



Public Debt: Annual Borrowing Plan 2004

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MINISTER OF FINANCE

Antonio Palocci Filho

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Otavio Ladeira de Medeiros

Rodrigo Silveira Veiga Cabral

Ronnie Gonzaga Tavares

William Baghdassarian*

* Technical Coordination.

For further information:

Tel: 55-61 412-3188; Fax: 55-61 412-1565

National Treasury Secretariat

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

70048-900 – Brasília - DF

E-mail: stndivida@fazenda.gov.br

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

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I. Brazil. National Treasury Secretariat II.Title



Economic growth, job creation and improved income distribution in Brazil require continued macroeconomic stability, so that domestic and foreign investors can grow confident in our economy. The achievements obtained in 2003 were a display of the Federal Government's commitment to stability by maintaining fiscal responsibility, a floating exchange rate and inflation under control. In addition, the positive impact of the fiscal efforts on the Federal Public Debt (DPF) indicators justifies the sacrifice stemming from an elevated primary budget surplus. In this same spirit, 2004 begins with the commitment to a consistent fiscal policy – one that contributes to increased efficiency in the productive sector and to higher savings and investment rates. These are essential elements for a turnaround in economic activity and a reduction in income inequality.

The management of public accounts, particularly of the public debt, plays a key role in the effort to achieve the goals mentioned above. In this sense, the Government has been engaged in trying to reduce not only the stock but also the cost of the public debt. The sharp decline in the risk premium on both the external and domestic debt over the course of 2003 is an example of our success in pursuing that goal. These are signs of responsible conduct of economic policy, which provides solid fiscal conditions for the reduction of country risk, whose influence on the environment and investment capacity of the productive sector cannot be dismissed.

The Annual Borrowing Plan – PAF 2004 presented here is in synch with the Government's central objectives and with the atmosphere of rising confidence in the Brazilian economy. The financing strategy for this year aims at improving the maturity profile and the composition of the public debt, following up on the achievements obtained in the new Government's first year. The goals and guidelines underscore the focus on the sustainability of public debt and the minimization of risks.

The PAF is increasingly consolidating itself as an important instrument for the strategic planning and subsequent assessment of the National Treasury as the public debt manager. The document is also a display of the Government's respect for the Brazilian society, as it ensures transparency and predictability on a relevant issue for every Brazilian's account. The results that we hope to achieve in 2004, within a context of balanced public finances, are promising and indicate the reconstruction of a basis for the economic development of our society.

Antonio Palocci Filho
Minister of Finance



Efficient management of the public debt helps to promote social welfare and a good functioning of the economy. It is, therefore, an important part of the set of Government policies.

The Annual Borrowing Plan for 2004 – PAF 2004 provides a detailed analysis of the National Treasury's program of action, displaying the guidelines and goals that debt managers will follow this year. The PAF 2004 is complemented by the "Public Debt Annual Report", a retrospective analysis that was published recently.

The PAF 2004 reflects the objective of the public debt management, which is to minimize long-term borrowing costs while keeping prudent levels of risk. The goal also involves measures to foster the development of a public debt market.

In line with the strategy to be followed by the National Treasury in 2004, the PAF presents the expected achievements for the year, expressed in the form of indicative bands. The document also discusses risk management for the public debt and brings improvements in the Asset and Liability Management model.

The expected results outlined here in the PAF reflect technical criteria, in accordance with advanced international practice in public debt management. Indeed, planning and execution of the National Treasury activities and Federal Public Debt management have been strengthened and improved, representing one of the factors contributing to the quality of the debt-management results this institution has achieved. The PAF, in addition to being a planning tool that helps articulate this work, also shows, by the fourth year in a row, the Federal Government's commitment to transparency and credibility, which are key factors for a good public management.

The message of this PAF is clear. Following the successful strategy of 2003 and meeting the country's needs, the PAF 2004 contemplates an increased participation of fixed-rate debt in the overall debt as well as the lengthening of these securities' maturities. To achieve that, the Treasury counts on, among other elements, the consolidation of the market for a new series of fixed-rate securities: National Treasury Notes series F - NTN-F. The current plan also anticipates growth in issuance of price-indexed securities – NTN series B and C, respectively linked to consumer price index IPCA and IGPM.

The implementation of the proposals in this PAF should therefore result in a continued improvement of indicators for the Federal Public Debt composition, domestic and external, and the minimization of the debt costs, meeting the medium- and long-term goals set by the National Treasury.

Joaquim Vieira Ferreira Levy
National Treasury Secretary

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Summary

Brazil's public debt managers seek to minimize long-term financing costs while keeping risk at prudent levels, contributing to the good functioning of public debt markets – which is key to achieve that goal. Within this context, the broad principle guiding the 2004 financing strategy refers to the monitoring of costs and various types of risk exposure. Market conditions permitting, the National Treasury will seek to:

- Lengthen the average maturity of securities issued in public offerings;
- Reduce the share of debt due in 12 months;
- Replace part of the securities linked to the exchange rate and to floating rates with fixed-rate and price-indexed debt; and
- Foster the development of the term structure of interest rates (fixed rate and price-indexed curves).

As usual, the Treasury will follow these guidelines depending on market opportunities, since the optimum path to achieve its goals cannot be dissociated from the environment facing public debt managers.

The financing strategy for 2004 was based on a number of issuance alternatives, each one of them compatible with a specific scenario generated using a prospective technique. This technique attaches a large weighting to the external environment in 2004, and eventual consequences on the domestic market.

The base scenario for 2004 foresees a favorable external outlook, with higher world economic growth and conditions favoring continued capital flows into emerging markets, allowing for external borrowing. On the domestic front, continued economic recovery is expected, with inflation converging to the Central Bank's target, a stable exchange rate and a gradual reduction in interest rates.

With regard to the borrowing requirements for 2004, an estimated R\$ 310.2 billion in domestic and external debt under the responsibility of the National Treasury is

expected to come due, of which R\$ 262.0 billion refer to Federal Domestic Public Debt – DPMFi and R\$ 48.2 billion corresponds to Federal External Public Debt - DPFe. Added to Central Bank debt maturities totaling R\$ 16.1 billion, overall Federal Public Debt – DPF due in 2004 is expected to total R\$ 326.4 billion. Deducting from this figure budget funds earmarked for DPF payments totaling R\$ 73.5 billion, the Federal Government's borrowing needs this year are estimated at R\$ 252.9 billion.

The financing strategy for 2004 will pursue the following line of action:

- Emphasis on fixed-rate securities, focusing on a gradual lengthening of the average maturity of the issues. The NTN-F¹ notes will play a key role in this effort, acting as a complement to the LTN and helping to extend the term structure of the public debt;
- Gradual increase in the share of price-indexed securities (NTN-B² e NTN-C³) in the overall debt;
- Net redemption of floating-rate securities (LFT), whose maturity should be lengthened over the course of the year just like it is proposed for fixed-rate securities;
- Issuance of NTN-D is not expected.

Regarding the financing strategy for the external debt, the plan for 2004 foresees issuance of US\$ 5.5 billion in bonds, of which US\$ 1.5 billion have been already issued in 2003.

Taking into account the Global 2034 issue⁴ on January 20, 2004, the remaining volume of external bond issuance planned for 2004 is US\$ 2.5 billion.

To display the expected results from the National Treasury's financing strategy in 2004, we opted to use bands, as in 2003.

¹ Fixed-rate security yielding semi-annual coupon payments that may be stripped to trade as separate instruments from the principal value (*strips*).

² Security linked to the IPCA index.

³ Security linked to the IGP-M index.

⁴ First sovereign issue to take place within the Strategic Committee for the External Debt Management – CODEX.

These bands were set based on simulations also considering the possibility of more volatile scenarios. It is important to stress that the bands refer to each item individually, i.e., a minimum result in one of the items does not imply minimum results in the remaining items.

The Treasury displays expected results for the DPMFi under the responsibility of both the National Treasury and the Central Bank as well as for the Federal Public Debt - DPF held by the public, as was done in the PAF 2003. The DPF includes statistics referring to liabilities in the form of securities as well as contracts under the responsibility of the National Treasury.

