante" (will speed up judicial process) and external control approval. Fourteen further measures are to be voted this year, aiming at improving the pace of judicial decisions.
Framework to subject the financial system to the Anti-trust Authority	Draft Law			Approved in the Financial and Tax Commission, is under consideration in the Constitution and Justice Commission
Regulatory Agencies Law	Draft Law # 3,337	2004		Under discussion in the Lower House. Requested as a priority. Expected to be voted by the end of Mar-05

... and have been translated into a comeback of the stock market

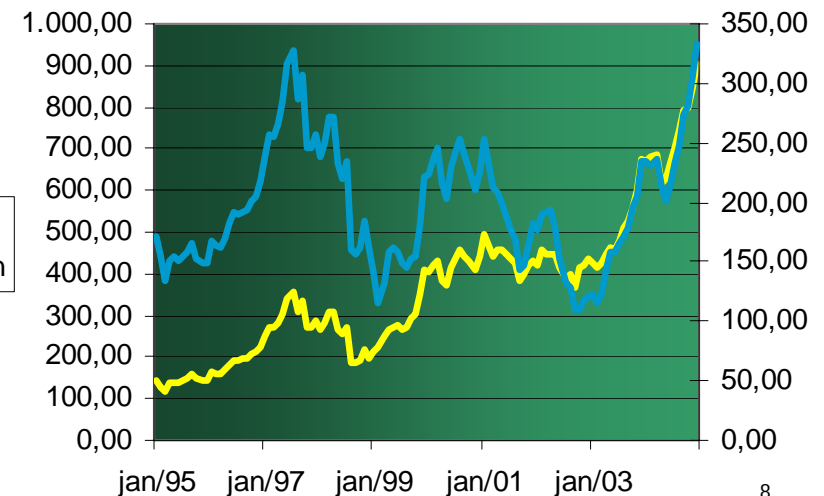
### Selected indicators in the stock market



- Stock appreciation also help pension funds to consider new investments (the Brazilian pension fund industry is among the 10 top in the world)

- Issues are helping to harness capital to increase exports (e.g., Natura, Grendene) and infrastructure (e.g., CCR road concessioner, LLA railroad operator, CPFL energy company)

### BOVESPA Market Cap



Looking Forward

The main challenge ahead is not *elections* or turbulence in international financial markets, but to ensure an environment more and more favorable to investment and new opportunities to low-income people.

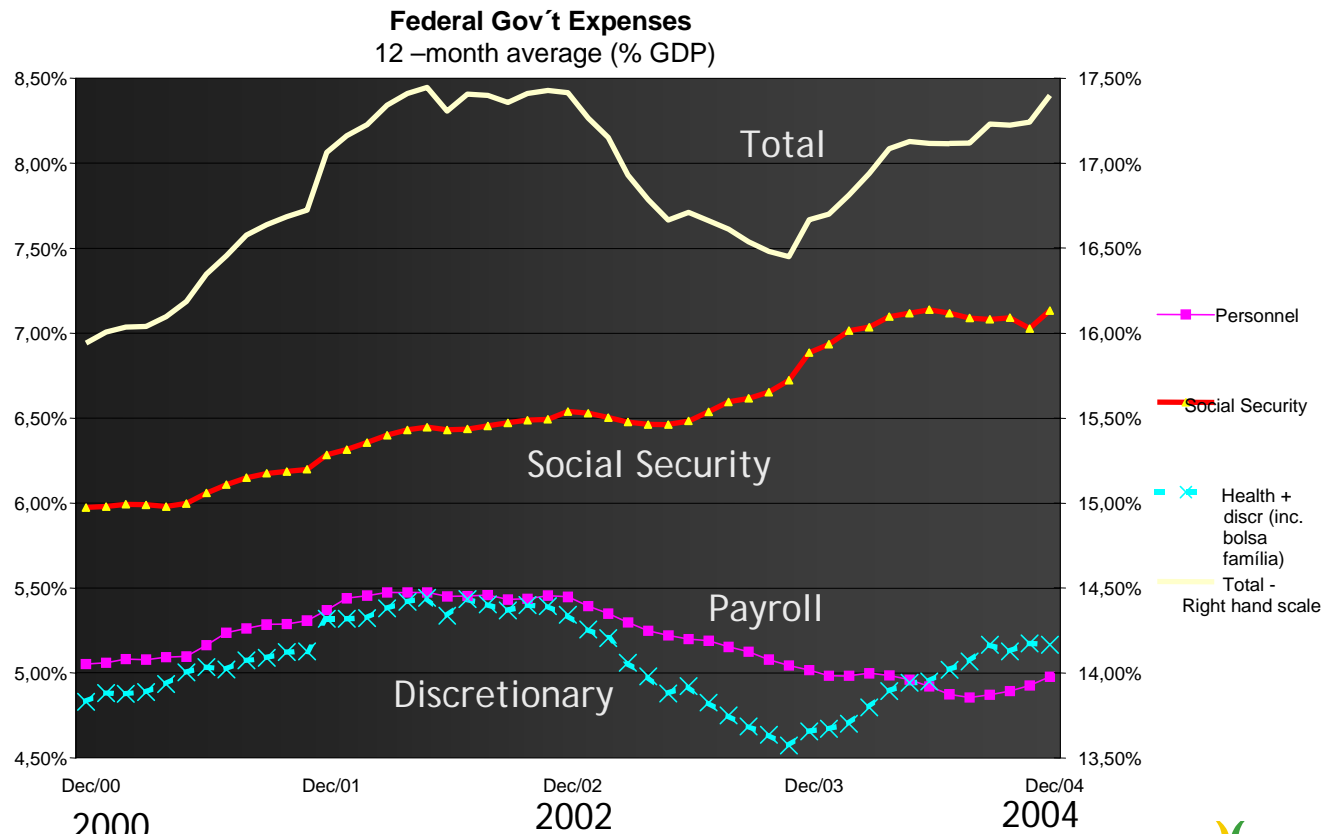
This goal is being sought by consolidating the hard-earned advantages from:

- Firm, rather than relaxed fiscal stance;
- Renewed commitment to put a lid on taxes;
- Strong external sector (current account surplus);
- Well-defined, comprehensive reform agenda;
- Private sector participation in well-regulated infrastructure sectors, e.g., through energy auctions, road concessions, municipal sanitation programs;
- Pilot Project with IMF to innovate in public investment;
- Strong and open financial sector.

