



# **Public Debt: Annual Borrowing Plan 2005**

**Number 5**

**Brasília  
February/2005**

**MINISTER OF FINANCE**

Antonio Palocci Filho

**EXECUTIVE SECRETARY OF THE MINISTRY OF FINANCE**

Bernard Appy

**NATIONAL TREASURY SECRETARY**

Joaquim Vieira Ferreira Levy

**CHIEF OF STAFF AT THE NATIONAL TREASURY**

José Cordeiro Neto

**DEPUTY SECRETARIES AT THE NATIONAL TREASURY**

Almério Cançado de Amorim

José Antonio Gragnani

Jorge Khalil Miski

Tarcísio José Massote de Godoy

**TECHNICAL STAFF FOR THE PUBLIC DEBT MANAGEMENT****Deputy Secretary**

José Antonio Gragnani

**Head of the Public Debt Operations Department**

Paulo Fontoura Valle

**Head of the Public Debt Strategic Planning Department**

Anderson Caputo Delfino Silva

**Head of the Public Debt Control Department**

Antônio de Pádua Ferreira Passos

**External Debt Adviser**

Ricardo Franco Moura

Carolina Avelino de Carvalho

Daniel Pereira da Silva

Edis Machado Canedo

Elvino de Carvalho Mendonça

Fernando Eurico de Paiva Garrido

Janete Duarte

João Alberto Travassos Evangelista

Jônathas Delduque Júnior

Jossifram Almeida Soares

Lena Oliveira de Carvalho

Leonardo Lima Chagas

Leopoldo Araújo Rodrigues

Luiz Fernando Alves

Márcia Fernanda Tapajós Tavares \*

Mário Augusto Gouvêa de Almeida

Otávio Ladeira de Medeiros

Renato Pontes Dias

Rodrigo Silveira Veiga Cabral

Ronnie Gonzaga Tavares

William Baghdassarian

\* Technical Coordinator

**For further information:**

Tel: (61) 412-3188; Fax: (61) 412-1565

National Treasury Secretariat

Edifício do Ministério da Fazenda, Esplanada dos Ministérios, Bloco P, 2º andar

70048-900 - Brasília - DF - Brazil

**E-mail:** stndivida@fazenda.gov.br

**Home Page:** <http://www.tesouro.fazenda.gov.br>

***Public Debt: Annual Borrowing Plan 2005** is an annual publication by the National Treasury Secretariat. The original document was written in Portuguese. Reproduction in full or in part is permitted provided that the source is given proper credit.*

**Circulation: 350 issues**

Public Debt: Annual Borrowing Plan 2005. 1/Finance Ministry, National Treasury Secretariat, Brasília: National Treasury Secretariat, February, 2005, number 5.

1.Public Debt 2. Annual Borrowing Plan 3. Planning 4. Strategy  
I. Brazil. National Treasury Secretariat II. Title



*The year 2004 was favorable for the Brazilian economy, as the country started to reap the benefits of the policy consolidation and adjustment initiated in 2003. Income levels were up, with vigorous job creation and the highest GDP growth rate in the last 10 years. The foreign sector expanded strongly, contributing to the growth of the economy and the reduction of the country's external exposure to financial risks. These results were reached in a setting of fiscal discipline and monetary stability, demonstrating that the measures adopted were correct and worthy to be incorporated as standard practices for the management of the Brazilian economy.*

*Evidently, there is room for improvement in our economy, in order to reach greater efficiency, prosperity, and a better distribution of income. In this sense, the Federal Government has been making great strides in its Growth Agenda, by means of structural reforms aimed at the reduction of the cost of capital, the strengthening of the business environment, and an effective social safety net. In order to achieve these goals, it will be necessary to maintain fiscal discipline and to continue improving the quality of public spending, including the efficiency of public spending in social programs. Reducing capital costs, developing credit, and lowering the costs of solving conflicts are essential ingredients to stimulate investments and, consequently, to support economic growth. Predictability in the economic policy is another important factor.*

*In this context, the National Treasury, for the fifth consecutive year, presents its Annual Borrowing Plan - PAF 2005. The PAF allows the Federal Government to present its objectives regarding the administration of the Federal Public Debt. Its regular publication contributes to increase the confidence of domestic and international markets in this important area of the economic policy. This year, its scope is broadened, as the National Treasury takes full responsibility for the administration of the Federal External Public Debt, in yet another step towards Brazil's institutional strengthening.*

*The PAF 2005 points out advances in various aspects of the public debt. The Plan insists on targeting the reduction of the country's exposure to liabilities linked to short-term interest rates and the exchange rate, and on increasing of the proportion of fixed-rate and price-indexed instruments in the overall debt. The PAF 2005 also projects further strengthening in the management of other risks, such as the refinancing risk, by envisaging the extension of the maturity of the debt and the reduction of mismatches between assets and liabilities. These results contribute to enhance the perception of the country risk and widen the investor base of the domestic and external debt, with a positive impact on the national economy and public welfare.*

*It is, therefore, with great confidence that I congratulate the National Treasury for defining and making public these clear and wide-ranging goals for the current year.*

**Antonio Palocci Filho**  
**Minister of Finance**



Throughout 2004, Brazil's economic indicators showed significant improvements, reflecting the consolidation of economic policies. For the first time in many years, strong economic growth was accompanied by a surplus in the external current account, fiscal discipline, and single-digit, declining inflation. These factors, together with the robustness of the national financial system, are already reflected in many financial indicators. In particular, the country-risk premium closed out 2004 at approximately 400 basis points, and domestic medium-term real interest rates are significantly lower than in previous years. Moreover, the public sector net debt /GDP ratio was down for the second year in a row, after almost ten years of increases.

Maintaining policies that allow the consolidation of our 2004 performance opens new perspectives for Brazil, its business sector, and its people. The decline in the country risk has reduced the cost of capital for companies and investments, particularly in the area of infrastructure. Economic stability has stimulated personal credit and the development of the financial market in new directions. These possibilities have been facilitated by the work of the National Congress, which has passed a series of wide-ranging reforms over the last two years.

After a major reform of the social security scheme for the Public Sector and a Tax Reform in 2003, Congress recently passed a new Bankruptcy Act, a new and responsible framework for the implementation of Public-Private Partnerships (PPP), a Framework Law for the electricity sector, and a reform of the real estate market, which will open new frontiers for mortgage and financial products, in addition to revitalize the construction sector. In 2004, the financial market benefited also from a reform of the taxation of savings accounts and, especially, of pension funds and life insurance.

These developments have strengthened the pension fund industry (which is already among the 10 largest in the world) and have been accompanied by a continual updating of the country's financial infrastructure that encompasses an efficient payment system, clear rules for transactions, and a wide and deep derivatives market working around the sixth largest futures exchange in the world, BM&F. Such progress was also mirrored in numerous innovations in the administration of the Federal Public Debt.

The Annual Borrowing Plan (PAF) for 2005 sets forth the financing guidelines for the National Treasury, including the goals and innovations proposed for this year. The primary objective of these guidelines and efforts is to minimize long-term financing costs, ensuring the maintenance of prudent risk levels, and contributing to the proper running of the market for the public debt.

An important innovation in 2005 is the transfer of the attribution of issuing Federal External Public Debt securities from the Central Bank to the National Treasury, a process initiated in the beginning of 2004. As a consequence, the planning for 2005 includes guidelines for the external debt, which were seen primarily as exogenous hypotheses until now.

The favorable performance of external debt securities, already reflected in the uneventful maturity of the first generation of bonds issued at the dawn of the so-called emerging markets, is now being consolidated by a judicious program of issuance of long-term securities in various currencies, as well as by the continuous development of a close relationship with an ever-widening range of investors, both institutional, such as pension funds, and in the retail market.

Within the scope of the domestic debt market, the volume of which is four times larger than that of the external debt and which average issuances amount to R\$35 billion a month (approximately US\$ 13

*billion a month), the objective is to continue the progress witnessed in recent years. In addition to envisage further enhancement of the primary and secondary market for the public debt, the PAF 2005 projects a new increase of the proportion of fixed-rate securities in the overall Public Federal Debt. This progress is expected to bring considerable gains in reducing the risks faced by the public sector, and to help increase the transmission of monetary policy impulses.*

*The proportion of securities indexed to price levels is also projected to rise, favored by the reform of long-term savings and the close contact between the Treasury and domestic pension funds. On the other hand, the share of floating-rate debt and of debt linked to the exchange rate is expected to fall. Furthermore, the Federal Debt management will continue seeking to reduce other types of exposure to risks, such as refinancing risk. The Treasury will continue to smooth the maturity schedule of Treasury Bills through repurchases, lengthen the maturity profile of the debt through competitive exchanges of other instruments, and keep a comfortable level of cash reserves.*

*Finally, the efforts of the National Treasury to further improve domestic financial markets will include the promotion of lower transaction costs, the harmonization of the taxation and execution of operations involving the public debt, and support to the competitive pricing of such securities. These are essential ingredients to widen the investor base and ensure that the Brazilian Public Debt becomes ever more solid.*

*Joaquim Vieira Ferreira Levy*  
**National Treasury Secretary**

**Contents**

Summary .....	9
Introduction .....	13
Section 1: Public Debt Planning .....	14
1.1 Objective and Guidelines of the Federal Public Debt (DPF) .....	14
1.2 Scenarios .....	14
Section 2: Borrowing Plan 2005 .....	15
2.1 Financing Assumptions and Requirements .....	15
2.2 Issuance Strategy .....	17
Domestic Debt .....	17
External Debt .....	18
2.3 Ranges for Quantitative Targets .....	19
Outstanding Stock by end 2005 .....	20
Debt Composition at end 2005 .....	20
Average Maturity at end 2005 .....	21
Debt Falling Due in 12 Months .....	21
Section 3: Risk Assessment .....	22
Section 4: Final Considerations .....	26
ANNEX – Brazilian Federal Public Debt Market .....	29
Federal Government Securities .....	29
Regulation .....	30
Custody .....	31
Taxation .....	31
ANNEX - Pricing .....	33
<b>Charts, Box and Tables</b>	
Chart 1 DPMFi Maturity Profile .....	16
Chart 2 DPFe Maturity Profile .....	16
Chart 3 Percentage of DPMFi Due in 12 Months .....	22
Chart 4 DPMFi Composition .....	23
Chart 5 Dollar Linked Domestic Debt – Including Swap and without Swap .....	24