The main results expected are:

- The average maturity of the DPF stock will increase to 40-45 months from 39 months. A similar change is expected for the DPMFi, whose average maturity should rise to 34-38 months at the end of 2004 from 31.3 months at the end of 2003;
- The share of debt due in 12 months for the DPF and the DPMFi should fall. For the DPF, the percentage is expected to decline to between 26% and 32% of the debt stock at the end of 2004 from 30.7%. The DPMFi indicator is expected to stay in the 30%-35% range, down from 35.3% in December 2003;
- The share of fixed-rate securities in the DPF stock is expected to stay between 9% and 19%, compared with 9,5% at the end of 2003. In the DPMFi, this percentage is expected between 13% and 23%, versus 12.5% in December 2003.
- The percentages of price-indexed securities in the DPF and the DPMFi are expected to rise to 12%-17% and to 14%-21%, respectively, up from 10.3% and 13.6% in December 2003;
- The share of floating-rate securities (Selic rate) is expected to fall to the 39%-47% range in the DPF, and to 50%-61% in the DPMFi;
- The share of exchange-rate-linked debt is expected to continue to decline gradually, building on the downtrend from 2003. Rounding the numbers, the share of this type of security in the DPF is expected to stay between 24% and 30%, while in the DPMFi the percentage is forecast at 5% to 7%, compared with 32.4% and 10.8% in December 2003, respectively.

Results for the DPF

Indicators	Dec/03	PAF-2004	
		Minimum	Maximum
Stock of DPF held by the public (R\$ billion)	965,8	1080	1150
Average maturity - Federal Outstanding Debt (months)	39,0	40	45
% Maturing in 12 months	30,7	26	32
Share of DPF (%)			
Fixed rate	9,5	9	19
Floating rate	46,5	39	47
Price Index	32,4	24	30
Exchange rate	10,3	12	17
Others	1,4	1	3

Source: STN/COGEP

Results for the DPMFi

Indicators	Dec/03	PAF-2004	
		Minimum	Maximum
Stock of DPMFi held by the public (R\$ billion)	731,4	820	880
Average maturity of DPMFi (months)	31,3	34	38
% due in 12 months	35,3	30	35
Share of DPMFi (%)			
Fixed rate	12,5	13	23
Floating rate	61,4	50	61
Price Index	10,8	5	7
Exchange rate	13,6	15	21
Others	1,8	1	3

Source: STN/COGEP

The debt stock is expected to reflect an increase in the cash reserves (funds exclusively available for the payment of the DPF), budget revenue flows foreseen for DPF payments, the recognition of liabilities associated with FCVS totaling more than R\$ 10 billion, and an expected decline in the volume of repo operations by the Central Bank, with a positive impact on the demand for federal debt securities, including longer-term ones. The replacement of repos with debt will not have a significant fiscal impact, since the Central Bank pays interest on those repo transactions. From a risk management perspective, the strategy of early redemptions – designed to smooth out and lengthen debt maturities – should proceed successfully.

As indicated above, the debt composition is also expected to improve.

The forecasts contrast, in many aspects, with the situation at the end of 2002, when, for example, only 14.7% of the DPMFi was made up of fixed-rate or price-indexed securities. The share of securities due in 12 months is also expected to drop sharply from 41.1% in December 2002.

A dynamic, thorough assessment of debt management risks requires information that goes beyond the debt composition. For this

task, the National Treasury has used a more systematic approach of Asset and Liability Management (ALM), which is a tool focusing on the net mismatch between the Federal Government's financial assets and liabilities, in terms of indices, maturities and cash flows.

As a principle, the ALM proposes a reduction in the mismatch between the stocks of financial assets and liabilities so as to immunize market risks, such as changes in interest rates and exchange rate. In a broader sense, this approach also takes into account the nature of the Federal Government's future surpluses and its sensitivity to the main indices and risk variables.

Within this context, some points are worth highlighting. Firstly, continued stability in the exchange rate and the implementation of a policy of early redemption for exchange-rate-linked liabilities, as in 2003, indicate the net liability may drop from R\$ 341.6 billion in December 2003 to between R\$ 276.7 billion and R\$ 320.1 billion by December 2004 (adjusted for inflation). The figure will depend on how many of the outstanding currency swap contracts that the Central Bank has with the market are renewed. In other words, the exposure to foreign exchange is expected to fall into the interval of 6.3% to 18.9%.

Another aspect that deserves attention is the expected reduction in the net liability linked to floating interest rates (Selic, TR and TJLP) of around 4.4% (R\$ 16.9 billion) in real terms.

The mismatch relative to inflation is also expected to diminish, with a real decline of 15.4% in net assets, resulting from a strategy to expand issuance of price-indexed securities this year.

Only the mismatch in fixed-rate securities is expected to increase, with the net liability forecast to grow from R\$ 82.5 billion at the end of 2003 to R\$ 169.4 billion a year later in the base scenario. This change, from a public debt risk management perspective, is positive and is in line with other objectives of the National Treasury.

The analysis of the debt maturity schedule shows a relative mismatch — mainly resulting from the long-term refinancing of state and municipal debt carried out by the National Treasury in the past. So the Federal Government's financial assets, largely represented by debt owed by States and Municipalities, have an average maturity of 151.9 months (12.5 years), against an average maturity of 39.0 months for the Treasury's liabilities. Some improvement is expected in 2004, with a 4-month reduction in the mismatch of average maturities.

Introduction

In line with the guidelines for the public debt management, particularly with regard to efforts to increase transparency and predictability, the National Treasury presents, for the fourth consecutive year, its Annual Borrowing Plan – PAF.

Compared with the 2003 edition, the Borrowing Plan for 2004 brings a number of changes designed to emphasize the financing strategy, expected achievements and risk analysis of the main debt indicators.

As a result, the Treasury now presents a separate analysis of the debt management in the previous year in the newly-created Public Debt Annual Report. The report for 2003 was released recently.

The Borrowing Plan for 2004 also includes guidelines for foreign bond issuance. The process of transferring external debt responsibilities to the National Treasury began in 2004 with the creation of the Strategic Committee for the External Debt Management - CODEX⁵.

The PAF is divided into 4 sections. Section 1 covers the process of public debt planning and presents the general guidelines for indebtedness as well as the National Treasury's expectations for macroeconomic variables.

Section 2 covers the characteristics of the instruments used to finance the debt and details of the issuance strategy. Also in this Section one will find forecasts for the upper and lower limits of debt indicators, which were calculated based on the financing strategies, guidelines and scenarios discussed.

Section 3 brings a detailed analysis of the recent developments and projections for the main risk factors for the debt.

Lastly, Section 4 covers Asset and Liability Management, a tool which allows for a broad view of the variables affecting the public debt and provides parameters for the medium-term debt management strategy.

⁵ CODEX will be explained in section 2

Section 1: Public Debt Planning

The elaboration of the Annual Borrowing Plan - PAF is a process that involves defining guidelines for the public debt management, establishing probable scenarios and the issuance strategy, which must contemplate information and guidelines for the Federal Public Debt.

The document explains the goals one year out, and is part not only of a broad discussion of medium- and long-term strategies but also of a broader reference for the public debt management.

1.1 Guidelines

Brazil's public debt managers aim at minimizing long-term financing costs while keeping risk at prudent levels, contributing to the good functioning of public debt markets – which is a key element to achieve that goal. Within this context, the broad guideline for the 2004 financing strategy refers to the monitoring of costs and various types of risk exposure. Market conditions permitting, the National Treasury will seek to:

- Lengthen the average maturity of securities issued in public offerings;
- Reduce the share of debt due in 12 months;
- Replace part of the securities linked to the exchange rate and to floating rates with fixed-rate and price-indexed debt; and
- Foster the development of the term structure of interest rates (fixed rate and price-indexed curves).

As usual, the Treasury will follow these guidelines depending on market opportunities, as the optimum trajectory to achieve its goals cannot be dissociated from the environment facing public debt managers.

1.2 Scenarios

The construction of the financing strategy for 2004 was based on different issuance alternatives resulting from an analysis of multiple scenarios, from which were derived the upper and lower limits for the debt indicators. The main assumption built into the scenarios is that, having tamed inflationary pressure and approved the pension and tax reforms last year,

the Government's main focus in 2004 will be economic growth.