The 2004 budget execution reflects the choice of saving cyclical revenues

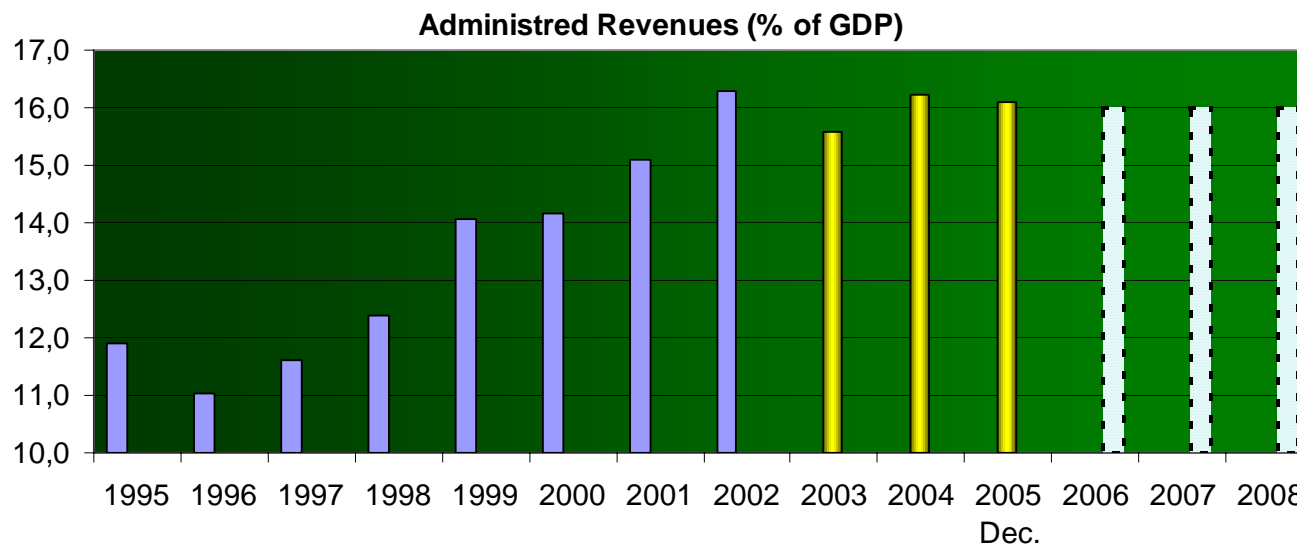
2004 budget highlights:

- Primary target raised to 4,5% of GDP (4,6% outturn);
- Stable public sector payroll outlays & discretionary expenditures below 2002 peak (as % of GDP);
- Social Security: slower, but still excessive, expenditure growth (it should *anticyclical!*).



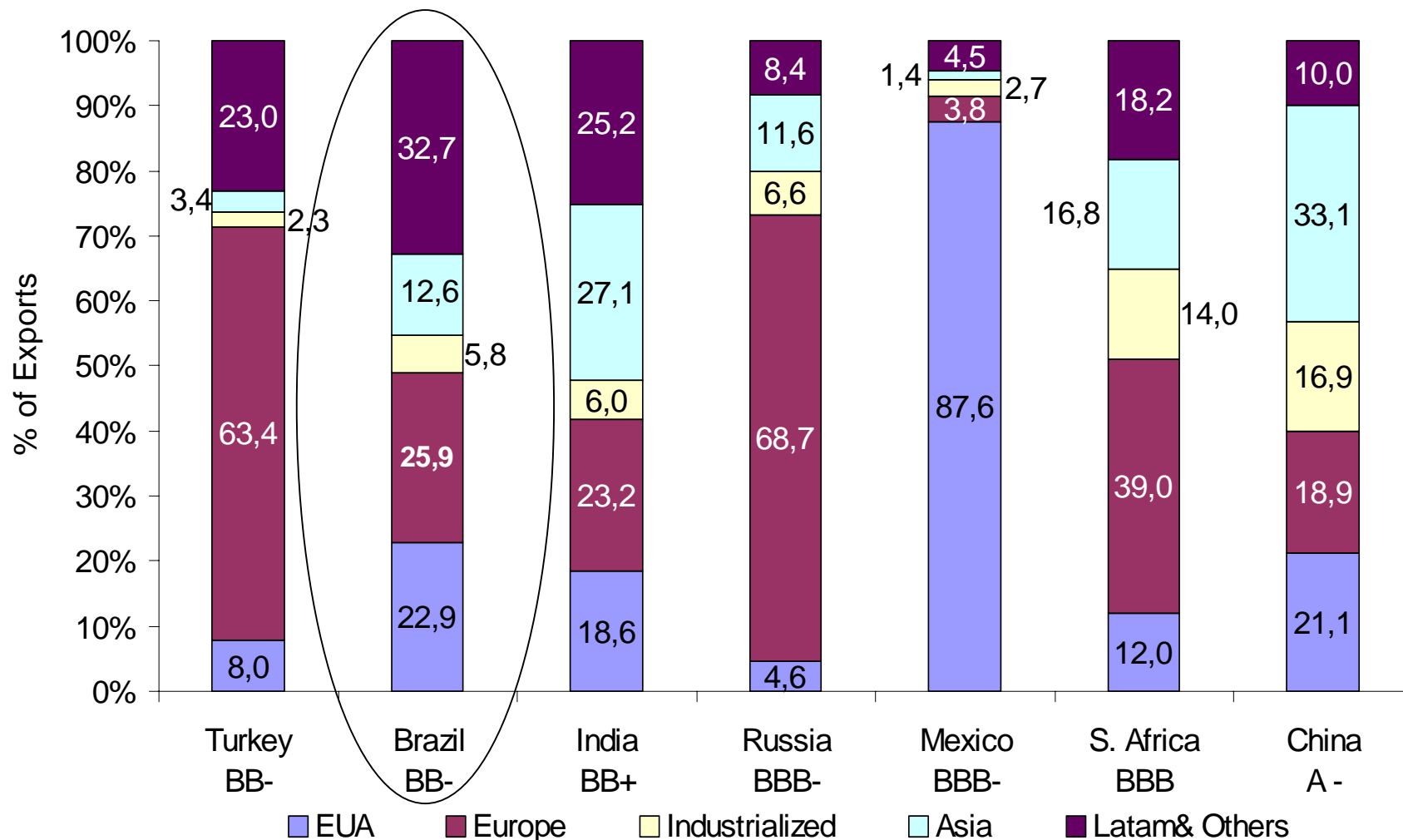
■ LDO 2006 Highlights:

- 4,25% primary target for 2006-2008, with potential allowance of R\$ 3 billion/year for IMF-pilot project investment;
- Ceiling of 16% of GDP for Administrated Federal Tax Revenue (excludes Social Security contributions);
- Ceiling of 17% of GDP for current expenditures (Central Government, including Social Security);
- The 2007-2008 LDO and budget law will consider further reductions in taxes and expenditure.



# Brazil exports are well diversified in terms of markets & destinations

Selected Countries Exports Concentrations - % of Exports - 2003



- Half of Brazilian exports are manufactures: cars, trucks, airplanes and engines & telecommunication equipment alone account for about 20% of all exports

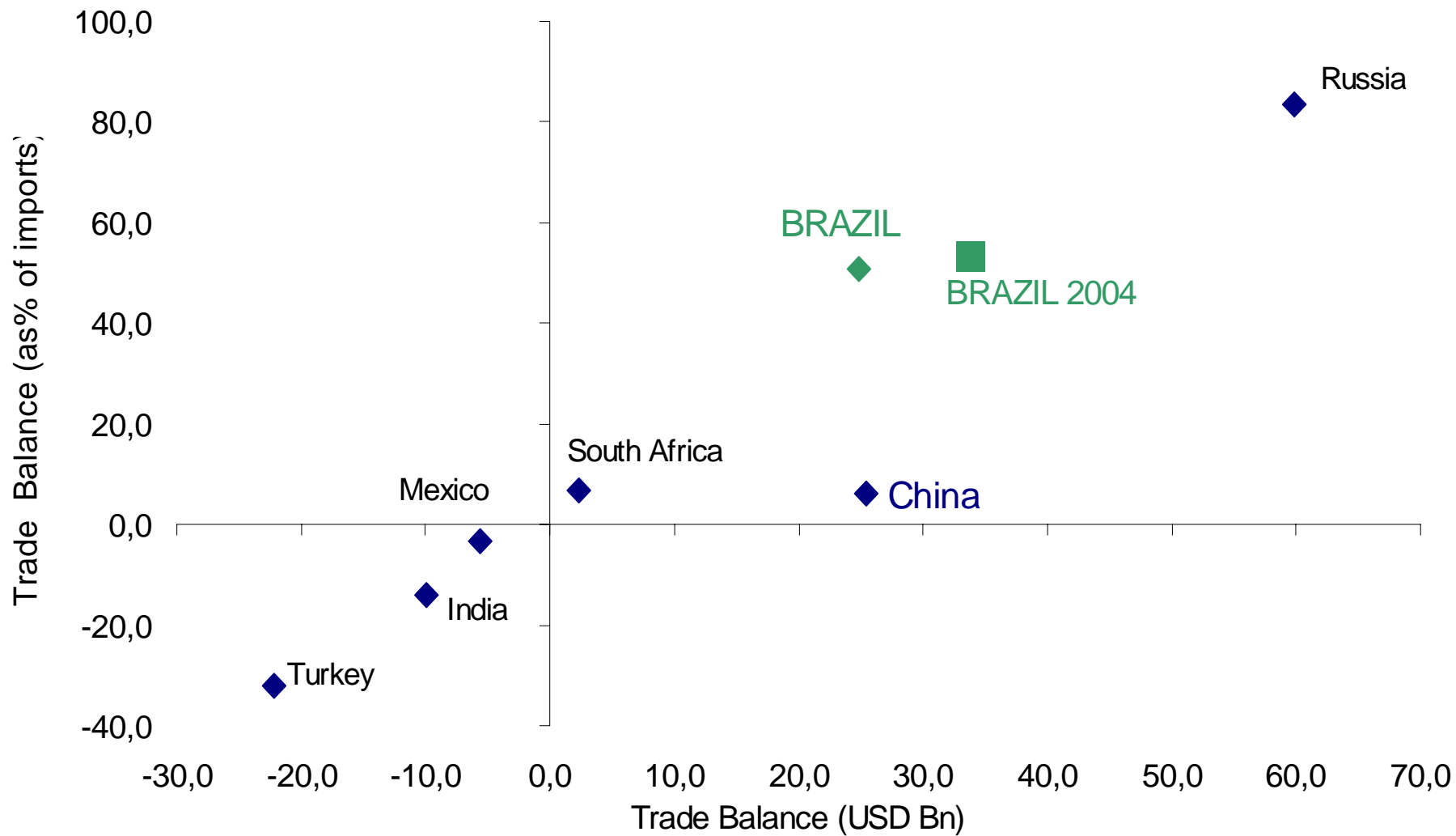
Source: IMF

\* Japan is among the industrialized countries



# Also, exports generate a high proportion of free cash flow

Selected Countries Trade "Effort" - 2003



Source: IMF and OECD



## Brazil is not alone in presenting an important structural reform scorecard

	BRAZIL	MEXICO	TURKEY	INDIA
<b>Infrastructure</b>	<ul style="list-style-type: none"> <li>• <b>Telecomm:</b> model is consolidated</li> <li>• <b>Electricity:</b> New framework consolidates early measures on secondary market for energy and private sector role</li> <li>• <b>Ports:</b> new concessions (RJ, MA, ES, SC).</li> <li>• <b>Roads:</b> resumption of concession process.</li> <li>• <b>Railroads:</b> rulings clarifying corporate structure and investment compensation</li> <li>• <b>PPP</b></li> </ul> <p><b>Pilot Project with IMF.</b></p>	<ul style="list-style-type: none"> <li>• Electricity: overhauling of supervisor;</li> <li>• Telecomm: Reporting of quality of service.</li> </ul>	<ul style="list-style-type: none"> <li>• Government is attempting to reduce cross subsidies in the energy sector (now favoring households and burdening business)</li> <li>• Several reforms have been started, but have not yet been completed</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Electricity and gas:</b> new rules for secondary markets;</li> <li>Ports, shipping, etc.: new support mechanisms</li> <li>• <b>Railroads:</b> strengthening of intermodal operation;</li> <li>• <b>agriculture:</b> crop insurance</li> <li>• <b>PPP.</b></li> </ul>
<b>BUSINESS ENVIRONMENT</b>	<ul style="list-style-type: none"> <li>• <b>Bankruptcy law:</b></li> <li>• <b>Consolidation of competition authorities</b> and clarification of attribution of different bodies (in congress)</li> <li>• <b>Gas:</b> continuation of auctioning of oil/gas fields and consolidation of supervisory powers since the end of government monopoly in 2001; review of gas transportation regulation (in discussion) .</li> <li>• <b>Judiciary Reform:</b>, increasing the predictability of rulings and speeding up conflict resolution</li> <li>• <b>Industrial policy</b> based on the support of research and lab infrastructure.</li> <li>• <b>Innovation law</b> providing incentives to researchers who team up with the private sector</li> </ul> <p>• <b>Stock markets:</b> most IPOs in the high-governance new market</p>	<ul style="list-style-type: none"> <li>• Bankruptcy law: focus on preserving viable firms</li> <li>• Oil and chemicals: discussions about liberalization of the market</li> <li>• Aviation: breaking up and privatization progressing, although at slower-than-anticipated pace.</li> <li>• Stock markets: new law protecting minority stockholders;</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Competition law:</b> harmonization with EU law</li> </ul>	<ul style="list-style-type: none"> <li>• Insolvency Law: new law facilitates forces reorganization of loss-making firms;</li> <li>• Competition: reduction of import restrictions and simplification of process.</li> </ul>