---

Chart 6 Impact of 1% FX Devaluation on Public Sector Net Debt/GDP .....	24
Chart 7 Mismatch Between Assets and Liabilities .....	25
Chart 8 DPF Maturity Profile by Indicator .....	26
Chart 9 Average Number of Investors in USD Issuances by the Republic of Brazil (2001 = 100) ..	27
Chart 10 Average Allocation per Investor in USD Issuances by the Republic of Brazil .....	28
Box I Results for the Federal Public Debt – DPF .....	11
Box II Results for the Federal Domestic Public Debt – DPMFi .....	11
Table 1 DPF Maturities .....	15
Table 2 Federal Government Financing Requirements .....	17
Table 3 Results for the Federal Public Debt – DPF .....	19
Table 4 Results for the Federal Domestic Public Debt – DPMFi .....	20
Table 5 DPMFi – Interest and Exchange Rate Stress Test .....	23

## Summary

### Goals

The management of the Federal Public Debt (DPF) is aimed at minimizing long-term financing costs, while maintaining risks at prudent levels and contributing to the favorable performance of the public securities market. In order to achieve these goals, the following general guidelines for the management of the public debt have been established:

- Lengthening of the DPF's average maturity, mainly by increasing the average term of securities issued in public offerings (auctions);
- Reduction of the share of debt due in 12 months;
- Gradual replacement of floating-rate (*Selic*-linked) securities, as well as of exchange-linked securities, by fixed-rate and price-indexed securities; and
- Support to the development of the term structure of interest rates for public securities.

The financing strategy for 2005 is translated into a range of possibilities for the issuance of specific debt instruments, based on the analysis of alternative scenarios. The main hypothesis adopted in the elaboration of the scenarios was the maintenance of the thrust of current economic policies. In addition, likely responses were introduced to several possible shocks to the economic environment.

The base scenario is drawn from market expectations for 2005 at the beginning of the year. Its premises are the absence of external shocks and the maintenance of current trends in the domestic economy, i.e., continuation of the economic recovery, convergence of the inflation path to the official target, stability of the exchange rate, a gradual fall in interest rates, and further improvements in the indicators of fiscal and external solvency.

The financial requirements for the federal public

debt in 2005 are the first factors considered in the definition of the issuance strategy. Specifically, R\$437.5 billion in debt is projected to mature in 2005, of which R\$ 399.2 billion correspond to the Federal Domestic Public Debt (DPMFi) and R\$ 38.3 billion to the Federal External Public Debt (DPFe). Considering the existence of budgetary resources of R\$60.1 billion, the Federal Government's net financial requirements are projected at R\$377.4 billion.

### Specific Guidelines

The DPMFi<sup>1</sup> financing strategy will pursue the following:

- Increasing the share of fixed-rate securities (*LTN<sup>2</sup>* and *NTN-F<sup>3</sup>*) in the total Federal Public Debt and the gradual lengthening of their average maturities;
- increasing the stock of price-indexed securities, with an emphasis on the *NTN-B<sup>4</sup>*;
- reducing the stock of floating-rate (*Selic*-linked) securities (*LFT<sup>5</sup>*);
- no issuance of *NTN-D<sup>6</sup>*.

The DPFe financing strategy will pursue the following:

- Creation of benchmarks in the main emerging markets (e.g., by currency);
- easing of the structure of maturities in the Federal External Public Debt, by means of new issuances and liability management operations;

1 See the Annex for details on the DPMFi and its market.

2 These are fixed-rate securities with a single payment, on the date of redemption.

3 These are fixed-rate securities with semi-annual payments in interest coupons, which can be stripped and traded separately from the principal.

4 These are IPCA-linked securities, with semi-annual payment in interest coupons.

5 These are floating-rate securities (*Selic*-linked), with a single payment on the date of redemption.

6 These are securities that pay semi-annual interest coupons computed over the principal, which is indexed to the US dollar.

- gradual reduction of the stock of Brady Bonds;
- widening the investor base; and
- maintenance of a close relationship with the international financial community, including institutional and retail investors.

The DPFe will be managed in accordance with the new Federal Senate Resolution 20/2004. With a view to grant greater flexibility to debt management, this resolution authorizes the repurchase and swap of external debt securities, as well as the use of derivatives. A new ceiling of US\$ 75 billion for gross external debt issuances was also established.

#### *Quantitative Targets*

The main targets for the DPF and the DPMFi by end 2005 are the following:

- The average maturity of the stock of the DPF should rise from 35.3 months (level in December 2004) to a range between 36 and 41 months. A similar increase is projected for the average maturity of the DPMFi, which should rise from 28.1 months to a range of 28 to 34 months.
- The proportion of the DPF due in 12 months is projected to fall to a range of 34% to 40% of the overall debt, while the equivalent range for the FPMFi is set at 40-45%.
- The share of fixed-rate securities in the DPF is projected within the 16-25% range, compared with 16.1% at the end of 2004. The share in the DPMFi is projected in the 20-30% range, from 20.1% at end-2004.
- The share of price-indexed securities in the DPF is projected in the 12-16% range, from 11.9% at the close of 2004. This share in the DPMFi is projected in the 15-20% range, from 14.9% in end 2004.

The outstanding debt is projected to rise beyond the federal government financing requirements, in line with a gradual migration of resources, now locked in repurchase agreements (*repos*) with the Central Bank, toward outright investments in

public securities. From a fiscal perspective, this migration and the accompanying rise in the public debt is neutral, since it implies a decrease in Central Bank liabilities. In addition, mid-range projections of the share of debt falling due in 12 months<sup>7</sup> indicate a reduction in refinancing risks, with the volume of redemptions falling also as a proportion of GDP.

In turn, the external debt program for 2005 envisages the issuance of up to US\$6.0 billion, of which US\$1.5 billion was pre-financed in 2004.

#### *Risk Assessment*

A further decline in the sensitivity of the DPMFi to stress in interest rates and the exchange-rate is projected for 2005. The changes in debt composition are such that stress tests indicate that the impact of sustained changes in those variables on the stock of the debt dropped by more than 60.0% in since 2002.

Similarly, the impact on the Public Sector Net Debt/GDP of a 1% variation in the exchange rate ratio has dropped from 0.36% in September 2002 to 0,13% by end of 2004, being projected to drop to 0,11% by end 2005 (that includes the impact on Central Bank swaps).

The net mismatches between asset and liabilities of the Federal Government are also expected to be down in 2005. In particular, net assets indexed to prices are projected to decline, while fixed-rate net liabilities are projected to increase.

<sup>7</sup> The share of debt maturing in up to 12 months has shown a declining trend since 1999, albeit showing a small increase in 2004 as a result of the sharp increase in the stock of LTN, which brought, on the other hand, a positive contribution to the duration of the overall debt.

**Results and Targets for the Federal Public Debt - DPF**

Indicators	Dec/04	PAF-2005	
		Minimum	Maximum
Stock of DPF held by the public (R\$ billion)	1013.9	1160	1240
Average maturity - Federal Outstanding Debt (months)	35.3	36	41
% Due in 12 months	39.3	34	40
<b>Share of DPF</b>			
Fixed-rate (%)	16.1	16	25
Floating-rate (%)	45.7	39	47
Price-Index (%)	24.2	18	23
Exchange-rate (%)	11.9	12	16
Others (%)	2.1	1	3

Source: National Treasury

**Results and Targets for the Federal Domestic Public Debt - DPMFi**

Indicators	Dec/04	PAF-2005	
		Minimum	Maximum
Stock of DPMFi held by the public (R\$ billion)	810.3	940	1000
Average maturity of DPMFi (months)	28.1	28	34
% Due in 12 months	46.1	40	45
<b>Share of DPMFi</b>			
Fixed-rate (%)	20.1	20	30
Floating-rate (%)	57.1	47	57
Price-Index (%)	5.2	3	5
Exchange-rate (%)	14.9	15	20
Others (%)	2.7	2	4

Source: National Treasury

**Mid-term and Institutional Outlook**

Looking beyond 2005, the benefits of the strategy adopted since 2003 will become even more apparent. Sustaining current trends in the composition of the public debt will yield very favorable indicators by 2006/2007. This improvement can happen quite naturally, since three fourths of the current stock of floating-rate (*Selic*-linked) securities fall due over the next 36 months.

There is room also to continue widening the investor base in the external debt. Since 2001,

the average number of investors in issuances by the Republic has risen by more than 400%, with average allocations in the primary markets now being a small fraction of those in the past. The investor base is also becoming more diversified: penetration in retail markets is increasing, and the interest of institutional investors with long-term objectives keeps growing.

Widening the scope for the domestic market is also a priority for the Treasury. This is to be achieved by further developing the Tesouro Direto program (which allows for internet-based direct

investment in public debt by individuals) and by lowering transaction costs also to foreign investors, building on constant improvements in the modern infrastructure that already serves domestic financial markets.

## Introduction

Upon presenting its 2005 Annual Borrowing Plan - *PAF 2005*, the National Treasury is, for the fifth consecutive year, presenting to the public, in a systematic way, its goals, premises, and priorities. The *PAF* is an instrument not only of planning, but of increasing transparency, and a means to impart the growing predictability of the management of the Brazilian Federal Public Debt—DPF.