The base-case scenario – which is the closest to market expectations for 2004 – is used to calculate central projections. The assumptions are: a favorable external environment, with higher world economic growth and continued capital flows into emerging markets. On the domestic front, continued economic recovery is expected, with inflation converging to the official target, a stable exchange rate and a gradual reduction in interest rates.

The alternative scenarios take into account, on one hand, the impact of increased volatility in the external market, which could limit capital inflows, put pressure on the exchange rate, send country risk higher and consequently narrow the possibility of interest-rate cuts. On the other hand, optimistic assumptions are: a longer rate-cutting cycle, and a benign outlook for inflation and other macroeconomic indicators. The projected indicators for the public debt presented here do not take into account scenarios implying large fluctuations or extraordinary shocks in the economy.

Section 2: Borrowing Plan 2004

This Section details the domestic and external financing strategies, and the assumptions used to set them. It also presents the expected results for the Federal Public Debt– DPF⁶ and the Federal Domestic Public Debt – DPMFi⁷.

Bank debt held by the public accounts for R\$ 16.1 billion of total DPMFi maturities. Total maturities are broken down by month in Table 1 and Charts 1 and 2:

2.1 Assumptions and Financing Needs

The projected results take into account not only the financing strategy but also other assumptions, such as expectations that contingent liabilities will be securitized and that budget funds will be used to pay down the debt.

Public debt strategies must also take into consideration the indirect impact of Central Bank actions on the DPF, particularly the use of monetary policy tools (open market transactions, level of bank reserve requirements, swap contracts, among others).

With regard to contingent liabilities, it is assumed that R\$ 11.5 billion⁸ in debt will be issued, of which the bulk referring to CVS⁹ securities.

The first factor considered in the elaboration of the 2004 strategy was the public debt financing and refinancing requirements. An estimated R\$ 326.4 billion in Federal Government debt held by the public is due this year, of which R\$ 278.1 billion refers to the DPMFi and R\$ 48.2 billion (US\$ 15.7 billion) to the external Federal Public Debt– DPF_e. Of external maturities, R\$ 33.0 billion refers to bonds (R\$ 16.9 billion in principal payments and R\$ 16.1 billion in interest), while the remaining R\$ 15.2 billion corresponds to contracts (R\$ 12.8 billion in principal and R\$ 2.4 billion in interest). Central

⁶ DPF corresponds to DPMFi consolidated with the external debt in bonds – which is made up of restructured debt (*Bradies*) and new bonds (bonds issued voluntarily) – and contractual external debt – with the IDB/World Bank, Paris Club and government agencies.

⁷ DPMFi corresponds to all securities in the domestic Federal Debt held by the public, issued by the National Treasury and the Central Bank (NBCE).

⁸ Value forecast in the last agreement between the Republic and the International Monetary Fund – IMF, in November 2003, slightly below the annual average of R\$ 14 billion forecast for the 2004/2006 period mentioned in the Annex of Fiscal Risks of the Budget Guidelines Law – LDO.

⁹ Securities issued by the National Treasury as part of the restructuring of debt originating in the Compensation Fund for Salary Variation – FCVS, stemming from the liquidation of mortgage contracts.

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/04	14.546,0	1.437,0	7.377,0	1.581,0	24.941,0	871,0	1.514,5	2.385,5	27.326,5
fev/04	-	3.860,0	5.636,0	297,0	9.793,0	984,7	1.510,1	2.494,8	12.287,8
mar/04	-	5.952,0	2.055,0	1.510,0	9.517,0	610,6	631,8	1.242,4	10.759,4
abr/04	20.017,0	3.056,0	2.544,0	963,0	26.580,0	545,1	15.584,0	16.129,1	42.709,1
mai/04	-	2.929,0	34.485,0	662,0	38.076,0	542,8	542,5	1.085,3	39.161,3
jun/04	-	1.951,0	17.862,0	640,0	20.453,0	4.303,0	359,5	4.662,5	25.115,5
jul/04	25.430,0	3.025,0	3.172,0	1.778,0	33.405,0	885,0	1.909,1	2.794,0	36.199,0
ago/04	-	3.879,0	19.256,0	321,0	23.456,0	213,2	1.072,8	1.286,0	24.742,0
set/04	-	2.568,0	12.073,0	830,0	15.471,0	708,9	2.748,9	3.457,7	18.928,7
out/04	25.010,0	5.191,0	9.559,0	1.148,0	40.908,0	559,8	6.059,2	6.618,9	47.526,9
nov/04	-	1.958,0	15.590,0	675,0	18.223,0	1.970,4	877,3	2.847,7	21.070,7
dez/04	-	3.410,0	13.254,0	648,0	17.312,0	3.030,0	201,9	3.231,9	20.543,9
Total	85.003,0	39.216,0	142.863,0	11.053,0	278.135,0	15.224,4	33.011,6	48.235,9	326.370,9

Source: STN/CODIV

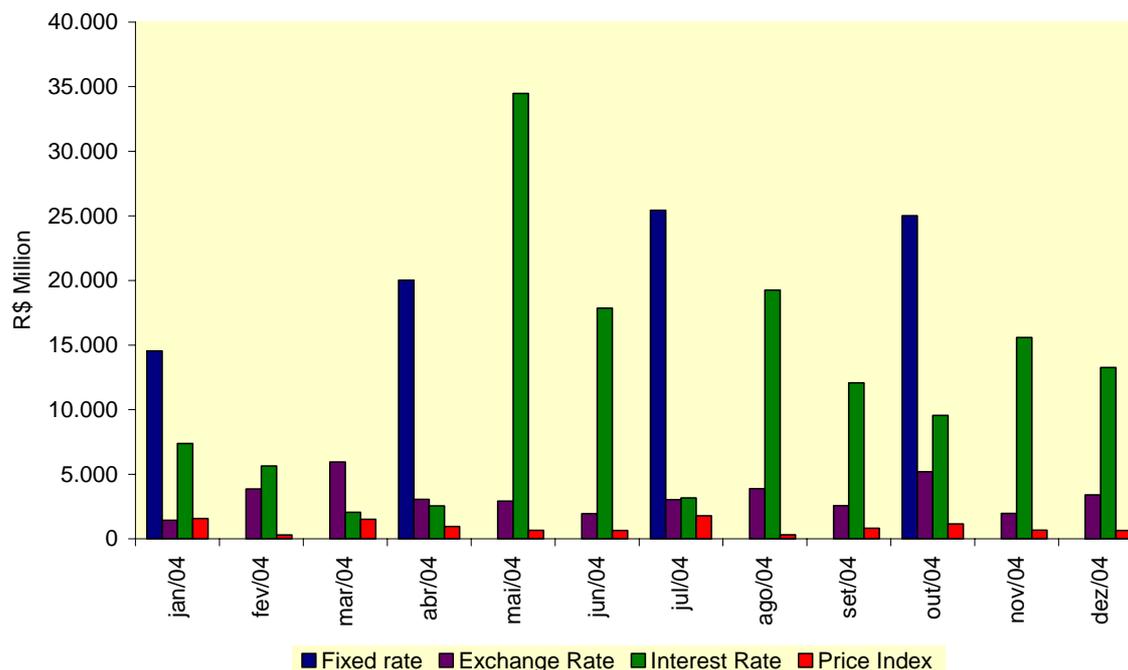
Position on 31/12/2003

DPFs maturities are expressed in reais, converted using the exchange rate on 31/12/03 (R\$/US\$ 2.88).