<b>FISCAL AND TRANSPARENCY</b>	<ul style="list-style-type: none"> <li>• Substantial share of procurement through internet</li> <li>• Fifth year of the Fiscal Responsibility Law</li> <li>• Transformation of PIS/COFINS in VAT.</li> <li>• Lower taxes on long-term savings, pension plans and life insurance</li> <li>• New taxation of securities backed by housing loans</li> </ul>	<ul style="list-style-type: none"> <li>• E-government;</li> <li>• New classification of expenditures, new periodic reporting requirements</li> <li>• Reduction in discretion regarding sub-national transfers</li> <li>• new bank prudential requirements.</li> </ul>	<ul style="list-style-type: none"> <li>• Decentralization of expenditure</li> <li>• Anti-corruption law.</li> <li>• Increased fiscal transparency.</li> </ul>	<ul style="list-style-type: none"> <li>• Budget execution procedures law;</li> <li>• New rules for fiscal transparency</li> <li>• Taxation: improvement in the taxation of capital gains and credit</li> </ul>
<b>HOUSING AND SANITATION</b>	<ul style="list-style-type: none"> <li>• Low-income, budget-supported housing program (<b>PSH</b>).</li> <li>• New rules for mortgages, protecting buyer and banks.</li> </ul>	<ul style="list-style-type: none"> <li>• Tax break for interest on housing loans.</li> </ul>		
<b>FINANCIAL SECTOR/ CREDIT</b>	<ul style="list-style-type: none"> <li>• Legislation on loans with payroll as collateral</li> <li>• Regulation of loan securitization mechanism (CC) Positive Credit Report for firms (Cadastro Central Bank)</li> </ul>	<ul style="list-style-type: none"> <li>• Microcredit with support of USAID;</li> <li>• Independence of Central Bank.</li> </ul>	<ul style="list-style-type: none"> <li>• Reform of banking system after 2001 shock.</li> </ul>	<ul style="list-style-type: none"> <li>• Liberalization of foreign investment</li> </ul>
<b>EDUCATION AND LABOR</b>	<ul style="list-style-type: none"> <li>view to effectively reach poor students (e.g., those coming from public high schools), on a merit base.</li> </ul>	<ul style="list-style-type: none"> <li>• New model for vocational training;</li> <li>• New system of skills certification.</li> </ul>	<ul style="list-style-type: none"> <li>• Reduction in the taxation of temporary workers</li> </ul>	
<b>SOCIAL SECURITY AND SAFETY NET</b>	<ul style="list-style-type: none"> <li>• Reform of public sector Social Security consolidation of income transfer mechanism (Bolsa Familia/Fome Zero)</li> <li>• Micro-entrepreneur program (in Congress)</li> </ul>	<ul style="list-style-type: none"> <li>• Additional resources to improve curricula and general education.</li> </ul>	<ul style="list-style-type: none"> <li>• Incentive to competition in the pharmaceutical sector.</li> <li>• Increase in the length of contribution period for social security benefits.</li> </ul>	<ul style="list-style-type: none"> <li>• Strong focus on financial support of very-low-income entrepreneurs.</li> </ul>