The 2005 Borrowing Plan presents the strategy elected by the Treasury and targets established for the public debt. It also provides an account of the risks surrounding the DPF and of measures to reduce and manage such risks.

The inclusion of guidelines for the external debt is noteworthy in the wake of the transfer of the attribution of issuing these securities from the Central Bank to the National Treasury in 2005.

The *PAF 2005* is divided into 4 sections, in addition to this Introduction. Section 1 presents the gene-

ral guidelines for the DPF planning process and outlines the economic scenarios that inform the debt strategy of the Treasury.

Section 2 discusses the Federal Government's financing requirements and the instruments to be used to satisfy them. It is the core section, where the targets for the year are laid out.

Section 3 is dedicated to an assessment of the risks associated with the DPF. The evolution of such risks in the recent period and projections regarding the main indicators measuring these risks are outlined there. The analysis in this section provides managerial indicators for the short-, medium-, and long-term planning of the DPF.

Section 4 concludes the document, summing up the progress already achieved in the management of the Brazilian Federal Public Debt, and the potential impact of current trends in a 2-year horizon. Some priorities set by the Treasury in terms of broadening the investor base in 2005 are also sketched.

## Section 1: Public Debt Planning

The 2005 Annual Borrowing Plan – *PAF 2005* presents the main targets for the management of the Brazilian Federal Public Debt - DPF. These targets translate into quantitative terms goals and guidelines drawn from a strategy based on a set of economic scenarios presented hereafter.

### 1.1 Objective and Guidelines of the Federal Public Debt (DPF)

The management of the Federal Public Debt, encompassing the domestic and external debts under the responsibility of the Federal Government, aims at minimizing long-term financing costs, thereby ensuring the maintenance of prudent risk levels and contributing toward the efficient operation of the public securities market, which are important elements for the attainment of that objective.

The general guidelines for the DPF management are the following:

- Lengthening of the DPF's average maturity, mainly by increasing the average term of securities issued in public offerings (auctions);
- Reduction of the share of debt due in 12 months;
- Gradual replacement of floating-rate (*Selic*-linked) securities, as well as of exchange-linked securities, by fixed-rate and price-indexed securities; and
- Support to the development of the term structure of interest rates for public securities.

These guidelines are to be implemented considering the room provided by market conditions.

### 1.2 Scenarios

The preparation of a financing strategy for 2005 involved several issuance alternatives, which were developed from the analyses of numerous scenarios. The main hypothesis adopted in preparing the scenarios was the maintenance of current economic policies. Scenarios included shocks to key variables and policy responses to them.

The baseline scenario broadly reflects market expectations for 2005 as of the beginning of the year. Its key underlying assumptions are the absence of significant external shocks and the maintenance of current trends in the domestic economy, namely, the continuation of the economic recovery, convergence of inflation to the official target, stability in exchange-rates, a gradual decline in domestic interest rates and further improvement in fiscal and external solvency indicators.

Alternative scenarios consider, in the downside, the possibility of increased volatility in international financial markets, which could reduce capital inflows, put pressure on the exchange-rate, and raise the country risk premium, thus narrowing the room for a drop in domestic interest rates. In the upside, a particularly benign external environment and high GDP growth without inflationary pressures could lead to an acceleration of the decline in interest rates. Although the set of scenarios used to draw the ranges for the debt targets encompasses a relative large gamut of situations, it does not include severe shocks in either the domestic or international economy.

## Section 2: Borrowing Plan 2005

This section will detail domestic and external financing strategies, as well as the premises on which they are based. It also presents the main quantitative targets for the Federal Domestic Public Debt—DPMFi<sup>8</sup> and for the Federal Public Debt—DPF<sup>9</sup>.

The outstanding debt maturing in 2005 is projected at R\$437.5 billion, of which the DPMFi accounts for R\$ 399.2 billion and the Federal External Public Debt - DPFe accounts for R\$ 38.3 billion. Specifically, DPF payments are distributed monthly as of Table 1 and Charts 1 and 2.

### 2.1 Financing Assumptions and Requirements

The DPF financing requirements for 2005 are the first set of factors to be considered in setting the volume target for the public debt.

**Table 1 - DPF Maturities**

R\$ Million

	Fixed rate	Exchange rate (a)	Interest rate (b)	Price Index	Total DPMFi	External (contracts)	External (bonds)	Total DPFe	Total DPF
Jan/05	25,413.3	4,136.1	1,068.3	664.2	31,281.8	794.9	1,861.5	2,656.4	33,938.2
Feb/05	0.0	1,938.3	21,598.4	438.4	23,975.1	50.3	1,565.3	1,615.6	25,590.7
Mar/05	0.1	341.8	23,051.7	609.1	24,002.8	81.4	664.4	745.7	24,748.5
Apr/05	58,208.3	540.1	3,989.5	1,237.3	63,975.1	146.9	5,871.3	6,018.2	69,993.3
May/05	0.0	61.1	29,423.1	802.0	30,286.3	52.5	530.3	582.8	30,869.1
Jun/05	0.0	52.6	20,894.2	617.4	21,564.2	3,127.6	415.8	3,543.4	25,107.6
Jul/05	39,459.4	150.4	1,769.2	8,496.6	49,875.7	24.1	10,448.3	10,472.4	60,348.1
Aug/05	0.0	62.2	38,299.9	427.4	38,789.6	40.4	1,041.9	1,082.3	39,871.9
Sep/05	0.0	350.6	27,974.7	619.3	28,944.7	83.2	1,044.9	1,128.0	30,072.7
Oct/05	32,614.2	3,064.6	4,803.9	1,280.7	41,763.4	125.7	5,824.6	5,950.3	47,713.7
Nov/05	-	3,913.6	17,032.0	822.4	21,767.9	43.8	900.5	944.3	22,712.2
Dec/05	-	51.8	11,083.6	11,875.5	23,010.8	3,284.7	235.5	3,520.2	26,531.1
<b>Total</b>	<b>155,695.5</b>	<b>14,663.2</b>	<b>200,988.4</b>	<b>27,890.4</b>	<b>399,237.4</b>	<b>7,855.3</b>	<b>30,404.2</b>	<b>38,259.6</b>	<b>437,497.0</b>

Source: National Treasury

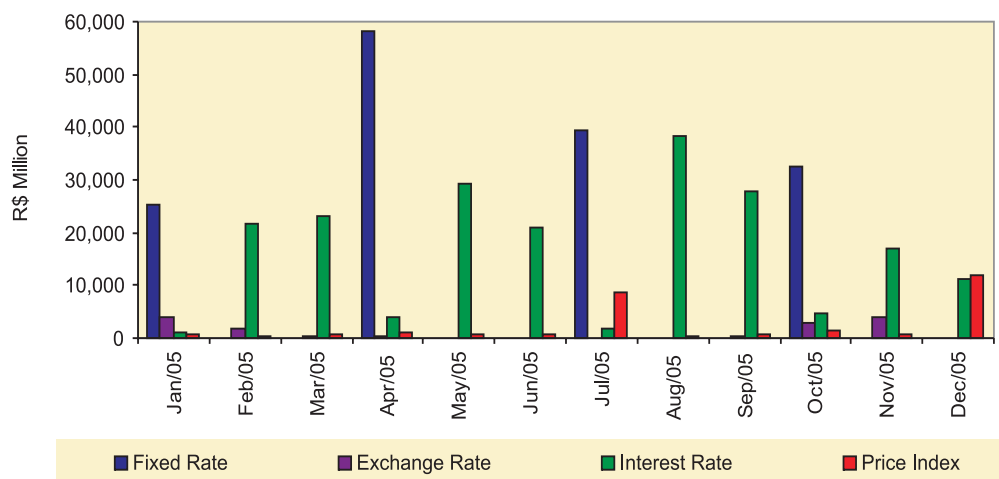
Position on 12/31/2004

(a) Securities issued by the National Treasury and the Central Bank (NBCE).

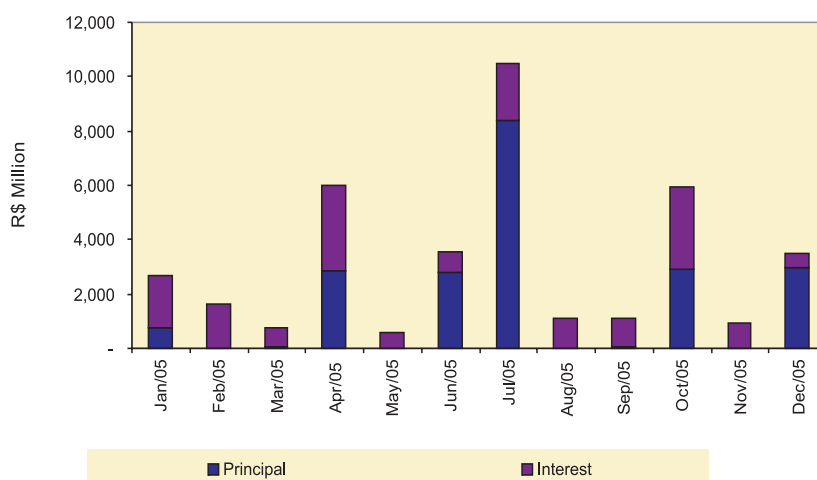
(b) Securities linked to the Selic, TR and TJLP rates.

<sup>8</sup> The term DPMFi refers to all securities of the Federal Domestic Public Debt held by the public and issued by the National Treasury and the Central Bank (the latter does not issue anymore).