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

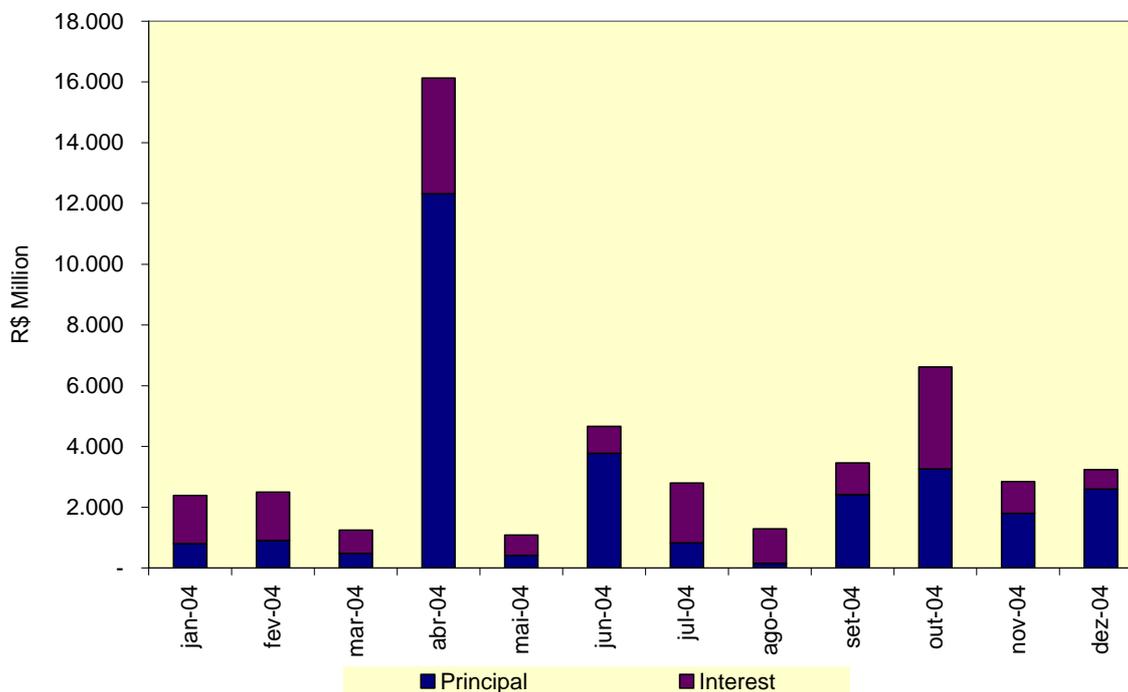
(b) Securities linked to the Selic, TR and TJLP rates.

Chart 1 – DPMFi Maturity Profile



Source: STN/CODIV

Chart 2 – DPFe Maturity Profile



Fonte: STN/CODIV

Another factor that must be considered is that the National Treasury counts on budget funds for debt payments totaling some R\$ 73.5 billion. Within this context, The Federal Government's

financing needs amounts to R\$ 252.9 billion, as is shown on Table 2.

Table 2 – Federal Government Financing Requirements

			R\$ Billion
A Estimated Maturities			326,4
National Treasury		<i>Domestic debt</i>	262,0
		<i>External debt</i>	48,2
Central Bank			16,1
B Budget Funds			73,5
C Financing Requirement (A-B)			252,9

Source: STN/CODIV

2.2 Issuance Strategy

Domestic Debt

The issuance strategy contemplated in this Plan allows for the development of a yield curve with fixed-rate and price-indexed benchmarks, which are key to steer the development of capital markets.

Fixed-rate securities

Issuance of fixed-rate securities (LTN¹⁰ and NTN-F¹¹) will be based on two objectives: i) an increase in their share of the public debt; and ii) a gradual lengthening of the average maturity of the issues. Here, it is important to stress that LTN securities will start the year being issued with maturities of 12 months (shortest bill) to 18 months (longest bill). By the end of the year, the average maturity is expected to be around 2 years.

The NTN-F will play a key role in lengthening the average maturity of fixed-rate securities, with the possibility of issues carrying maturities in excess of four years – which has so far been the standard for this series.

Price-indexed securities

Issuance of price-indexed bonds (NTN-B¹² and NTN-C¹³) is also expected to increase in 2004.

The same maturities¹⁴ issued at the end of last year are expected again this year. However, depending on market conditions, the Treasury might introduce new terms in an effort to consolidate benchmarks for the medium- and long-term yield curves.

In this market, the calendar of monthly issues offered during two-stage auctions is expected to be maintained. This system allows for the swap of shorter-term securities for longer-term securities in the second stage of auction, in line with broad objective of lengthening the average maturity of the debt. Additionally, the Treasury will continue to accept floating-rate notes and exchange-rate-linked bonds as payment for

price-indexed bonds in an effort to help improving the composition of the public debt.

Floating-rate securities (Selic linked)

A net redemption of floating-rate securities linked to the Selic rate (LFT) is expected. In addition, the Treasury will seek to continue lengthening the term of these securities, which have been typically issued carrying a 2009 maturity.

Exchange-rate-linked debt

NTN-D issuance is not expected. However, the Central Bank, within the scope of foreign-exchange and monetary policies, may continue to supply investors with hedging instruments by means of derivatives contracts. These derivatives may fully or partially replace exchange-rate-linked debt and currency swap contracts that expire over the course of the year.

Other actions

In an effort to reduce the concentration of redemptions, the National Treasury plans to buy back very-short-dated LTN security and to offer to swap short-term LFT for longer-dated bonds.

Additionally, public buyback auctions targeting longer-term NTN-B and NTN-C are planned to increase liquidity in these bonds, which will likely reflect in increased demand for them during their respective primary offerings.

The National Treasury also intends to continue organizing the distribution of these bonds' maturities, following these rules:

- 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 expiry of standard derivatives contracts;
- price-indexed bonds: NTN-B – maturity in the second month of each quarter; NTN-C – maturity in the third month of each quarter;
- LFT: maturity in the third month of each quarter.

¹⁰ Zero-coupon, fixe-rate securities.

¹¹ Fixed-rate bonds with semiannual coupons that can be stripped and negotiated separately.

¹² Linked to the IPCA.

¹³ Linked to the IGP-M.

¹⁴ August/06, May/09, May/15 and August/24 for NTN-B; and March/11, July/17, April/21 and January/31 for NTN-C.

External debt

In addition to the general guidelines for the public debt, the management of the External Federal Public Debt in Bonds – DPMFe follows its own set of principles that have been cemented over the years, which are:

- Consolidation of the term structure of interest rates in strategic markets (dollar, euro and yen), with liquid benchmarks;
- Expansion of the base of investors in Brazilian sovereign risk;
- Gradual redemption of restructured debt, as permitted by market conditions;
- Creation of benchmarks so that other issuers may access the long-term credit market, which is still incipient in the domestic capital market.

The bond issuance plan for 2004 totals US\$ 5.5 billion, of which US\$ 1.5 billion has been already raised in advance during 2003.

A continued favorable scenario, along with the reduction in the country's risk spread, allowed for the 2034 dollar-denominated global bond issue on January 20, 2004 (Global 2034). It marked the longest bond issued by the Brazilian Government in four years. The cost was the smallest among Brazil's long-term sovereign issues, with a 8.75% coupon and a spread of 376 basis points over the comparable U.S. Treasury benchmark.

It was also the first sovereign bond issue to take place within the scope of the Strategic Committee for the External Debt Management – CODEX (see Box 1).

Due to the Global 2034 issue, the remaining volume of bonds planned for 2004 is US\$ 2.5 billion.

Additionally, other liability-management transactions may take place this year to improve the country's debt profile.

Box 1 - Strategic Committee for the External Debt Management – CODEX

The National Treasury and the Central Bank inked an agreement on January 7, 2004, governing operations related to the Federal External Debt in Bonds – DPMFe in 2004 and the transfer of all themes related to external debt management to the National Treasury. The transfer is to be completed over the course of this year (as stated in the Official Gazette on January 8, 2004 – Section 3).

This agreement also created the Strategic Committee for the External Debt Management – CODEX, integrated by the National Treasury Secretary, the Deputy Secretary responsible for the Federal Public Debt – DPF management, the Central Bank Director for International Affairs and the Head of the External Debt Department and International Relations (DERIN) of the bank. The committee's main task will be to establish guidelines and approve plans for the Republic to issue new bonds on the international market and to conduct liability management transactions for the Brazilian external debt.

The agreement establishes the terms of the full transfer of responsibility for the external debt management to the National Treasury, in accordance with what had already been established in Decree 4,643, from 24.03.2003. Over the course of the last decade, a number of elements of this activity had been performed by the Central Bank, by means of an agreement inked between the two institutions. The Transition Accord marks yet another step toward increased transparency in the separation between fiscal and monetary policies.