## Social Reforms are integral part of the overall strategy

- PSH
- Pró-Uni
- Bolsa Família
- Microcrédito

<b>FISCAL AND TRANSPARENCY</b>	<ul style="list-style-type: none"> <li>• Transformation of PIS/COFINS in VAT.</li> <li>• lower taxes on long-term savings, pension plans and life insurance</li> <li>• New taxation of securities backed by housing loans</li> </ul>
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<b>EDUCATION AND LABOR MARKETS</b>	Overhauling of tax-supported grants by private universities with a view to effectively reach poor students (e.g., those coming from public high schools), on a merit base.
<b>SOCIAL SECURITY AND SAFETY NET</b>	<ul style="list-style-type: none"> <li>• Reform of public sector Social Security</li> <li>• Reform of minimum benefit law (LOAS, 2003) and consolidation of income transfer mechanism (Bolsa Família/Fome Zero)</li> <li>Micro-entrepreneur program (in Congress)</li> </ul>

## ■ PPP

- Law approved and Steering Committee established;
- Decree authorizing the transfer of resources to the Guarantee Fund signed;
- Treasury preparing by-laws for the Guarantee Fund, which will be managed by a third-party under the supervision of CVM (e.g., BBOTVM).

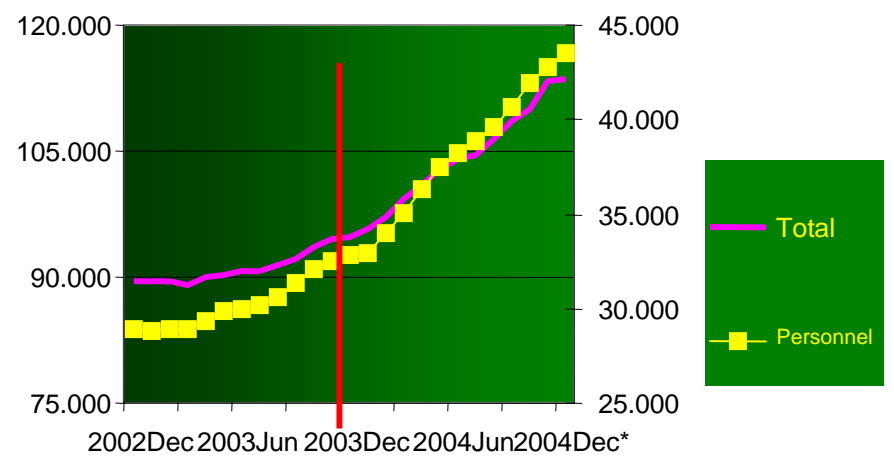
## ■ Pilot Project

- Successful selection of projects in Transportation, Irrigation, and R&D (as per *Progress Report n. 1* available at the Internet);
- Implementation of road maintenance work and duplication of BR 101-South; development of monitoring procedures (integral part of the project);
- Coordination with National Integration Minister to implement irrigation projects;
- Sanitation: CMN Resolution allowing the use of direct credit resources (Caderneta de Poupança) to fund municipal projects with private companies

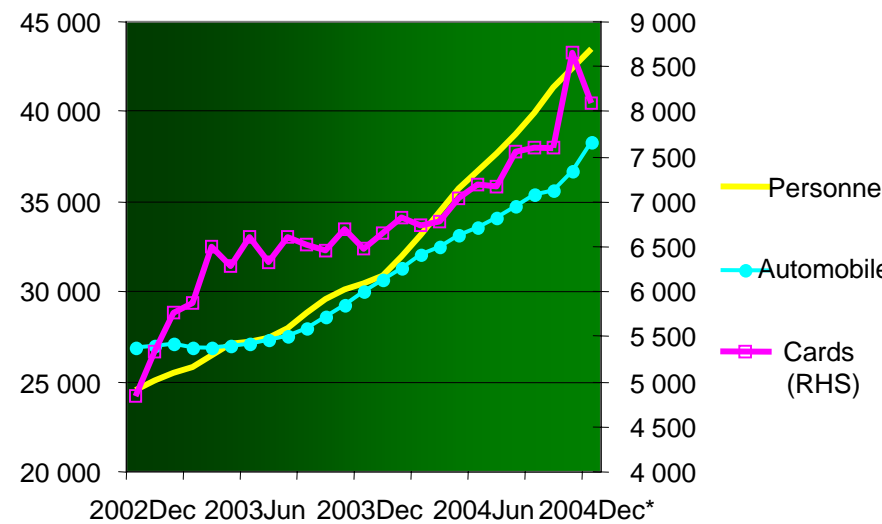
# The banking sector helped support domestic demand in 2004

LOOKIN FORWARD- THE ROLE OF BANKS AND COST OF MONEY

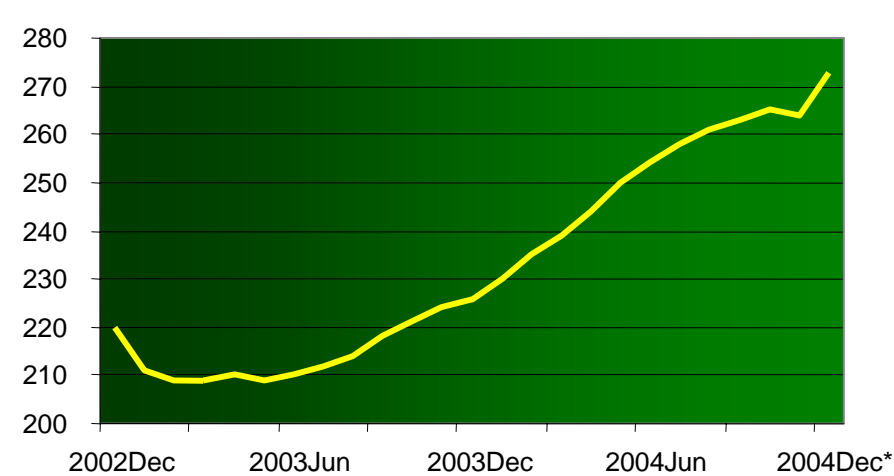
Personal Credit (R\$ million at 2004 prices)