<sup>9</sup> The term DPF is understood as the DPMFi consolidated with the Federal External Public Debt—DPFe, which is made up of restructured securities (Bradies), the External Contractual Debt (IDB/IBRD, Paris Club and Governmental Agencies), and ordinary market issuances (Global, Euros and Samurais).

**Chart 1 - DPMFi Maturity Profile**


Source: National Treasury

**Chart 2 - DPFe Maturity Profile**


Source: National

Of that overall debt maturing in 2005, R\$431.5 billion are under the responsibility of the National Treasury, with the remaining R\$6.0 billion under the responsibility of the Central Bank (these are *NBCE*). Payments linked to external bonds amount to R\$30.4 billion (R\$14.1 billion in principal and R\$16.3 billion in interest), with the remaining R\$7.9 billion corresponding to outlays associated with the contractual debt (R\$6.8 billion in principal and R\$1.1 billion in interest).

Budgetary resources (e.g., the primary surplus)

are projected to provide R\$60.1 billion to defray the Republic financing requirements.

The outstanding stock of the Federal Public Debt at the end of 2005 will also reflect the scheduled recognition of implicit liabilities, mostly *CVS*<sup>10</sup>, and the potential migration of resources currently locked in repurchase agreements (*repos*) with the

<sup>10</sup> *CVS* are securities issued by the National Treasury under the process of recognition of debts originated from the insurance scheme (Wage Variations Compensation Fund—*FCVS*) of the old House Financing System (*SFH*), which was dismantled in the early 1990s.

Central Bank. The securitization of CVS liabilities are projected to add to up to R\$13.0 billion<sup>11</sup> to the overall debt. The overall amount of repos offered by the Central Bank, on the other hand, exceeds R\$ 47.2 billion.

**Table 2 – Federal Government Financing Requirements**

		R\$ Billion
A	Estimated Maturities	<b>437.5</b>
	National Treasury	393.2
	<i>Domestic debt</i>	393.2
	<i>External debt</i>	38.3
	Central Bank	6.00
B	Budget Funds	<b>60.1</b>
C	Financing Requirement (A-B)	<b>377.4</b>

Source: National Treasury

## 2.2 Issuance Strategy

### **Domestic Debt**

The issuance strategy envisaged for 2005 focuses on improving the profile and composition of the Federal Public Debt, with an increase in the share of fixed-rate and price-indexed securities, and a drop in the share of floating-rate and exchange-linked securities. The prominence given to issuing the first two instruments will, inter alia, help develop fixed (nominal) and price-indexed (real) yield curves.

The issuance strategy also incorporates the effects in the demand for fixed-income assets expected to arise from government measures recently adopted to foster long-term savings. These measures include the sliding tax schedule for income and capital gains from long-term investments, and the exemption of portfolio adjustments from the CPMF transaction tax, through the creation of the *Conta Investimento* tax-free environment.

### **Fixed-rate securities**

Issuance of fixed-rate securities (*LTM*<sup>12</sup> and *NTN-F*<sup>13</sup>) will aim at two objectives: i) to increase the share of such securities in the public debt; and ii) gradually lengthen their average maturity. These goals are to be achieved through the mix of LTNs with initial maturity ranging from 9 to 18 months and the issuance of medium-term *NTN-F* coupon-bearing notes.

The *NTN-F* will be issued in the seasoned maturity of 2008 (started in 2004) and a new series maturing in 2010, which allows the development of a five-year yield curve.

### **Price-indexed Securities**

The amount of price-indexed securities (*NTN-B*<sup>14</sup> e *NTN-C*<sup>15</sup>) to be issued in 2005 is also expected

<sup>12</sup> LTN are fixed-rate, discount securities with a single payment at maturity.

<sup>13</sup> NTN-F are fixed-rate securities with semi-annual payment in interest coupons, which can be stripped and negotiated separately from the principal.

<sup>14</sup> NTN-B are securities with principal indexed to the IPCA consumption price index, and semi-annual payment of coupons of a fixed interest rate over the indexed principal.

<sup>15</sup> NTN-C are securities similar to the NTN-B, except that their principal is indexed to the IGP-M price index.

<sup>11</sup> This is the amount forecast for 2005 in the Annex of Fiscal Risks of the 2005 Budgetary Guidelines Law.

to grow vis-à-vis 2004, with an emphasis on the issuance of *NTN-B*. The current spanning of issuances (going as far as 2045) will be maintained, as well as the different payment months of semiannual coupons (February and August for about half of the maturities, and May and November for the remaining).

The Treasury expects to continue issuing *NTN-B* monthly, using two-stage auctions. This system allows for the swap of shorter-term securities for longer-term securities in the second stage of the auctions, a mechanism that contributes to the lengthening of the debt average maturity. The National Treasury also expects to continue accepting floating-rate notes and securities linked to the exchange-rate as payment for price-indexed securities, again with a view to improve the public debt composition.

### **Floating-rate (Selic-Linked) securities**

The outstanding stock of floating-rate securities linked to the *Selic* rate (*LFT*<sup>16</sup>) is expected to decline, with net redemptions along the year. The Treasury will strive to roll over the remaining stock in conditions such that the average maturity of those securities is lengthened.

### **Exchange-rate linked securities**

The guideline adopted in the 2004 *PAF* of refraining from issuing *NTN-D*<sup>17</sup> is maintained in 2005. On the other hand, this objective is not extended to the rolling over of exchange-rate-for-Selic swaps issued by the Central Bank, which depends on the monetary policy objectives of the Central Bank.

### **Other Actions**

The National Treasury plans to continue to buy back *LTN* in the months before they are due, in order to smooth the redemption schedule.

<sup>16</sup> *LFT* are floating-rate securities (Selic-linked), with a single payment at maturity.

<sup>17</sup> *NTN-D* are securities with principal indexed to the US\$/R\$ exchange-rate and semiannual interest payments.

Similarly, it expects to offer swaps of short-term *LFT* for longer-term securities.

Additionally, systematic buyback auctions targeting longer-term *NTN-B* and *NTN-C* are envisaged as a measure to help increase the liquidity of these securities and the demand in their own primary markets.

If necessary, exceptional auctions will also be organized for the simultaneous buying and selling of securities, as was done a few times in 2004. The main objective of this type of operation is to provide price parameters in times of great volatility and/or reduced liquidity. Ensuring the competitive pricing of public securities in any situation is important for institutional investors and for the adequate functioning of the market.

Maturities will continue to be scheduled as follows:

- Fixed-rate securities (*LTN* and *NTN-F*): maturity in the first day of January, April, July and October (first day of each quarter), in order to coincide with the expiration of derivatives contracts in organized public markets;
- Price-indexed securities (*NTN-B*): maturity of principal in May and August and of interest coupons in the second month of each quarter; and
- Floating-rate securities (*LFT*): maturity in the third month of each quarter, with new issues maturing in 2007 and beyond.

### **External Debt**

The management of the external and domestic debt is now further integrated, with the transfer of responsibilities of sovereign issuances from the Central Bank to the Treasury as of January 2005. In addition to follow the general guidelines for the Federal Public Debt management, the Federal External Public Debt (DPFe) issuance will be bound to the following guidelines:

- Creation of benchmarks in the leading emerging securities markets;

- Option to undertake liability management operations when relevant;
- Gradual reduction of the stock of Brady bonds;
- Broadening of the investor base; and
- Further deepening of relations with the international financial community and specific groups of investors.

The management of the DPF is now bound by the Senate Resolution No. 20/2004, which has granted greater flexibility to the Treasury. That Resolution authorizes repurchases and bond-swapping operations, as well as the use of derivatives by the Treasury, while setting a new ceiling of US\$ 75 billion for gross new issuances.

The external issuance program for 2005 contemplates the issuance of up to US\$ 6.0 billion, of which US\$ 1.5 billion was already pre-financed

in 2004. In addition, the Treasury can undertake liability-management transactions, in accordance with the integrated management of assets and liabilities of the Republic.

### 2.3 Ranges for Quantitative Targets

Targets for the Federal Public Debt (DPF) and the Federal Domestic Public Debt (DPMFi) are set as ranges for several key indicators. This approach aims at providing a clear reference for the National Treasury's refinancing policy, without, however, unduly restricting its flexibility to face shocks or other unexpected events. This balance between predictability and room to respond to shocks is essential for the efficient management of the public debt in the environment faced by the Brazilian economy.

Tables 3 and 4 summarize the ranges for the DPF and the DPMFi

**Table 3 - Results and Targets for the Federal Public Debt - DPF**

Indicators	Dec/04	PAF-2005	
		Minimum	Maximum
Stock of DPF held by the public (R\$ billion)	1013.9	1160	1240
Average maturity - Federal Outstanding Debt (months)	35.3	36	41
% Due in 12 months	39.3	34	40
<b>Share of DPF</b>			
Fixed-rate (%)	16.1	16	25
Floating-rate (%)	45.7	39	47
Price-Index (%)	24.2	18	23
Exchange-rate (%)	11.9	12	16
Others (%)	2.1	1	3

Source: National Treasury

**Table 4 - Results and Targets for the Federal Domestic Public Debt - DPMFi**

Indicators	Dec/04	PAF-2005	
		Minimum	Maximum
Stock of DPMFi held by the public (R\$ billion)	810.3	940	1000
Average maturity of DPMFi (months)	28.1	28	34
% Due in 12 months	46.1	40	45
<b>Share of DPMFi</b>			
Fixed-rate (%)	20.1	20	30
Floating-rate (%)	57.1	47	57
Price-Index (%)	5.2	3	5
Exchange-rate (%)	14.9	15	20
Others (%)	2.7	2	4

Source: National Treasury

The targets for the DPF and the DPMFi by the end of 2005 are consistent with the Treasury's financing strategy aimed at lengthening the debt's average maturity, smoothing refinancing requirements, reducing short-term refinance risk, and raising the share of fixed-rate and price-indexed securities in the overall debt, with a corresponding decline in the proportion of debt linked to short-term interest rates and to the exchange rate.