2.3 Expected Results

The achievements expected for 2004, based on the National Treasury's financing strategy, are presented in the form of minimum and maximum forecasts for debt indicators, as in 2003. This approach aims at providing a clear reference for the National Treasury's refinancing policy without nonetheless restricting its flexibility when deemed necessary.

The indicators, as in 2003, refer to the Federal Domestic Public Debt – DPMFi and to the Federal Public Debt – DPF. The DPF is a broader measure of debt including external liabilities in the form of bonds and contracts.

We expect the DPF and the DPMFi to have the following profile at the end of 2004 (Tables 3 and 4):

Table 3 – Results for the DPF

Indicators	Dec/03	PAF-2004	
		Minimum	Maximum
Stock of DPF held by the public (R\$ billion)	965,8	1080	1150
Average maturity - Federal Outstanding Debt (months)	39,0	40	45
% Maturing in 12 months	30,7	26	32
Share of DPF (%)			
Fixed rate	9,5	9	19
Floating rate	46,5	39	47
Price Index	32,4	24	30
Exchange rate	10,3	12	17
Others	1,4	1	3

Source: STN/COGEP

Table 4 – Results for the DPMFi

Indicators	Dec/03	PAF-2004	
		Minimum	Maximum
Stock of DPMFi held by the public (R\$ billion)	731,4	820	880
Average maturity of DPMFi (months)	31,3	34	38
% due in 12 months	35,3	30	35
Share of DPMFi (%)			
Fixed rate	12,5	13	23
Floating rate	61,4	50	61
Price Index	10,8	5	7
Exchange rate	13,6	15	21
Others	1,8	1	3

Source: STN/COGEP

Stock

The DPF stock is expected to total between R\$ 1.08 trillion and R\$ 1.15 trillion at the end of 2004. The DPMFi stock is projected in the R\$ 820-880 billion range.

The stock growth accommodates increased demand for public debt following a sharp drop in 2002. That year, approximately R\$ 70 billion in securities failed to be refinanced by the National Treasury and became part of the daily liquidity drained by the Central Bank by means of repos in the open market. Even though this situation began to reverse in 2003, there is still R\$ 55.7 billion in repo operations between 10 and 63 working days being kept by the Central Bank. As the economic environment gradually returns to normal in Brazil, a significant portion of these resources are expected to migrate to public debt and other longer-dated domestic financial assets. Therefore, while the apparent rise in the public debt reflects, to a certain degree, a policy of maintaining cash reserves, the bulk of the expansion above the nominal fiscal deficit stems from the expected absorption of the liquidity excess. It is important to note that, as the National Treasury absorbs this liquidity, the Central Bank's liability to the market falls in the proportion of the reduction in the volume of repo transactions. So, from a net public-sector debt perspective, the impact of this migration is neutral, but it signals more stability in the debt since the financing terms will be longer.

It is also worth remembering that even though the repo operations are not part of the public debt, open-market transactions are included in the overall Federal Government liabilities for the purpose of analyzing the Government's exposure. It is part of the Asset and Liability Management – ALM approach discussed in Section 4.

Average maturity

The average maturity of the DPF stock is expected to rise from 39 months in December 2003 to between 40 and 45 months at the end of 2004. A similar outcome is expected for the DPMFi, which had ended 2003 with a maturity of 31.3 months. This maturity should be extended to the range between 34 and 38 months until the end of 2004. An increased share of price-indexed securities and

lengthening of fixed-rate securities will contribute to the result.

Debt due in 12 Months

The share of the DPF coming due in 12 months was 30.7% at the end of last year. By December 2004, we expect the indicator to be between 26% and 32%. In the DPMFi, the expected range is 30% to 35%, compared with 35.3% at end-2003.

Debt composition

The share of **fixed-rate securities** in the DPF is expected to be between 9% and 19% of the overall debt stock by December 2004, against 9.5% at end-2003. For the DPMFi, this indicator is expected in the 13%-23% range at the end of 2004, compared with 12.5% a year earlier.

Price-indexed securities are expected to see their share in the DPF rise to 12%-17%, and to 15%-21% of the DPMFi, versus 10.3% of the DPF and 13.6% of the DPMFi at the end of 2003, respectively.

Floating-rate securities (Selic linked) are forecast to account for a shrinking portion of the debt, dropping from 46.5% of the DPF and 61.4% of the DPMFi at end-2003 to 39%-47% and to 50%-61% by this year's end, respectively.

The share of **foreign-exchange-rate-linked debt** is expected to continue to fall in 2003. In the DPF, it is forecast between 24% and 30% at the end of 2004, versus 32.4% in 2003. For the DPMFi, a range of 5%-7% is expected, versus 10.8% in December 2003.

Section 3: Risk Assessment and Outlook for 2005-2006

3.1 Introduction

This section analyzes refinancing-risk controls in more detail, the recent trajectory of the main indicators of such risk and the outlook for continued improvement during the next two years.

The section also analyzes the opportunities for further advance in the reduction of debt exposure to risk factors – highlighting those related to changes in interest rates and in the exchange rate – in the light of the debt redemption schedule for the following two years.

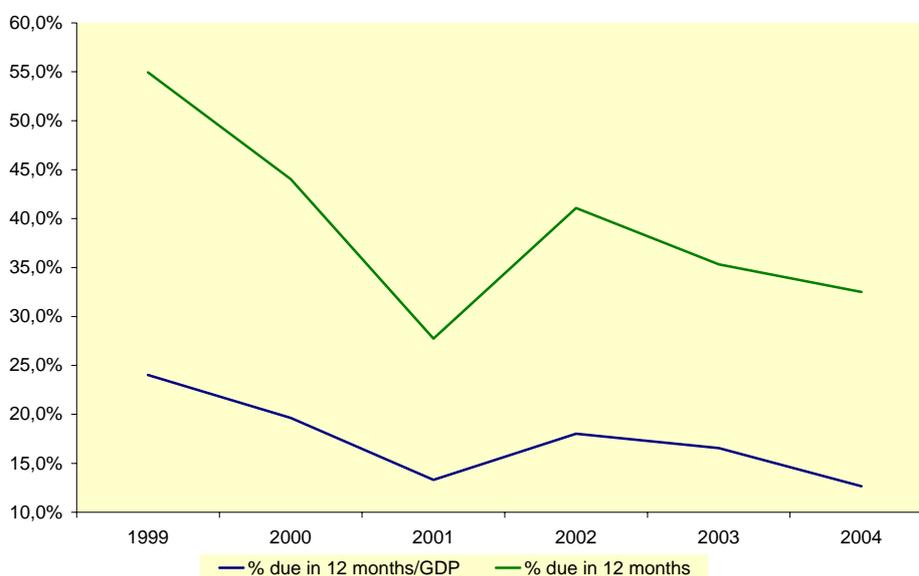
3.2 Refinancing Risk

Refinancing risk is defined as the Government's risk of facing elevated costs to finance itself, or, in an extreme situation, the risk of failing to honor its commitments. This risk is associated with the debt redemption schedule minus funds

available in the Government's cash account, and with how sensitive the debt is to shocks on the economy.

As has been shown, the percentage of short-term securities in the overall debt has been falling. From a different angle, the refinancing risk relates to the volume of debt due in 12 months as a share of GDP, which reflects the general availability of funds in the economy. Chart 3 shows how these two indicators are correlated throughout time. The share of DPMFi due in 12 months, which was 54.9% in December 1999, has been falling and could finish this year at 32.5%, if we consider the midpoint projected for 2004. The financial volume of debt due in 12 months as a share of GDP is projected to be at 12.7% at the end of 2004 – roughly half the amount from five years ago (24.0% in 1999). The amount of debt due in 12 months as a share of GDP, in particular, is expected to be in a more comfortable position this year, even better than in 2001, before the turbulence of 2002.

Chart 3 – DPMFi Maturity Concentration Due in 12 Months



Source: STN/COGEP

It is important to stress that the ratios reflect a conservative approach on the part of the National Treasury, as they do not include the balance of the cash reserves (funds available

exclusively for debt payments), expected budget revenue flows during the year that are earmarked for debt payments (around R\$ 73.5 billion in 2004) and the buyback strategy that

the National Treasury has been using to smooth out the maturity schedule and help lengthening the debt profile.