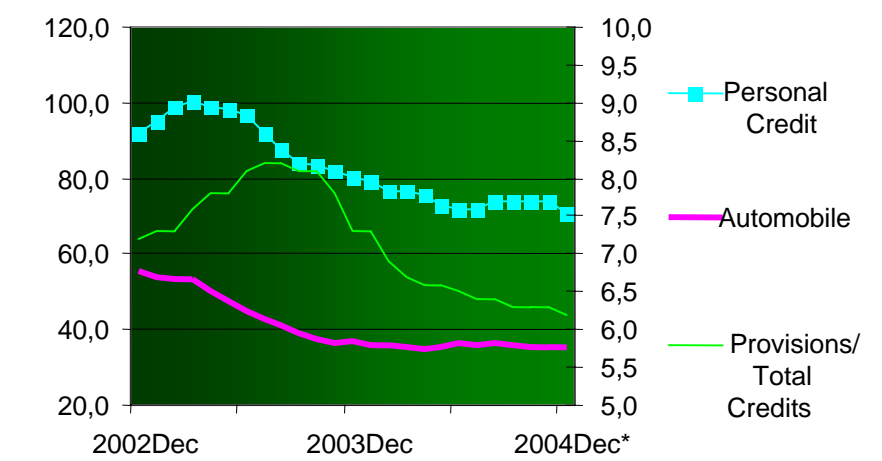
Personal Credit per group (current prices)



Average Maturity of Personal Credit (in days)



Consumer Interest rates (% a.a.) and Credit Provisions (% of total loans)



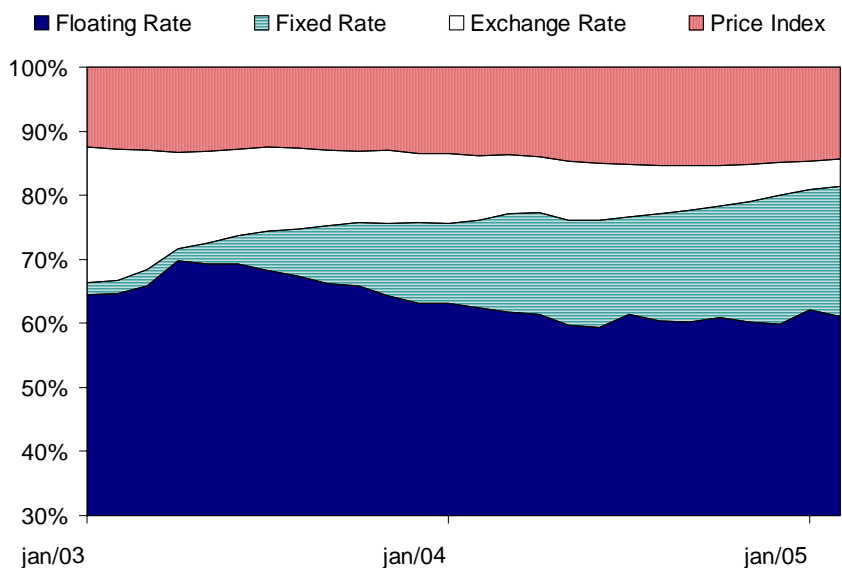
## ... but there are broader issues

Improving the credit rating of the public sector will help unleash private sector investment demand

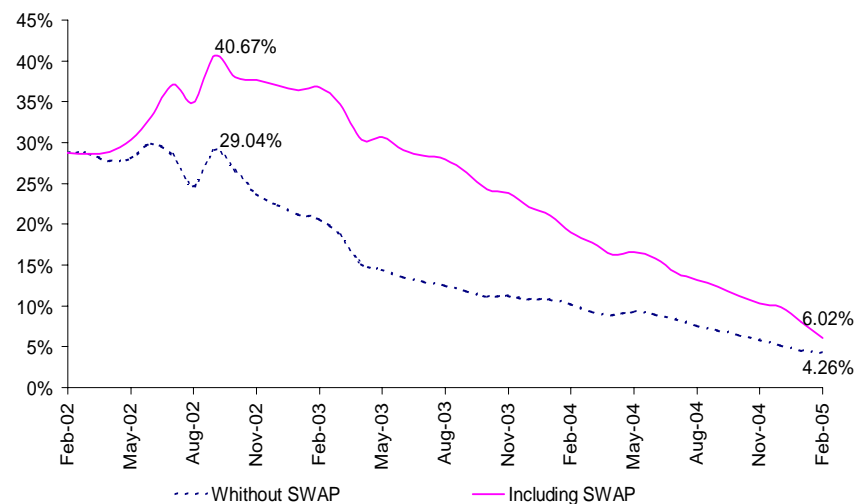
- Public sector credit ratings should not hold corporations down:
  - Petrobras has large proven reserves, the technology to develop them, financial resources to do it (most of its earnings are retained) ; still, the company faces a high cost of capital;
  - CVRD stock price is increasing, but market cap still reflects a high discount rate in long-term projects;
  - Many other private companies in the steel, energy, transportation, sanitation, agribusiness, logistics and technology (e.g., biotech) sectors have the competitive skills and important capital needs.
  