### **Outstanding Stock by end 2005**

The outstanding stock of the DPF is expected to be between R\$1.16 trillion and R\$1.24 trillion by the end of 2005, from R\$1.01 trillion at the end of 2004. The DPMFi stock is projected in the R\$ 940 billion-R\$1.0 trillion range, from R\$810.3 billion at the end of 2004.

The projected increase of the outstanding stock in 2005 results largely from the expected migration to the public debt of resources currently locked in repurchase agreements (repos) with the Central Bank. In December 2004, repos with the Central Bank amounted to R\$47.2 billion<sup>18</sup>. *Ceteris paribus*, the increase in the public debt owing to

a reduction in Central Bank operations is neutral from a fiscal standpoint, since both pay market interest rates. The balance tends, nonetheless, to be favorable to the Treasury, because new issuances of the public debt are typically of longer maturity than Central Bank repos.

### **Debt Composition at end 2005**

Reflecting PAF 2005 guidelines, the share of fixed-rate and price-indexed securities is projected to show a clear increase in the course of 2005.

The share of fixed-rate securities in the DPF is projected to be in the 16- 25% range, from 16.1% at the end of 2004. For the DPMFi, this indicator is projected in the 20%-30% range, from 20.1% at the end of 2004.

The share of price-indexed securities in the DPF is projected to rise to the 12%-16% range, from 11,9% at the end of 2005, while the share in the DPMFi is projected at the 15%-20% range, from 14.9%, also at end 2004.

Inversely, the proportion of floating-rate (Selic-linked) and exchange-rate linked securities in the total debt is projected to shrink. The upper limits of the targeted range are very close to the starting point at end 2004.

<sup>18</sup> Central Bank repurchase agreements are either in floating-rate (for periods of less than one month) or fixed-rates (for periods of up to 6 months). The R\$ 47,2 billion figure can be found in the December 2004 issue of the monthly Press Release "Divida Pública Mobiliária Federal interna e Mercado Aberto", issued by the National Treasury and the Central Bank.

***Average Maturity at end 2005***

The average maturity of the DPF stock is projected in a range of 36-41 months, from 35.3 months in December 2004. In turn, the average maturity for the DPMFi is projected to be in a range of 28-34 months, from a starting point of 28.1 months at the end of 2004.

To allow for an increase in maturity, a larger proportion of longer-term LTN (up to 18 months) and NTN-F (which currently mature in 2008 and 2010), as well as of price-indexed bonds (which maturities stretch to 2045) will be required to replace the maturing stock of LFT.

Recent changes in the taxation of savings (e.g., the lowering of the income tax on the revenue

from long-held, long-term fixed income instruments) are expected to foster the demand for long-term securities and will help support the projected increase in the average maturity of the public debt.

***Debt Falling Due in 12 Months***

The proportion of the DPF and the DPMFi maturing in up to 12 months is projected to decline, albeit the upper limit for this indicator is equivalent to the proportion observed at end 2004. The share of the DPF falling due in 12 months is projected to be between 34% and 40% by the end of 2005, while the same percentage for the DPMFi is projected to be between 40% and 45% by that time.

### Section 3: Risk Assessment

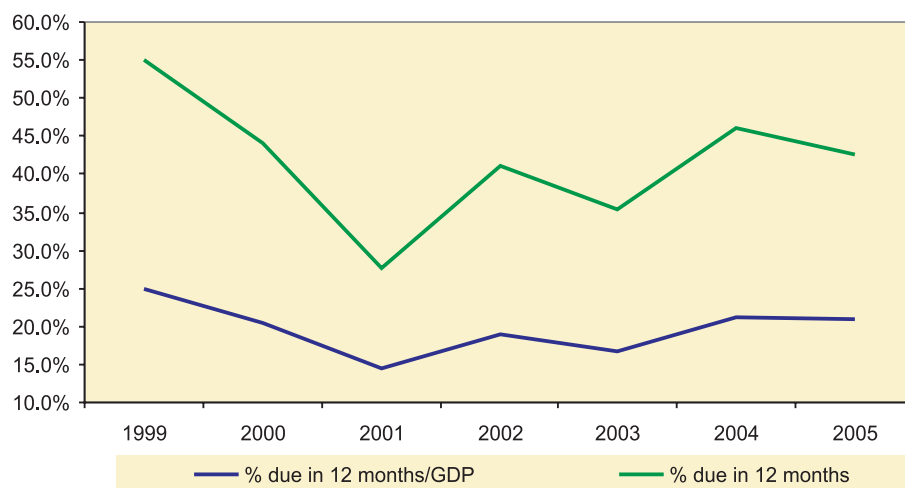
The reduction of the public debt exposure to risk is another key consideration for an effective debt management. From the refinancing risk perspective, the targets for the percentage of the Federal Domestic Public Debt - DPMFi due in up to 12 months<sup>19</sup> correspond to a reduction in the ratio of total redemptions within 12 months to GDP<sup>20</sup> (Chart 3).

Benefits from reducing the share of the debt maturing within 12 months are expected to be buttressed by high levels of cash reserves and a substantial flow of budgetary resources available

to pay down the debt. In addition, a well-tested strategy of early repurchases and swaps of short-term securities for longer-term securities will continue to help smooth out larger concentrations of redemptions at the beginning of some quarters.

Improvements in the composition of the debt are also helping reduce market risks, i.e., those linked to changes in market conditions. In particular, the increase in the participation of fixed-rate and price-indexed securities, coupled with the reduction of floating-rate and exchange-rate-linked securities, help reduce the volatility of cash requirements in the course of the year.

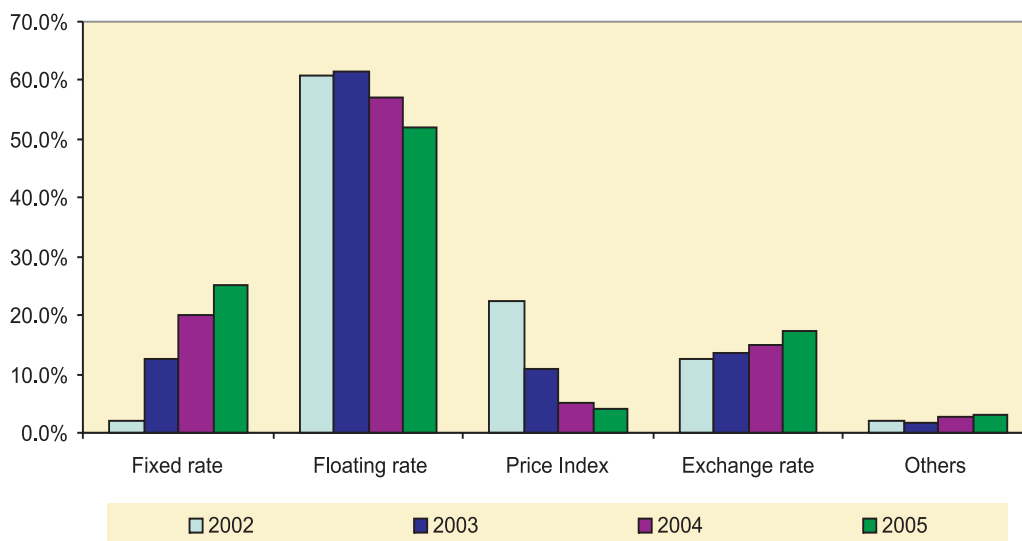
**Chart 3 - Percentage of DPMFi Due in 12 Months**



Source: National Treasury

<sup>19</sup> Despite the tendency of this indicator to decrease after 1999, it increased in 2004 as a result of increases in the stock of LTN, fixed-rate securities with maturities that are typically shorter than the average debt maturity.

<sup>20</sup> For this estimate, the mid-point of the minimum and maximum limits of the PAF was used.

**Chart 4 - DPMFi Composition**


Source: National Treasury

Stress tests highlight the strides made in reducing the vulnerability of the public debt. In particular, the impact on the outstanding debt of shocks in the exchange and domestic interest rates has been considerably reduced since 2002<sup>21</sup>.

Table 5 simulates the impact of strong and persistent shocks in the exchange rate and short-term interest rates on the debt linked to these indices<sup>22</sup>.

Taking the stock outstanding in December 2004, the impact was evaluated considering two conditions: the actual composition of the debt at that date and the composition existing in December 2002. The increase in the debt at the end of 2004, resulting from pressure on those variables was already a small fraction of what would have been if the composition in end-2004 were the same as in late 2002. This impact is projected to be even smaller by the end of 2005.

**Table 5. DPMFi - Interest and Exchange Rate Stress Test**

Index	Share of DPMFi (%)				Stress Impact (R\$ Billion)			
	2002	2003	2004	2005*	2002	2003	2004	2005*
<b>Floating-Rate</b>	60.8	61.4	57.2	52.0	33.59	33.91	31.62	28.73
<b>Exchange-Rate</b>	22.4	10.8	5.1	4.0	98.37	47.25	22.57	17.57
<b>Total</b>	83.2	72.2	62.4	56.0	131.96	81.17	54.19	46.29

\* The 2005 DPMFi composition corresponds to the median point of the indicative PAF-2005 targets.