As mentioned previously, refinancing risk must also be monitored from the viewpoint of its sensitivity to macroeconomic variables, reflecting uncertainty regarding expected cash flows.

For this purpose, the *cash-flow-at-risk (CfaR)*¹⁵ methodology can be useful. It tries to estimate, in view of specific probabilities for shocks in those variables, the maximum possible volume of debt falling due within a certain period of time, measured in local currency terms. The model considered shocks in interest rates, exchange rate, inflation and values with a probability of up to 95% of occurring¹⁶.

Charts 4 and 5 show the profile of the debt redemption schedule and the risks of changes in those values (*CfaR*) up until end-2004. Chart 4 shows a familiar picture. The bars in Chart 5 show the increase in DPMFi maturities that may occur each month with a probability of up to 95%, given the stochastic models adopted. The line is a measure of volatility in these maturities, displaying the ratio between the 95% limit and the average volume of maturities.

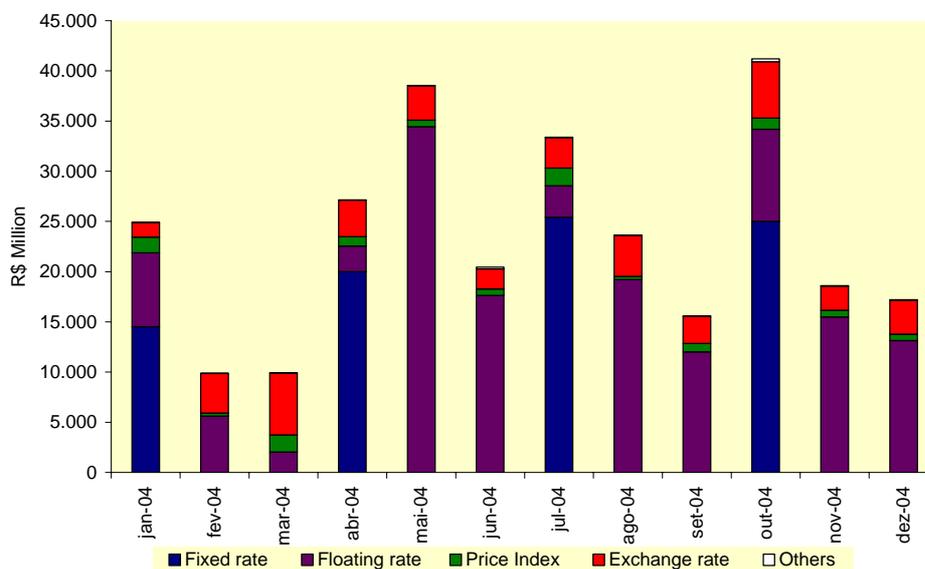
As expected, volatility tends to increase in longer time horizons if one consider continuity in certain shocks and the accumulation of uncertainty.

On the other hand, the Charts clearly illustrate the advantages of having fixed-rate debt to reduce refinancing risk. The months of larger fixed-rate debt maturities (January, April, July and October) are those that present the smallest expected fluctuation in debt value, as the value to be paid upon maturity is known in advance.

¹⁵ The National Treasury also uses other stochastic instruments to monitoring risks, as for example, the *cost-at-risk (CaR)* and the *budget-at-risk (BaR)*. Additionally, the risk analysis approach used by the National Treasury was recently validated at the "Workshop on Public Debt Management in Brazil", placed in Rio de Janeiro - Brazil, in march 2003. These instruments were discussed by many OECD countries public debt managers, also OECD and World Bank specialists.

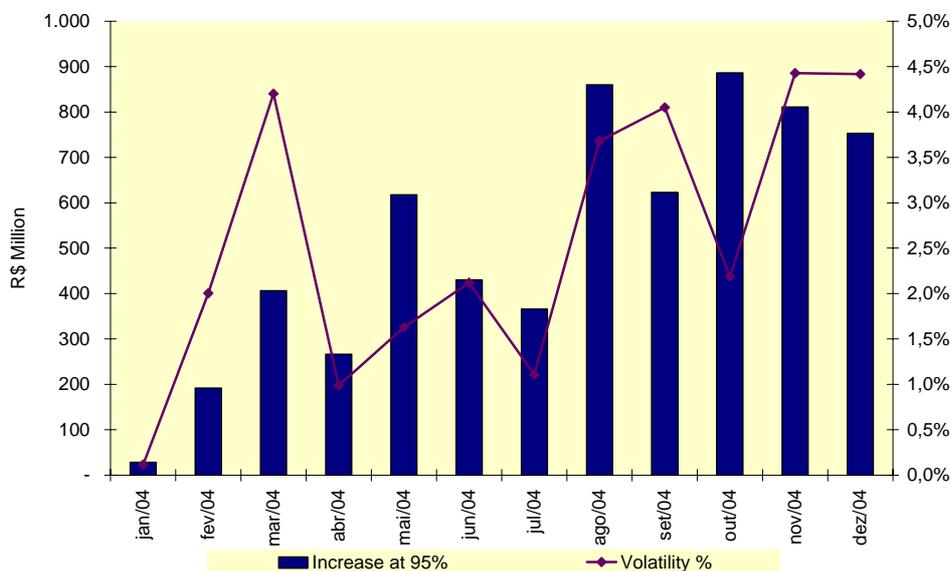
¹⁶ In fact, the analysis is focused on the risk of positive variation, i.e., the observed maturing share may be higher than its expected value

Chart 4 – DPMFi Maturity Profile by indicator



Source: STN/COGEP

Chart 5 – Cashflow-at-risk – Cfar



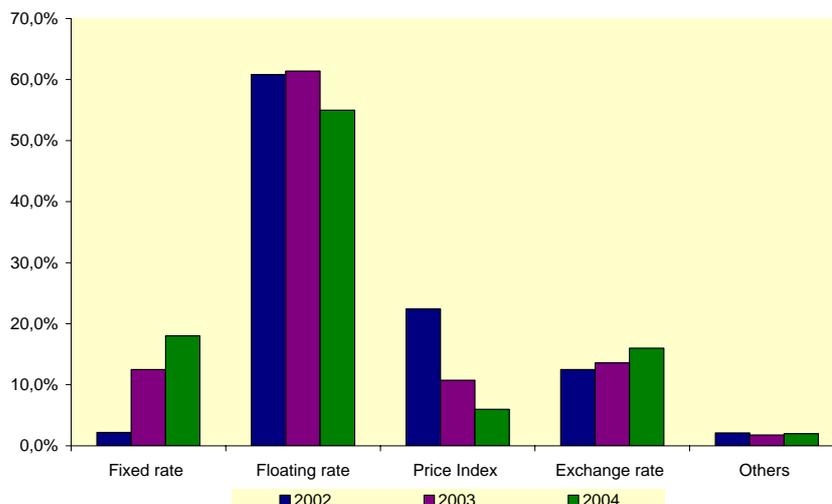
Source: STN/COGEP

3.3 Maturities and Margins for Improvements in the Debt Composition

Chart 6 shows the debt composition at the end of 2002, 2003 and 2004, considering the

average projected limits as basis for 2004. These numbers confirm the positive results that can be achieved in the first two years of the present administration.