- In addition to help reduce the Debt/GDP ratio, the Treasury is working to
  - Improve the debt composition;
  - Make domestic public debt more attractive to external investors.

# Improving the Public Debt Composition

## Domestic Debt Profile



## Domestic Exchange Rate Debt as % of Domestic Debt

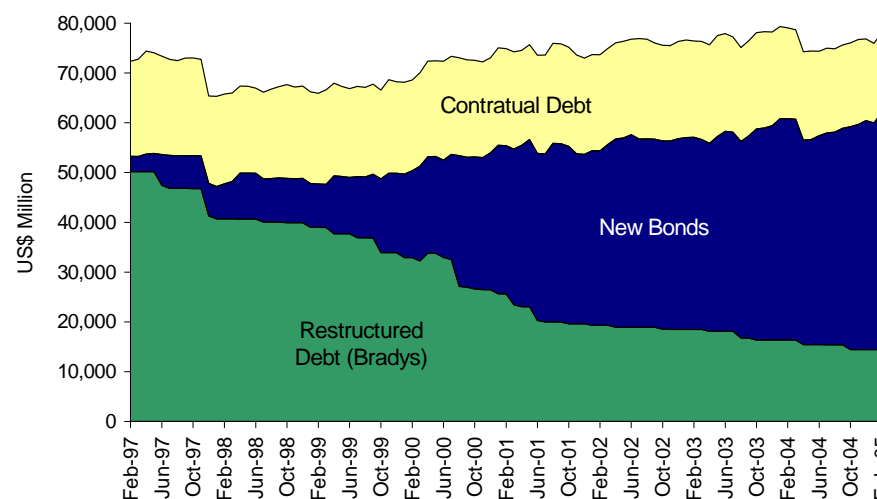


## Domestic Debt -Stress Test over Interest and Fx-rate (R\$ billion)

Index	Domestic Debt (DPMFi) Share (%)			Stress Impact		
	2002	2003	2004	2002	2003	2004
<b>SELIC</b>	60.8	61.4	57.2	33.59	33.91	31.62
<b>Fx rate</b>	22.4	10.8	5.1	98.37	47.25	22.57
<b>Total</b>	83.2	72.2	62.4	131.96	81.17	54.19

Obs: Stress is represented by a 3 standard deviation shock over the average SELIC rate and over the real Fx-rate devaluation cumulated in 12 months (Jan/00 to Dec/04).  
Reference: DPMFi as of Dec/04 (R\$ 810.13 billion). The stress for the SELIC corresponds to a 1 year period whereas for the FX-rate it is instantaneous.  
source: Nacional Treasury.

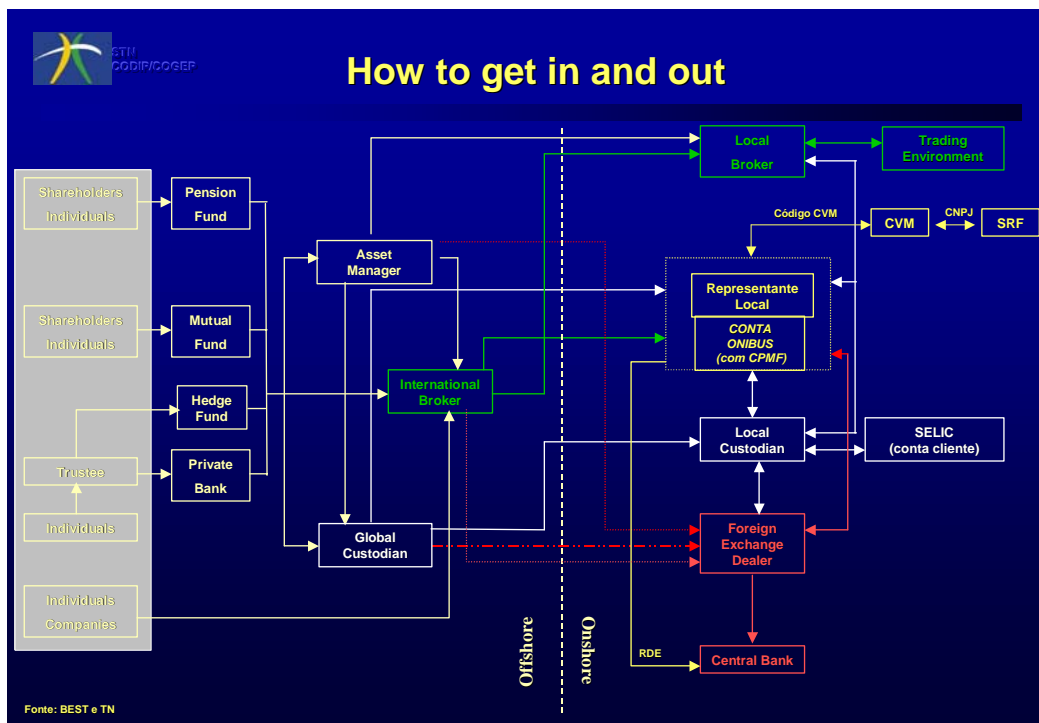
## A steady level of public external debt



\* The impact is measured in absolute terms



# Making domestic financial markets more attractive to foreign investors



Currently, there are no restrictions to invest in Brazil, but investors are not familiar with procedures

BEST and the Treasury are working to change that

\* \* \*

First step is to increase public awareness

Second step is to better harmonize tax, administrative requirements

## Points to Consider:

- Simplification of x-market with recent CMN resolution unifying x-rate markets;
- Registration requirements limited to statistical purposes and alignments to investors' own compliance rules;
- 24 hour enabling process by CVM; scope for harmonization by Revenue Service (definitive CNPJ);
- Goal of establishing a seamless settlement/convertibility process;
- Goal of consolidating taxes without multiplying special regimes.