Source: National Treasury

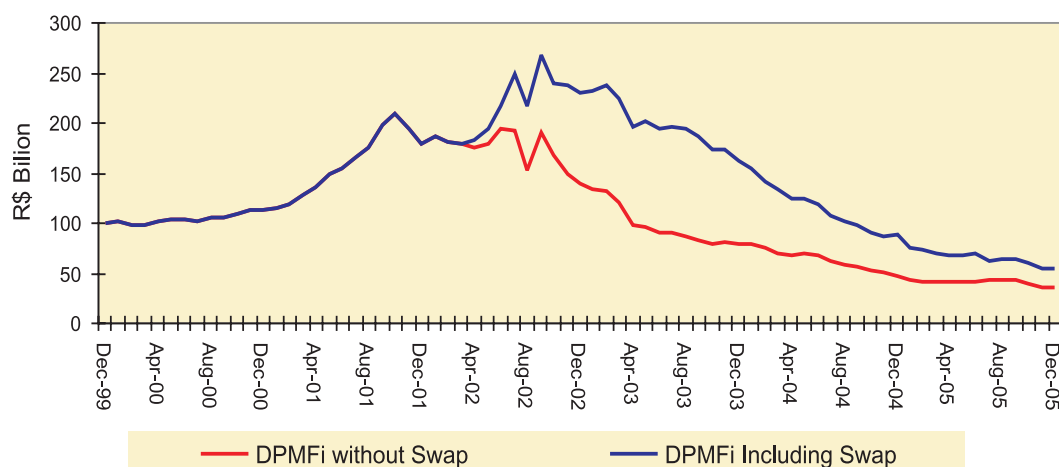
<sup>21</sup> For further details on the methodology of this test, see Annual Debt Report 2004.

<sup>22</sup> This exercise considers the impact of shocks to these variables sustained for a 12-month period and size corresponding to three standard deviations of the 12-month rolling average of the interest and exchange rates observed in the period between January 2000 and December 2004 (monthly observations).

The reduction in the sensitivity of the debt was more marked in the case of shocks to the exchange rate, although it also declined in the case of short-term interest rates. Specifically, the sensitivity of the debt to these variables has dropped to about 1/3 of its value in 2002. Indeed, had the debt structure existing in 2002 been maintained, pressures such as those simulated in the exercise would increase the amount of the debt over a period of 12 months by R\$131 billion (i.e., more than 16% of the DPMFi). However, the structure of the debt projected for the end of 2005, points to an impact of R\$46 billion, i.e., less than 6% of the DPMFi.

The reduction in the exposure to the exchange rate is further illustrated in Charts 5 and 6. In 2002, a depreciation of 1% in the exchange rate implied an increase in the Public Sector Net Debt - DLSP (including the effect of swaps) equivalent to 0.36% of GDP. At end-2004, the same shock would result in an increase in that ratio by 0.13 percentage points. The value projected for end-2005, considering the mid-range targets for the composition of the debt, is of 0,11% of GDP.

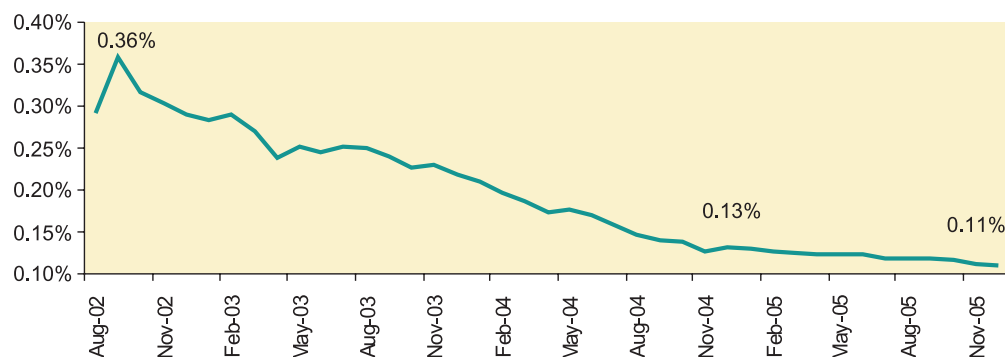
**Chart 5 - Dollar Linked Domestic Debt - Including Swap and without Swap**



Source: National Treasury

Note 1: The figure projected for 2005 considers both the absence of new issues of NTN-D (in line with the PAF-2005 guidelines) and no rolling over of exchange-rate swaps by the Central Bank.

**Chart 6 - Impact of 1% FX Devaluation on Public Sector Net Debt / GDP**



Source: National Treasury and Central Bank of Brazil.

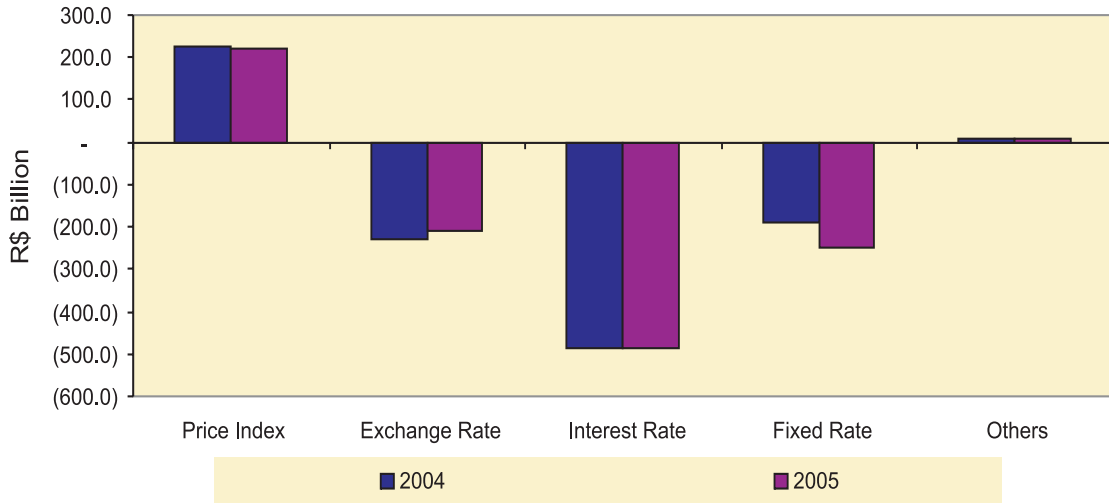
Note 1: The chart shows the impact of the DLSP/GDP ratio when the exchange-rate goes up by 1%.

Note 2: Estimates for 2005 consider the net external debt in dollars constant.

Another improvement in risk management refers to mismatches between types of assets and liabilities. In particular indexation mismatches are also projected to decline in 2005. Chart 7 shows that, considering mid-range values for the issuance of each instrument, liabilities

mismatches of interest and foreign exchange rates will be reduced. The positive mismatching of price-indexed assets is projected to be roughly stable, while the net exposure of the federal government to fixed-rate net liabilities is projected to increase, a change that is favorable to the Treasury.

**Chart 7 - Mismatch Between Assets and Liabilities**



Source: National Treasury

## Section 4: Final Considerations

Looking beyond 2005, the benefits from the strategy adopted in 2003 become more apparent. Keeping the trends in debt composition observed in 2003 and 2004 may result in a very favorable debt structure by 2006-2007. This make over can be achieved naturally, since three fourths of the current stock of floating-rate (Selic-linked) securities fall due over the next 36 months (Chart 8).

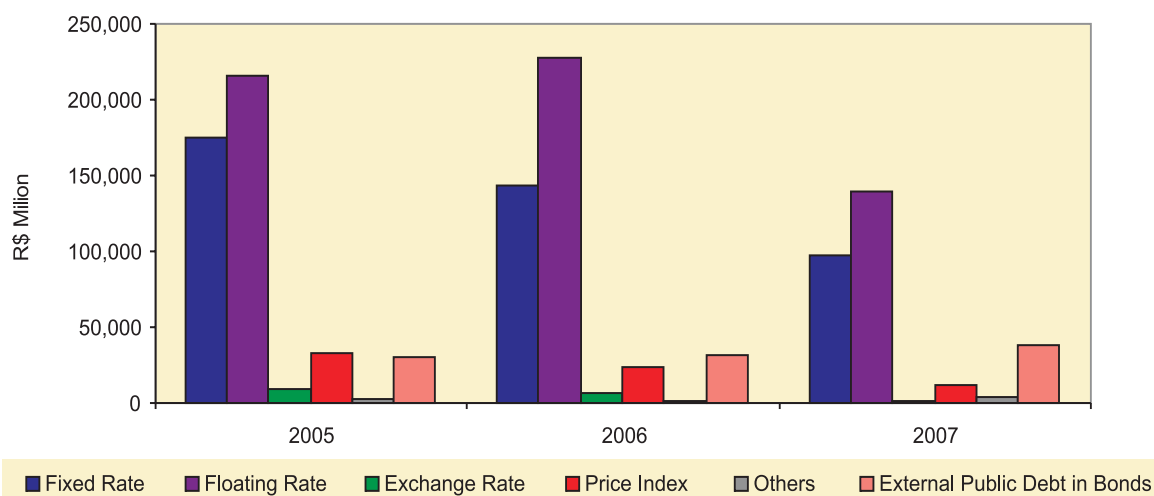
The gradual change in the debt composition should be accompanied by further extension of the average maturity and the decrease in the percentage of the debt due in 12 months.

Improvements in the Brazilian debt profile, combined with the further strengthening of the economy and the maintenance of a consistent balance of macroeconomic policies, have allowed the National Treasury to expand the scope of its

actions to broaden the Federal Public Debt - DPF investor base.

The broadening of the investor base in the domestic market is already visible in the increasingly active participation of pension funds in the public securities market, particularly in the segment of price-indexed long-term securities. It is also reflected in the organic growth of the Tesouro Direto internet-based program for individual investors. Also, reforms in the taxation of financial savings, including the exemption of portfolio adjustments from the CPMF financial transaction tax, are reducing the distortions that have inhibited a closer involvement of investors in decisions affecting the management of their funds. The strengthening of the governance of investment funds, promoted by the Securities and Exchange Commission - CVM, particularly through the CVM Normative Instruction N<sup>o</sup>. 409/2004, is yet another concurring factor to the development of the new landscape.