Chart 6 – DPMFi Composition



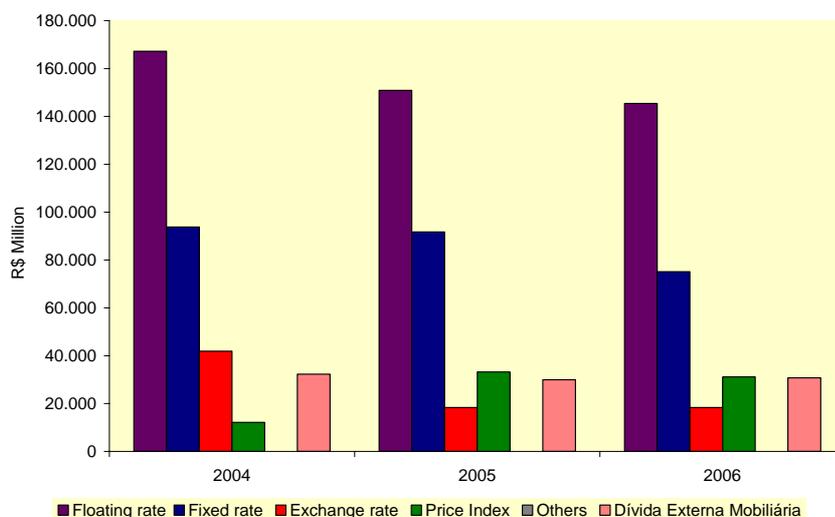
Source: STN/COGEP

Chart 7 shows the maturities of DPF by type of index during the following 36 months. Note that the LFT maturities in 2005 and 2006 account for some 57% of the total liability linked to the floating Selic rate at the end of 2004. Maturities of domestic exchange-rate debt represent around 66% of the total exchange-rate-linked in December 2004.

significant improvement in debt composition. In this case, as part of a broader economic and fiscal strategy, the Government may significantly reduce the risk and the burden of the debt on public accounts and on the Brazilian economy. As was the case in 2003, the National Treasury must stay alert to take advantage of the safest and cheapest opportunities brought about the Government's economic policy.

These numbers translate into an opportunity – assuming continued economic stability and the achievement of the economic growth rate targets for 2005-2006 – to obtain an extremely

Chart 7 – DPF Maturity Profile by Indicator



Source: STN/COGEP

Section 4: Asset and Liability Management

Asset and Liability Management (ALM) is a tool designed to monitor and minimize public debt risks that provides subsidies for medium- and long-term planning.

It is important to stress that the ALM is strictly a management tool and involves only the assets and liabilities that directly or indirectly impact the financing strategy of the DPF¹⁷.

The ALM analysis centers on the mismatch of the Federal Government's financial assets and liabilities in terms of index, duration and cash flows. It is, therefore, a broader analysis than that exclusively centered on public debt indices, i.e., on financial liabilities. Therefore the indicators for stock, average duration, short-term debt, among others, differ from those observed in previous sections.

It is important to stress that this instrument is going through a process of upgrading and validation by the National Treasury. The improvements underway take into account not only the international experience but also the development of a broader view of the Federal Government's financial assets and liabilities. Under this caveat, the results presented here have an indicative nature, but are nonetheless important to guide planning for the DPF.

Table 5 describes the Federal Government's main assets and liabilities considered in the ALM.

¹⁷ The criterion for inclusion of assets and liabilities in the ALM is different from that utilized in the DLSP, given its management nature. So the ALM should not be viewed as an indicator of debt sustainability.

Table 5 – Description of the Federal Government’s Main Assets and Liabilities

Description of the Federal Government's main assets and liabilities		
	Asset	Liability
Inflation	Law 9496/97, Law 7976/89, MP 2185, royalties, purchase of receivables and structured operations	NTN-B, NTN-C
Exchange rate	Law 7976/89, refinancing programs for the external debt owed by states and municipalities and receivables from Treasury's structured operations	NBCE, NTN-D, currency swaps, external debt
Interest rate	Law 8727/93, counterpart of currency swaps and Treasury's structured operations	LFT, CVS, open-market operations
Fixed rate	securitized rural-credit transactions	LTN, NTN-F
Others	Treasury's equity holdings	--

Source: STN/COGEP

Laws 9496/97, 7976/89, 8727/93 and MP 2185 refer to debt refinancing programs for states, municipalities and state-owned companies, whose debt is mostly linked to price-indexes. These debts are the Federal Government’s biggest asset. It also includes assets linked to the exchange rate (partly from Law 7976/89) and floating interest rates (partly from Law 8727/93).

The exchange-rate-linked asset also includes other relevant items such as states and municipalities obligations due to refinancing programs of their external debt, and receivables from Treasury structured operations. As a matter of fact, there are structured assets across all types of index, except in the “Others” line. In the fixed-rate segment, for example, these assets correspond to securitized rural credit.

The counterpart of currency *swaps* with the Central Bank is part of the asset linked to interest rates, while the National Treasury’s equity holdings are within the “Others” line.

The Federal Government’s liabilities¹⁸ include, in addition to the DPF, currency *swaps* and open-market operations by the Central Bank.

The previous sections of this document emphasize indicators referring to the federal liability. Before proceeding, Table 6 describes the Federal Government’s financial assets from a global viewpoint. The value exceeds R\$ 535 billion, with an average maturity¹⁹ of nearly 152 months, of which 7.7% are due in the next 12 months. More than half the stock (57%) is linked to price-indexes and 12.3% is linked to the exchange rate. We expect this situation to stay relatively stable through the end of 2004, with a modest increase in the average maturity to 153.4 months and the share of debt due in 12 months going to 8.7%.

¹⁸ Also considered in a risk analysis of contingent assets and liabilities of the National Treasury, such as guarantees, counter-guarantees and other contingent liabilities stated in the Budget Guidelines Law.

¹⁹ Calculation of average maturity and short-term debt on Table 6 excludes open-market operations, *swaps* and Government equity holdings.

Table 6 – Indicators for the Federal Government’s Financial Assets

Indicators	dez/03	dez/04
Stock (R\$ billion)	535,9	536,7
Average maturity (months)*	151,9	153,4
% due in 12 months*	7,7	8,7
Composition of Asset Stocks (%)		
Fixed rate	1,7	1,8
Floating rate	25,4	25,5
Price Index	12,3	11,2
Exchange rate	57,7	58,6
Others	2,9	2,9

Source: STN/COGEP

* Excludes counterparts of currency swaps, open-market operations and the government's equity holdings

4.1. Mismatch in Stock

As a principle, the ALM analysis proposes reducing the mismatch between the stocks of financial assets and liabilities in order to immunize market risks, such as those stemming from changes in interest rates and in the exchange rate.

In the absence of sufficient assets to balance the equation, one must consider that the corresponding asset to the net liability will be represented by the present value of the Federal Government’s future surpluses. In this sense, for the net liability not to add to volatility in redemption flows, it must have characteristics similar to taxes, which is the basis for primary surpluses.

Brazilian taxes are mainly characterized by their denomination in domestic currency, they are well distributed throughout time, and move with a certain time lag with regard to GDP nominal increase. In this sense, there are advantages in a strategy of issuing medium- and long-term price-index and fixed-rate bonds that allow for more homogeneous flows, with the objective of financial balance between revenues and expenditures.

Table 7 below shows the main sources of mismatch between assets and liabilities expected for December 2004²⁰.

²⁰ Results achieved considering the base scenario and strategy.

Table 7 – Federal Government's Financial Assets and Liabilities*

R\$ Billion

Index	Dec/03			Dec/04**		
	Asset	Liability	Mismatch	Asset	Liability	Mismatch
Price Index	309,0	99,1	(209,9)	314,3	136,7	(177,6)
Exchange rate***	66,1	407,7	341,6	60,1	380,2	320,1
Floating rate***	136,0	517,1	381,1	137,1	501,2	364,2
Fixed rate	9,0	91,5	82,5	9,5	178,9	169,4
Others	15,8	-	(15,8)	15,8	-	(15,8)
Total	535,9	1.115,5	579,6	536,7	1.197,1	660,4

Source: STN/COGEP

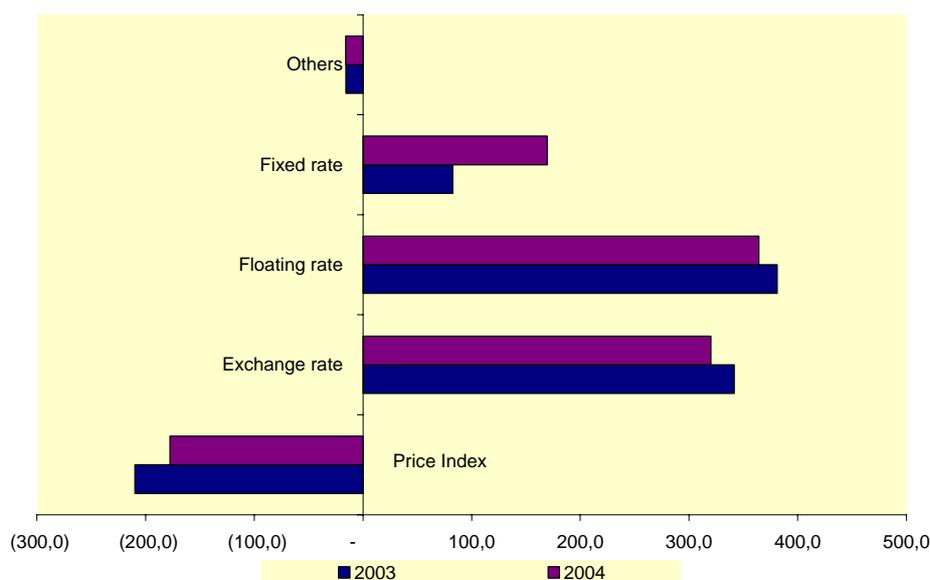
Obs : net assets in parentheses

* Values for December 2003 differ from those presented in the "Public Debt Annual Report - 2003" due to improvements in the "asset and liability integrated management" model in the PAF 2004.

