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1. Public Debt 2. Annual Borrowing Plan 3. Planning 4. Strategy

I. Brazil. National Treasury Secretariat II. Title

I believe that greater strength and trust were the hallmark of Brazil in 2005. The country got stronger because, for three years, the Federal Government has demonstrated that its leadership can provide businesses and workers with the conditions required to expand economic activity with low inflation, keep public accounts in order and ensure a burgeoning external sector. We can trust the future because we have learned that, once we avoid the temptation to address political problems through shifts in economic policies, the country comes out ahead and, in a democracy, these problems are solved when they are dealt with forthrightness and due respect for institutional process.

The Federal Government's efforts to buttress the economy by strengthening fiscal and monetary policies, while improving the quality of and creating fiscal room for public investment, have proved their value. As we start 2006, growth in employment, income and domestic credit provides conditions for an acceleration in economic activity. Also, in addition to contribute to lower inflation and open the economy further, those policies have helped market expectations point to an improved outlook in a year in which the democratic process will once again culminate in general elections.

Economic development has been accompanied and supported by important changes in the federal public debt profile. A sharp reduction in the exchange rate exposure, growth in the share of fixed-rate securities and a steady decline in the debt/GDP ratio are only the more evident results of persistent work and a well-designed strategy in this area. In this context, I am glad to present once more the National Treasury Annual Borrowing Plan – PAF.

The PAF 2006 is an important tool for achieving fiscal and transparency goals. It presents the objectives and guidelines adopted by the management of the Federal Public Debt – DPF. It underscores that the strategy implemented by the National Treasury continues to aim at changing the composition of the federal public debt, observing market conditions. Progress in this area has been real. The importance of replacing floating-rate debt with fixed-rate and price-indexed debt is well known. Hence, I am confident that the market has taken note that the ratio of LFT in the DPF is likely to drop below 40% by the end of this Administration.

Initiatives underway to increase the share of the real-denominated debt held by foreign investors build on the progress achieved by the country in many areas in recent years. This is particularly so in the case of the goal of increasing the presence of international investors in the domestic debt. In the wake of the unprecedented issue of sovereign bonds denominated in real, attention must be given to the measures taken by the National Treasury and other areas of the Ministry of Finance to facilitate the access of these investors to domestic markets. It is our belief that these initiatives will accelerate the process of lengthening public debt maturities, enhance competition in security markets and, ultimately, reduce the Federal Government's financing costs.

Finally, it should be reaffirmed that fiscal responsibility, which has been a hallmark of the current Administration, coupled with prudent and transparent management of the Federal Public Debt, has unmistakably helped increase the country's credibility and welfare.

Antonio Palocci Filho
Minister of Finance

Economic stability and the bases for sustained growth were further consolidated in Brazil last year. Fiscal targets were met for the seventh year in a row; the consolidated public sector debt/current GDP ratio declined for the third consecutive year; and the ratio between the external debt and trade flows provided new evidence that the external sector has undergone a structural shift. This progress has been reflected in the decline in the risk premium associated with the external debt and an improvement – albeit still incipient –in the risk classification of the Brazilian public debt by specialized rating agencies. This progress has also contributed to growing external demand for Brazilian public securities and to the ongoing transformation of the composition and profile of the Domestic Federal Public Securities Debt – DPMFi.

The Annual Financing Plan – PAF 2006 sets out the guidelines and targets for the National Treasury this year. These are part of an unfolding strategy adopted in 2003. The main goals of the Federal Public Debt – DPF management are kept: increased participation of fixed-rate securities, which has risen from 2% of the DPMFi in early 2003 to close to 28% at the end of 2005; a larger role for long-term, price-indexed securities; and lower participation of Selic-indexed securities in the DPF. The reduction of Selic-indexed securities is bound to occur naturally, reflecting the relatively high proportion of LFT maturing in 2006 and the reduction in the participation of these securities in primary Treasury auctions in 2005 (LFT accounted for just over 3% of auctioned volume in December 2005).

No exchange-rate linked domestic securities will be issued in 2006, in line with the practice and strategy in place since 2003. The external exposure of the Treasury is also to be reduced by a decrease in the rollover rate of the External Federal Public Debt in 2006-2007 to close to 75% of the maturing debt. On the other hand, the National Treasury will continue to work towards increasing the access of international investors to the domestic public securities market, taking full advantage of the excellent transaction regulations and infrastructure already in place. The Treasury will carry out several activities aimed at providing the international community with updated information on this matter. This work will continue to be done in cooperation with the Stock Exchange Commission –CVM, the Central Bank, and the private sector.