**Chart 8 - DPF Maturity Profile by Indicator**



Source: National Treasury

The broadening of the investor base in the external sovereign debt market is well illustrated by the increase in the number of participants in issuances by the Republic since 2001. The average number of investors participating in issuances has risen by more than 400% since 2001. This

diversification has also been reflected in a significant decrease in the size of the average primary allocation of new issuances.

The increase in the number of investors has been accompanied by a diversification both

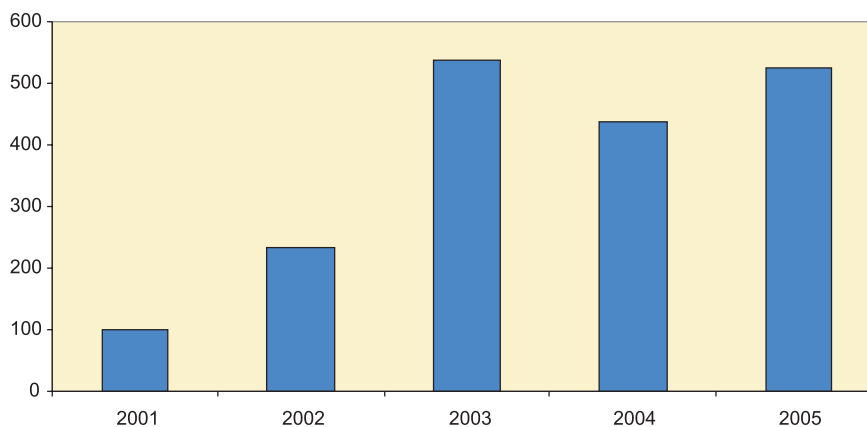
geographical and by type of investors and currency. Besides the success of the distribution of issuances in the retail market, especially in the so-called private bank segment, the participation of institutional investors with long-term objectives has been important.

Changes in the debt profile, as well as in the international fixed-income market, have opened new opportunities for the management of the Brazilian Public Debt. These opportunities should be judiciously exploited and largely based on reducing transaction costs and further enhancing the transparency of domestic markets.

The public debt domestic market is increasingly mature and vigorous. Brazil's financial market infrastructure is internationally recognized as one of the best in the world. The real-time gross payment system introduced in 2002 ensures that financial transactions are conducted with the

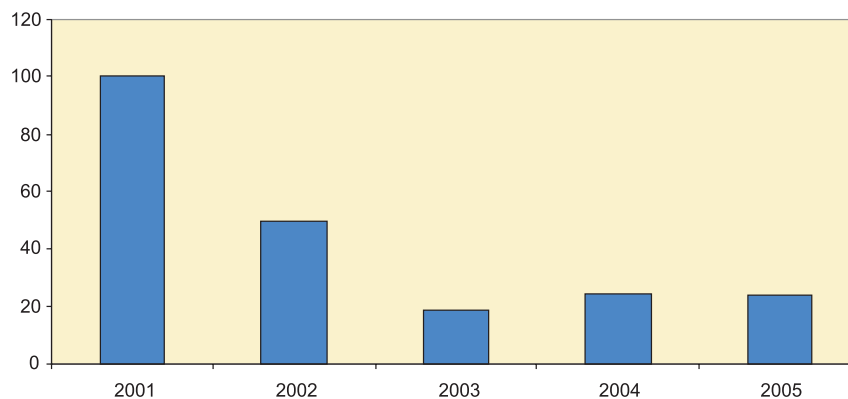
highest level of security. The smooth operation of Selic and Cetip clearing and settlement systems for several decades has promoted safety, speed and transparency in the clearing, custody and pricing of fixed-income securities. This infrastructure capable of providing swift and secure transactions is complemented by the vibrant operation of the 6th largest futures exchange in the world – the BM&F. Also, many mechanisms to reduce obstacles to international capital movements have been in place for more than 10 years, while the Central Bank has recently indicated that it is studying ways to streamline the rules regulating the foreign exchange market. Such improvements can productively be accompanied by further harmonization of the rules regulating the clearance of foreign exchange-rate operations, and the registration and settlement of securities belonging to non-residents, as well as by other administrative initiatives.

**Chart 9 - Average Number of Investors in USD Issuances by the Republic of Brazil (2001 - 100)**



Source: National Treasury

*Chart 10 - Average Allocation per Investor in USD Issuances by the Republic of Brazil  
(2001 = 100)*



Source: National Treasury

In sum, the progress achieved in the different strands of the economic strategy adopted by the Brazilian government in the last two years has reinforced the favorable evolution

of the profile of the Brazilian Public Debt. Looking forward, these policies will help make the debt managed by the National Treasury ever more solid.

## ANNEX – Brazilian Federal Public Debt Market

The Brazilian financial market is for all accounts one of the most liquid and sophisticated among emerging markets, offering a wide range of debt instruments (fixed-rate, floating-rate and inflation-linked bonds). The preparation of the PAF revolves largely around this market. An overview of the features of the main securities making up the Federal Domestic Public Debt - DPMFi and the main regulations and taxes affecting foreign investors in these securities can, thus, help understand the strategy followed by the Treasury.

### Federal Government Securities

Federal bonds are issued by the National Treasury and traded in the secondary market. They come with fixed nominal rates (LTN and NTN-F) and floating-rates (LFT), as well as with principal linked to the price index (NTN-C, linked to the IGP-M<sup>23</sup>, and NTN-B, linked to the IPCA<sup>24</sup>). Notes linked to the US dollar have not been issued since 2002. The LTN and LFT fixed- and floating-rate bills are the most liquid instruments, but all Treasury instruments can be used as collateral to repo operations with the Central Bank and in the secondary market.

In Brazil, fixed-income instruments are issued with fixed maturity dates (e.g., the first day of each quarter in the case of LTN), rather than fixed maturities. Moreover, the day count of bonds referred in BRL differs from those in USD, as shown in the tables below.

Main Features of Current Public Federal Debt Fixed-Income Instruments

Bonds	Type	Issuer	Coupon	Amortization	Days count
LFT	Floating-rate (Selic)	Treasury	Zero	Bullet	Business 252
LTN	Fixed-rate	Treasury	Zero	Bullet	Business 252
NTN-F	Fixed-rate	Treasury	Semiannual (10%)	Bullet	Business 252
NTN-C	Inflation-linked (IGP-M)	Treasury	Semiannual (6%)	Bullet	Business 252
NTN-B	Inflation-linked (IPCA)	Treasury	Semiannual (6%)	Bullet	Business 252
NTN-D	US Dollar linked	Treasury	Semiannual (12%)	Bullet	30/360
NBCE*	US Dollar linked	Central Bank	Semiannual (12%)	Bullet	30/360

\* The Central Bank, in compliance to the Fiscal Responsibility Law, has stopped to issue debt as of May, 2002. All open market operations are now conducted using Treasury instruments, although there is still an outstanding stock of dollar-linked NBCE notes issued by the Central Bank before 2002.

23 IGP-M – General Price Index, released by Fundação Getúlio Vargas (FGV), composed of 60% IPA wholesale price index, 30% IPC consumer prices and 10% civil construction prices.

24 IPCA – Consumer Price Index, produced by the Instituto Brasileiro de Geografia e Estatística (IBGE). It captures price variations in a basket of goods of families with incomes of up to forty minimum wages.

<b>Business Days/252 exponential</b>	<b>30/360 exponential*</b>
<ul style="list-style-type: none"> <li>Does not accrue on weekends or holidays.</li> <li><math>i_e = (1 + i_a)^{(\text{business days}/252)} - 1</math> where, <math>i_e</math> = effective rate in the period <math>i_a</math> = effective annual rate</li> </ul>	<ul style="list-style-type: none"> <li>Considers that each of the 12 months of the year are of 30 days.</li> <li><math>i_e = (1 + i_a)^{(d/360)} - 1</math> where, <math>i_e</math> = effective rate in the period <math>i_a</math> = effective annual rate</li> </ul>

\*Where,

$$d = (A2 - A1) \times 360 + (M2 - M1) \times 30 + (D2 - D1)$$

and

d = number of days between date 1 and date 2;

D1 , M1 e A1 = day, month and year related to date 1; and

D2, M2 e A2 = day, month and year related to date 2.

The National Treasury carries out auctions of LTN, LFT and NTN-F every week, usually at lunch time on Tuesdays<sup>25</sup>, and of inflation-linked bonds once a month. The Treasury also holds repurchase auctions in order to provide liquidity and price references to the market, as well as to smooth the debt maturity profile. Every month, the Treasury releases a calendar informing the auction dates of each type of instrument, together with a ceiling for the overall volume of debt to be issued in the corresponding period.

Auctions are typically held in American style (Multiple Price), although Dutch bid-pricing (Uniform Price) may also be used. Primary offerings are cleared and settled through the Special System for Settlement and Custody - Selic on the subsequent business day (T + 1). Secondary market operations are cleared and settled through the Selic on a delivery-versus-payment basis (DVP) against same-day bank reserves. Both types of settlement are electronic.

Currently, there are 12 primary dealers and 10 secondary (specialist) dealers. Both foreign and domestic banks can be dealers and the make up of the list is updated every six months considering the performance of individual institutions, including the ability to provide liquidity in the secondary market. In the last 18 months, 7 dealers have been replaced, with some coming back to participate in the list.

Brazilian Federal bonds can be negotiated in the secondary market in two forms: over-the-counter and through the screen. Screen transactions are done through the Brazilian Mercantile and Futures Exchange - BM&F and the Brazilian Clearing and Depository Corporation - Cetip systems. These transactions, as well as those over-the-counter, are registered in the Selic.