** Real values (base = dez/2003). Deflated using expectations for the IPCA (Focus report)

*** The numbers generated assume 100% of Central Bank currency swaps will be rolled over. If none is rolled over, the mismatch in exchange rate falls from R\$ 320.1 billion to R\$ 276.6 billion and the interest-rate mismatch rises from R\$ 364.2 billion to R\$ 407.7 billion.

Chart 8 – Mismatch in Assets and Liabilities



Source: STN/COGEP

The expected profile of net mismatches indicates expectations of improvement in the composition of the Federal Government's financial assets and liabilities over the course of the year.

A few points are worth highlighting. First, a stable scenario for the exchange rate and the implementation of a policy of net redemption of exchange-rate liabilities, as was done in 2003, indicate that the net liability, in real terms, may fall from R\$ 341.6 billion in

December 2003 to between R\$ 276.7 billion and R\$ 320.1 billion by December 2004. The outcome will depend on the percentage of outstanding currency swap contracts renewed by the Central Bank. In other words, a 6.3%-18.9% reduction in the overall exposure to foreign exchange is expected.

Another aspect that deserves attention is an expected decline²¹ in the net liability linked to floating interest rates (Selic, TR, TJLP) of 4.4% (R\$ 16.9 billion) in real terms compared to 2003.

The mismatch relative to price-indexes is also expected to fall, with a reduction of 15.4% expected for net liability in real terms as a result of a strategy to increase issuance of inflation bonds this year.

Only the fixed-rate mismatch is expected to grow, with the net liability rising from R\$ 82.5 billion at the end of 2003 to R\$ 169.4 billion a year later. This change, from a viewpoint of risk management in the public debt, is positive and is in line with the National Treasury guidelines.

4.2. Mismatch in Maturities

Another aspect of the Asset and Liability Management approach is the distribution of redemption over time. For this analysis, the average maturities of assets and liabilities are compared to determine the mismatch.

This analysis is important because, even in the event of a perfect composition between stocks, there can be a mismatch in the structure of maturities of the Federal Government's financial assets and liabilities, which may result in an elevation of exposure to refinancing risk in the public debt. It is, therefore, an analysis focusing on the time component of financial structures that complements the analysis of debt stock in order to neutralize risks.

Analyzing the schedule of debt maturities there is a relative mismatch — resulting mainly from the long-term nature of debt refinancing accords inked between States and Municipalities and the National Treasury in the past. Therefore, a large portion of the Federal Government's financial assets is represented by debt owed by States and Municipalities. These debts have an average maturity of 151.9 months (12.5 years), against 39.0 months in the Treasury's liabilities. However, some improvement is expected in 2004, with a reduction of 4

months in the mismatch of average maturities.

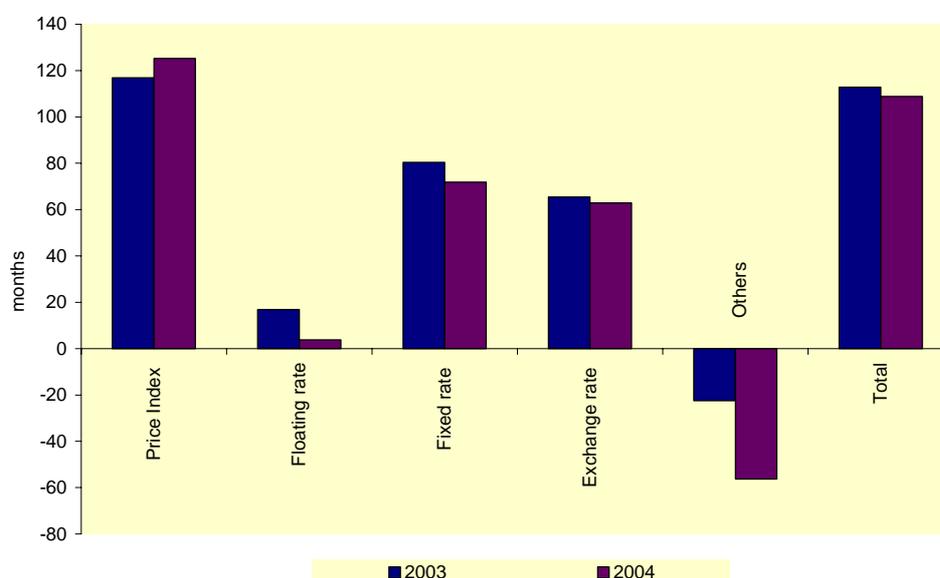
²¹ Assuming that all Central Bank currency swaps be rolled over.

Table 8 – Average Maturity of Financial Assets and Liabilities

Index	2003			2004			months
	Asset	Liability	Mismatch	Asset	Liability	Mismatch	
Price Index	193,7	76,8	(116,9)	190,5	65,2	(125,3)	
Floating rate	39,2	22,3	(16,8)	34,6	30,8	(3,7)	
Fixed rate	86,9	6,5	(80,4)	86,0	14,2	(71,9)	
Exchange rate	106,0	40,5	(65,5)	102,3	39,5	(62,9)	
Others	70,2	92,7	22,5	67,9	124,1	56,3	
Total	151,9	39,0	(112,9)	153,4	44,5	(108,9)	

Source: STN/COGEP

Chart 9 – Average Maturity: Difference between Assets and Liabilities



Source: STN/COGEP

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4.3. Mismatch in Flows

Table 9 shows the mismatch between the Federal Government's financial asset and liability flows, in an analysis of concentration over time. One can see that flows of net fixed-rate and floating-rate liabilities are concentrated in the short and medium term (up to 4 years), while flows of net assets linked to price-index have an average maturity of more than 10 years.

On the other hand, the distribution of flows of net exchange-rate-linked liabilities is more uniform throughout time, mainly as a result of the external debt.

Table 9 – Profile of the Mismatch between flows of the Federal Government's Assets and Liabilities

R\$ Billion

	Price Index	Exchange rate	Floating rate	TR	Fixed rate	Others	Total	%
Up to 1 year	(2,2)	95,3	243,2	(4,5)	162,5	(0,6)	493,7	0,6
Up to 6 months	(0,7)	56,2	152,0	(2,4)	67,7	(0,2)	272,7	0,3
6 to 12 months	(1,5)	39,1	91,2	(2,2)	94,7	(0,4)	221,0	0,3
1 to 2 years	8,0	62,4	148,7	(3,4)	28,9	(0,3)	244,3	0,3
2 to 3 years	1,8	46,9	143,3	(2,9)	(0,9)	(0,3)	187,9	0,2
3 to 4 years	(7,3)	33,8	41,9	(0,7)	(0,2)	(0,3)	67,3	0,1
4 to 5 years	0,9	19,0	12,0	(2,7)	(0,2)	(0,3)	28,8	0,0
5 to 10 years	(43,4)	46,2	5,1	(8,9)	(1,2)	(1,0)	(3,2)	(0,0)
More than 10 years	(167,6)	(8,9)	0,2	(1,2)	(1,8)	(1,0)	(180,4)	(0,2)
	(209,7)	294,7	594,4	(24,3)	187,0	(3,7)	838,3	1,00

Source: STN/COGEP

Position on 31/12/03

Obs : net assets in parentheses

1 figures in present value

2 excludes currency swaps, open-market operations and the Treasury's equity holdings.