Another objective for 2006 is to lengthen DPF maturities and reduce the share of the debt falling due in the coming 12 months. In this sense, working together with the Central Bank, the National Treasury will continue to promote the use by portfolio managers of benchmarks that reflect a broader composition of the public debt. Also, the ongoing dialogue with segments of the financial industry, including pension funds, will help pave the way for the transition in the public securities domestic demand structure, already operating in an environment of reduced macroeconomic volatility and gradual decline of interest rates.

The success achieved by the Treasury in implementing the targets set out in PAF 2005, despite the increased burden put on monetary policy in late 2004, suggests that the PAF 2006 targets are likely to be reached, particularly considering the inflation falloff registered in the second half of 2005. The macro scenario projected by the market for 2006 points to the maintenance of current fiscal policies, good performance in the external sector, and low inflation. That underpins the projected drop of the whole domestic yield curve – albeit at a more gradual pace than could be suggested by the evolution of the sovereign debt risk premium. It also confirms the consolidation of the medium-term scenario captured by a rather benign constellation of economic indicators.

Turning to a particular and important program to broaden the investor base, the Tesouro Direto Program will continue to be among the top priorities of the National Treasury to reach retail domestic investors and increase their acquaintance with the Federal Public Debt. The policy of organic growth of the program will, in general, be maintained, as no major advertising campaign is envisaged. The *growth rate of Tesouro Direto in the last six months suggests that more than 70,000 investors will be enrolled by end-2006, resulting in R$ 2.0 billion in cumulative sales.*

To sum up, the National Treasury reaffirms its commitment to transparency and predictability in managing the public debt, as it incorporates the best risk management techniques and maintains a standard of prudence inherent to its objective of ensuring minimum financing costs over the long run. For that purpose, the greatest asset available to the National Treasury in its efforts to serve Brazilian society will always be the contribution made by its talented and devoted technical staff, together with the firm, secure and experienced leadership enjoyed by the debt management team.

Joaquim Vieira Ferreira Levy
National Treasury Secretary

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Executive Summary

The central objective of the management of the Federal Public Debt – DPF is **to minimize long-term financing costs, while ensuring the maintenance of prudent risk levels and contributing to the smooth operation of the public securities market**. In this framework, and subject to market conditions, this debt management observes the following general guidelines: lengthen the average DPF maturities; reduce the share of DPF maturing within 12 months; gradually replace Selic-indexed and exchange-indexed securities with fixed-rate or price-indexed paper; smooth the external public debt profile; promote the development of the yield curve of the domestic and external debt; and broaden the domestic and external investor base.

The preparation of the 2006 borrowing strategy incorporates a variety of issuance possibilities based on alternative scenarios, which inform the upper and lower limits defining ranges for the debt targets. The main hypothesis underpinning all scenarios was the maintenance of the current thrust of the economic policy.

The base scenario is close to market expectations[1] for 2006 and is the benchmark for point statistics (where these, rather than ranges are used). Assumptions underlying this scenario include the absence of major external or domestic shocks and the maintenance of current trends of the Brazilian economy. The latter include further economic development and strong external accounts, anchored in fiscal responsibility and the convergence of inflation to 4.5%, which will help interest rates to drop further and foster fiscal and external solvency. More optimistic scenarios are also considered, given that the balance of risks may suggest some downside risk for the yield curve, on the heels of market expectations pointing to the maintenance of the primary surplus, the strong performance of external accounts, and low levels of inflation, as well as the decline of the risk premium of the sovereign debt to 300 basis-points.

The first step to draw borrowing strategies is the definition of DPF borrowing requirements. DPF outlays are projected at R$ 481.5 billion in 2006[2]. Of this total, R$ 451.4 billion refer to the Domestic Federal Public Securities Debt – DPMFi and R$ 30.1 billion to the External Federal Public Debt – DPFe. Considering these outlays and the availability of R$ 62.1 billion in budgetary resources, net Federal Government borrowing requirements for 2006 come to R$ 419.4 billion.