JP Morgan and Bloomberg already have Brazilian DOMESTIC R\$ DEBT listed on their screens

GRAB JP MORGAN Govt JBRL

Brazil Local Markets Fixed Income Rates - (55-11)3048-3995 18:36 GMT

Indicative Prices - Good for BRL 10MM - Latest update at 15:36 06 Page 1 of 1

Tenor	Bid	Offer	Chg	Maturity	Bid	Offer	Chg	Maturity	Bid	Offer
30d	19.28	19.38	-0.02	02May05	19.25	19.35	-0.02	01Apr05	19.42	19.38
60d	19.36	19.46	-0.06	01Jun05	19.35	19.45	-0.07	01Jul05	19.73	19.69
90d	19.43	19.53	-0.06	01Jul05	19.42	19.52	-0.07	01Oct05	19.85	19.77
150d	19.50	19.60	-0.11	01Aug05	19.48	19.58	-0.07	01Jan06	19.73	19.63
180d	19.50	19.60	-0.15	03Oct05	19.50	19.60	-0.15	01Jan07	19.16	19.06
270d	19.37	19.47	-0.15	02Jan06	19.37	19.47	-0.15	Government Bill NTN-F		18.18
360d	19.22	19.32	-0.16	03Apr06	19.22	19.32	-0.16	Government Bills LFTs		
720d	18.38	18.68	-0.25	03Jul06	19.08	19.23	-0.15	(Selic +)		
1080d	17.68	18.28	-0.28	02Oct06	18.90	19.05	-0.18			
1440d	17.10	17.90	-0.29	02Jan07	18.63	18.78	-0.22			
1800d	16.59	17.59	-0.31	02Apr07	18.44	18.59	-0.25			
2160d	16.48	17.28	-0.32	02Jul07	18.28	18.48	-0.27			
2520d	16.33	17.13	-0.33	01Oct07	18.13	18.33	-0.27			
				02Jan08	18.00	18.20	-0.27			
				01Apr08	17.87	18.07	-0.27			
Overnight CDI				01Jul08	17.73	17.93	-0.28			
19.2200				01Oct08	17.59	17.79	-0.28			

Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500  
 Hong Kong 852 2977 6000 Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000

JP Morgan screen includes:

Swap Spreads and Futures

LTN

LFT

NTN-F (5-year Reais fixed-rate bond)

Bloomberg screen includes:

NDF Analysis

Deposit Rates of up to 10 years with implied forward x-rate

GRAB Govt NDF

BRL partial onshore deposit rate not available.

**Non-Deliverable Forwards Analysis**

Currency **BRL** BRAZIL REAL Settled in **USD**

Spot rate **2.59650** Value date **4/ 8/05** BRL day count Act/360

Dates	Forward rate	BRL-deposit rate	USD rate	Days			
Points	Outright	Implied	Onshore	Difference			
1W 4/15/05	0.00755	2.60405	17.7887	19.3260	-1.5373	2.8263	7
1M 5/ 9/05	0.03150	2.62800	17.0148	19.3260	-2.3112	2.8913	31
2 6/ 8/05	0.06200	2.65850	17.2047	19.3945	-2.1898	3.0400	61
3 7/ 8/05	0.09450	2.69100	17.6349	19.4608	-1.8259	3.1231	91
4 8/ 8/05	0.12742	2.72392	17.8479	19.5000	-1.6521	3.2100	122
5 9/ 8/05	0.16033	2.75683	18.0331	19.5225	-1.4894	3.3000	153
6 10/11/05	0.19325	2.78975	18.0469	19.5450	-1.4981	3.3894	186
9 1/ 9/06	*****	*****	*****	19.4075	*****	3.6175	276
1Y 4/10/06	0.37175	2.96825	18.3769	19.2700	-0.8931	3.7900	367
2 4/ 9/07	0.72210	3.31860	16.7751	0.0000	16.7751	4.0651	731
3 4/ 8/08	*****	*****	571.6901	0.0000	571.6901	4.2596	1096
4 4/ 8/09	*****	*****	390.7935	0.0000	390.7935	4.4028	1461
5 4/ 8/10	*****	*****	301.4891	0.0000	301.4891	4.5186	1826
7 4/ 9/12	*****	*****	188.2682	0.0000	188.2682	4.6779	2558
10 4/ 8/15	*****	*****	120.8674	0.0000	120.8674	4.9091	3652
10/11/05	0.19325	2.78975	18.0469	19.5450	-1.4981	3.3894	186

Reset: 0 Source: BRL-CMP ; USD-CMP Onshore: BRAZIL Calculate: 2 Deposit rate

Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 920410  
 Hong Kong 852 2977 6000 Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2005 Bloomberg L.P.  
 6724-108-0 06-Apr-05 15:39:19



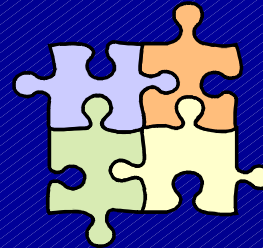
# Just consistency with Government Policies stated back in 2003



MINISTÉRIO DA FAZENDA  
Secretaria do Tesouro Nacional



## I Seminário Internacional de Fundos de Pensão **BRAZIL: Piecing together a STRATEGY TO MOVE FORWARD**



Joaquim Vieira Levy  
Secretário do Tesouro Nacional  
Rio de Janeiro, Maio de 2003



### PILLARS TO DEVELOPMENT



**Fiscal and  
Monetary  
Responsibility**

Fiscal and Monetary  
Targets, Abiding to  
contracts, LRF

**Affordable  
Safety Net**

Social  
Security  
Reform

**Entrepreneur  
ship**

Tax Reform,  
Capital Markets,  
Chapter 11

No non-sense reforms

# *Thank you !*



The Brazil we all know... and the Brazil we are building



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



Ministry of Finance