The BM&F's electronic system, SISBEX, allows transactions of public bonds among banks and is complemented by the Cetip system, which provides pension and mutual funds with an electronic trading platform. In support of SISBEX, BM&F has recently created an Asset Clearing improving liquidity and safety in the financial assets operations.

<sup>25</sup> In weeks with Monetary Policy Committee - COPOM meetings, LTN auctions are conducted on Thursdays.

## Regulation

Foreign investment in Brazil is regulated by the National Monetary Council – CMN and the Security and Exchange Commission – CVM. The CMN defines the policy and framework of the National Financial System, while the CVM monitors and regulates financial transactions (such as those with federal bonds, derivatives and equities).

Typical non-resident<sup>26</sup> investments in equities, fixed income and commercial foreign exchange are ruled by Central Bank Resolution N° 2689, of January 2002, following CMN directives. Article 6° of the Resolution N° 2689 restricts transactions of non-residents to involve authorized stocks, commodities, futures exchanges and over-the-counter markets regulated by the local Security and Exchange Commission—CVM, or via a registration, settlement and custody system accredited by the Central Bank.

Central Bank Circular N° 2677, of April 1996 opens, however, an alternative road for those investors not using the commercial exchange-rate (FX) segment regulated by Resolution N° 2689. If the agent decides to invest through the alternative floating exchange market, she will be under the same regulations applied to domestic investments, also set in Central Bank Circular N° 2677.

The Central Bank is reviewing this regulation with a view to streamline the “commercial” market and clarify the so-called TIR market regulated by Circular N° 2677, although these changes are not expected to substantially modify the landscape for investors in the Public Federal Debt.

## Custody

The Federal bonds custody is done through the Special System for Settlement and Custody – Selic, which is managed by the Central Bank. Financial institutions are required to hold separate custody accounts for their clients, distinguishing these funds, for instance, from proprietary resources.

## Taxation

The taxation of foreign investment is the following regime (Central Bank Resolution N° 2689):

- Income tax: **15%** on capital gains and other income earned on money market instruments, including government bonds and CDs  
**10%** on swaps and equity funds  
**exempt** = Capital gains and income earned with derivatives traded in exchanges and equities.
- IOF tax: **1% per day** on  $(1-n/30)^{27}$  of the income from fixed income investments. Applicable to investments unwound within 30 days of inception
- CPMF tax: **0.38%** levied only on the arrival and departure of the funds, not on internal transactions.  
**exempt** = Financial resources used exclusively in operations with equities and contracts referenced to equities or equity indices.

<sup>26</sup> Non-resident investor is defined as a person, corporation, fund, or institutional investor with residence, head-office or domicile outside Brazil.

<sup>27</sup> where “n” is the number of days between the investment and the remittance of funds

On the other hand, for investors accessing the market through mechanisms stated in the Central Bank Circular nº 2677, taxes are broadly similar to those applied to domestic investors.

- Income tax: **20%** on capital gains and other income earned on Equity, Fixed Income and Swap trades.
- IOF tax: Same as for commercial market
- CPMF tax: **0.38%** on every transaction  
**except** = trades in equity and equity indices.

For Further information contact the Brazilian National Treasury Investor's Relations at  
**brazildebt@fazenda.gov.br**

**Fax: ++ 55 61 412-1565**

or check the sites below:

<http://www.tesouro.fazenda.gov.br>

<http://www.bcb.gov.br>

<http://www.cvm.gov.br>

<http://www.receita.fazenda.gov.br>

## ANNEX - Pricing

### 1) LTN

$$PU = \frac{VN}{(1+i_p)} = \frac{1.000}{(1+i_p)}$$

where,

PU = Unit price

VN = Nominal Value

$i_p$  = effective rate in the period

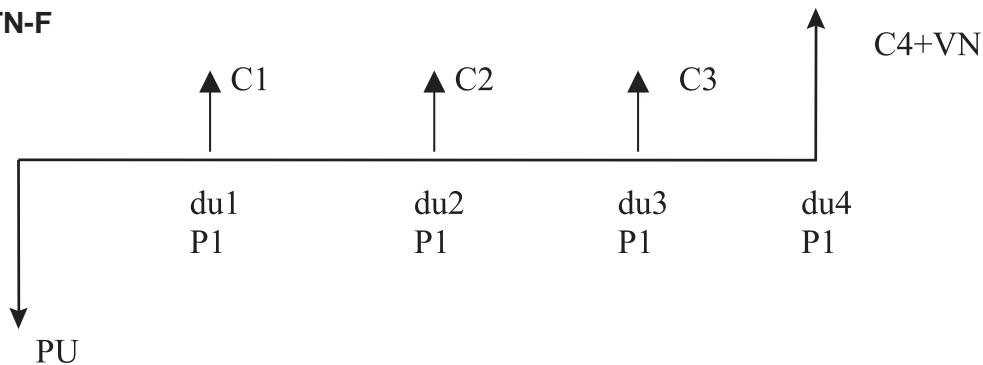
All trades are done in annual rates, following the formula below:

$$(1+i_p) = (1+i_a)^{\frac{du}{252}}$$

where,

$i_a$  = effective annual rate

### 2) NTN-F



$$PU = \frac{C1}{1+i} + \frac{C2}{(1+i)^2} + \dots + \frac{Cn}{(1+i)^n} + \frac{VN}{(1+i)^n}$$

$$PU = \sum_{t=1}^n \frac{C_t}{(1+i)^t} + \frac{VN}{(1+i)^n}$$

where,

du = business days between trade day and cupom payment dates

C = Cupom payment (semiannually)

VN = Nominal Value (R\$ 1.000,00)

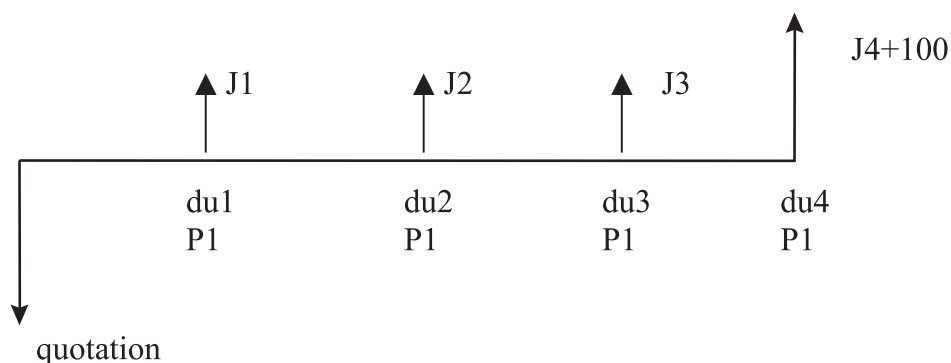
i = effective annual rate

and,

$$C = \left[ (1+0,10)^{\frac{1}{2}} - 1 \right] * 1000 = 48,81$$

**3) NTN-B and NTN-C**

$$PU = VNA \times \text{quotation}$$



$$J = \left[ (1 + 0,06)^{\frac{1}{2}} - 1 \right] * 100 = 2,956$$

$$\text{quotation} = \frac{J1}{1+i} + \frac{J2}{(1+i)^2} + \dots + \frac{Jn}{(1+i)^n} + \frac{100}{(1+i)^n}$$

$$PU = \sum_{t=1}^n \frac{J_t}{(1+i)^t} + \frac{100}{(1+i)^n}$$

where,

VNA = Up to date Nominal Value<sup>28</sup>

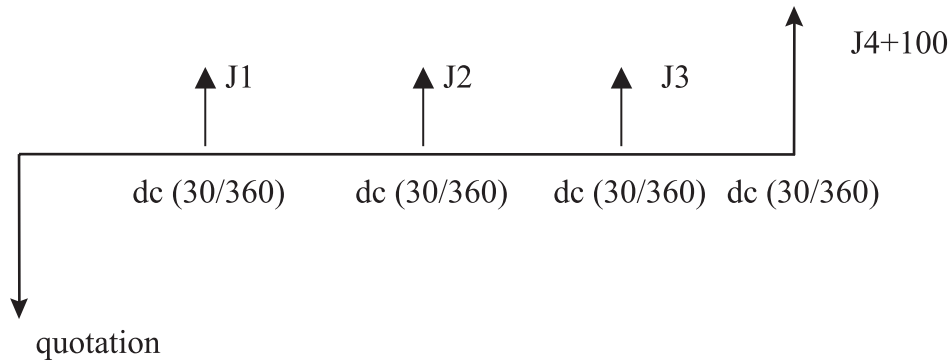
i = effective annual rate

du = business days between trade day and coupon payment dates

<sup>28</sup> NTN-B and NTN-C have Nominal Values of R\$ 1.000,00 as of 01/07/2000. The up to date Nominal Value is computed taking into account the accrued inflation from that date until the day of transaction.

**4) NTN-D**

$$PU = VNA \times \text{quotation}$$



$$J = \left[ 6 * \frac{1}{2} \right] = 3$$

$$\text{quotation} = \frac{J1}{\left(1 + \frac{i}{k}\right)^{k*1}} + \frac{J2}{\left(1 + \frac{i}{k}\right)^{k*2}} + \dots + \frac{Jn}{\left(1 + \frac{i}{k}\right)^{k*n}} + \frac{100}{\left(1 + \frac{i}{k}\right)^{k*n}}$$

$$PU = \sum_{t=1}^n \frac{J_t}{\left(1 + i/k\right)^{k*t}} + \frac{100}{\left(1 + i/k\right)^{k*t}}$$

where,

*i* = nominal annual rate

*k* = 2 (semiannual cupom)

VNA = Up to date Nominal Value<sup>29</sup>

<sup>29</sup> NTN-D have Nominal Value of R\$ 1.000,00 as of 01/07/2000. The up to date Nominal Value is computed taking into account the FX variations from that date until the day of transaction.