Federal Government Borrowing Requirements in 2006

R$ Billion

A	Estimated Outlays			**481.5**
		National Treasury	*Domestic debt*	444.9
			External debt	30.1
		Central Bank		6.5
B	Resources from the Budget			**62.1**
C	Financing Requirements (A-B)			**419.4**

Position on 12/31/2005
Source: National Treasury

1 According to the Relatório de Mercado (Market Report), released by the Central Bank.
2 Position on 12/31/2005.

Another important consideration in drawing the 2006 borrowing strategy is the projected increase in the access of foreign investors to the DPMFi. This growing participation of foreign investors is expected to help lengthen debt maturity and reduce the need of issuing sovereign bonds in the coming years. Also, the prefinancing of the 2006-2007 external debt program achieved so far suggests that there will be no major difficulty to fulfill the external borrowing requirements for 2006 and the existence of room to address some of the 2007 requirements along the year.

Summing up, the DPMFi financing strategy is based on the following guidelines:

- Increase the share of fixed-rate securities (LTN and NTN-F) in the public debt, while raising the average issue term of these securities.
- Raise the volume of bonds referenced to the Broad National Consumer Price Index – IPCA (NTN-B).
- Continue to redeem Selic-indexed papers (LFT) on a net basis, while raising average issue terms.
- Avoid the issuance of NTN-D, keeping up with the policy established in 2003.

The external financing program for 2006-2007 calls for issuing up to US$ 9.0 billion in debt markets, implying a roll over of approximately 76% of the maturities of Bradies and new bonds, as well as of contractual debt with the Paris Club. Of this total amount, the National Treasury had already raised US$ 3.5 billion in the debt market by the end of 2005. It had also bought approximately US$ 5.7 billion on the spot market. The US$ 9.2 billion raised by that time were equivalent to more than 70% of the external debt outlays projected for 2006, or about the full service of this debt up to October 2006.

The ranges for the 2006 targets for the DPF and DPMFi at the end of 2006 are presented in the next two tables. This year, a new indicator, called the **average life**, was added to help international comparisons, since most countries use this concept to express their debt's refinancing risk. The average life differs from the traditional and more conservative average maturity because it considers principal payments only, excluding interest coupon payments.

Results and Targets for the Federal Public Debt – DPF

Indicators	Dec/05	PAF-2006 Minimum	PAF-2006 Maximum
Stock of DPF held by the public (R$ billion)	1157.1	1280	1360
Average Maturity (month)	32.9	35	41
Average Life (month) *	56.3	60	70
% Due in 12 months	38.2	28	33
Share of DPF			
Fixed rate (%)	23.6	25	33
Price index (%)	13.1	16	22
Floating rate (%)	43.9	35	43
Exchange rate (%)	17.6	11	15
Others (%)	1.8	1	3

* Since these data have been calculated through the use of the commonly used international methodology, the statistics allow comparisons with the indicators of other countries[3].
Source: National Treasury

[3] The average maturity concept presented in the PAF 2006 is quite close to the duration concept, since this indicator considers the current value of all cash flows (interest coupon plus principal). On the other hand "average life" considers only flows of principal.

Results and Targets for the Domestic Federal Public Securities Debt – DPMFi

Indicators	Dec/05	PAF-2006 Minimum	PAF-2006 Maximum
Stock of DPMFi held by the public (R$ billion)	979.7	1130	1200
Average Maturity (month)	27.4	30	35
Average Life (month) *	40.3	44	52
% Due in 12 months	41.6	31	36
Share of DPMFi			
Fixed rate (%)	27.9	28	37
Price index (%)	15.5	18	24
Floating rate (%)	51.8	39	48
Exchange rate (%)	2.7	1	3
Others (%)	2.2	2	4

* Since these data have been calculated through the use of the commonly used international methodology, the statistics allow comparisons with the indicators of other countries.
Source: National Treasury

The 2006 targets imply a broad-based improvement of the DPF and DPMFi in terms of both debt composition and maturity. Specifically, **the share of fixed-rate paper will continue to rise, accounting to 28%-37% of the domestic debt by end 2006. The share of Selic-linked debt, on the other hand, will continue to drop. This share has reached just below 50% of the DPMFi by early 2006 and is projected to be in the 39%-48% range by end 2006. This outlook implies that Selic-linked debt is very likely to account for less than 40% of DPF by end 2006.**

The share of price-indexed bonds is projected to rise further, with mid-range statistics very close to 20% of DPF. On the other hand, exchange-rate linked securities will account for a very residual share, between 1% and 3% of the outstanding federal domestic debt.

A higher share of fixed-rate and price-indexed bonds in the DPF has made the public debt less sensitive to exchange and interest shocks. If the debt structure were the same as in 2002, the outcome of a stress scenario, considering the DPF volume outstanding in December 2005, would be a surge in the DPF stock of R$ 331.8 billion. This increase would be of just R$ 113 billion if one considered the debt composition projected for end 2006 (taking mid-range target values for the share of each type of security). In other words, DPF market risk has been reduced by 65% since 2002. A similar exercise for the DPMFi would yield a 75% reduction of this risk, with the potential surge dropping from R$ 161.1 billion to R$ 36.9 billion.

Interest and Exchange Rate Stress Test

Indicators	Share of DPF (%)					Stress Impact (R$ Billion)				
	2002	2003	2004	2005	2006*	2002	2003	2004	2005	2006
Floating rate	42.4	46.5	45.7	43.9	39.0	29.63	32.49	31.91	30.68	27.25
Exchange rate	45.8	32.4	24.2	17.6	13.0	302.20	213.92	159.67	116.13	85.78
Total	88.2	78.9	69.9	61.5	52.0	331.83	246.40	191.59	146.81	113.03

Indicators	Share of DPMFi (%)					Stress Impact (R$ Billion)				
	2002	2003	2004	2005	2006*	2002	2003	2004	2005	2006
Floating rate	60.8	61.4	57.2	51.8	43.5	35.97	36.32	33.86	30.68	25.74
Exchange rate	22.4	10.8	5.1	2.7	2.0	125.13	60.11	28.71	15.08	11.17
Total	83.2	72.2	62.4	54.5	45.5	161.11	96.43	62.57	45.76	36.91

*The composition of DPF and DPMFi for 2006 corresponds to mid-range target values in the 2006 PAF.
Source: National Treasury

Lengthening the DPF maturity and average life will also **reduce refinancing risk**, as reflected in the decline in the percentage of debt falling due in 12 months. The percentage of DPMFi maturing in 12 months is projected to drop to 31%-36% of the outstanding stock, from 41.6% in December 2005. Refinancing risk will also drop owing to factors such as the improvement in debt composition, which reduces payment volatility; maintenance of a liquidity cushion with comfortable balances (budget resources available exclusively for DPF payments); and continuity of the practice of anticipated redemptions and exchanges of short-term securities for longer term paper. The cashflow-at-risk - CfaR[4] tool, for instance, demonstrates that the volatility of cash flows will continue to decline, due in particular to the increased share of fixed-rate debt in the overall debt composition.

This PAF also presents, for the first time, an analysis of **strategy risk** – i.e., the risk of accomplishing the targets. **This risk is estimated to be small**, because, for instance, the maturity pattern of LFT in 2006-2007 will help smooth the replacement of theses securities with LTN. This prospect was highlighted in the 2005 PAF and helped fashion the strategy of the Treasury for the gradual improvement of the debt composition along the year. This strategy was reflected by the fact that LFT accounted for just 25% of the securities issued in the second half of 2005, while LTN accounted for more than half. Just keeping this pattern in 2006 would allow the share of LFT in the DPMFi to drop to 45% by the end of the year. A favorable outlook for the financial conditions in 2006 suggests that this drop can be larger, allowing the strategy announced and implemented by the National Treasury since 2003 to continue to unfold smoothly.

[4] Cashflow-at-risk – CfaR is a stochastic tool that helps measure, at a given significance level, the deviations of specific cashflows due to unexpected fluctuations in the indexing factors used to calculate earnings.

Introduction

Published by the National Treasury, the Annual Borrowing Plan – PAF has consolidated its position as the primary instrument to inform investors and the public about targets, assumptions, priorities and strategies underpining the management of the Federal Public Debt – DPF. This document provides information on the short, medium and long-term planning of public debt management, thus enhancing the predictability of the debt strategy.

PAF 2006 presents the financing strategy and the expected outturn for the major DPF indicators at the end of the year. The PAF also presents a risk assessment of the DPF and a summary of the measures taken to minimize these risks.

"...information on the short, medium and long-term planning of public debt management..."

This document comprises 4 sections, in addition to the Introduction. Section 1 discusses the objectives and guidelines underlying the DPF management, together with the macroeconomic scenarios used by the National Treasury to elaborate the 2006 financing strategy.

Section 2 starts presenting an estimate of the Federal Government Borrowing Requirements in 2006. Next, it discusses the guidelines and objectives for the debt management and delves into issuance strategy. The section concludes with the presentation of major DPF indicative targets, which are established as ranges for year-end values.

Section 3 presents an analysis of the refinancing and market risk faced by the DPF, in light of the changes in the public debt composition and maturities projected in Section 2. Section 3 also underscores the compliance (strategy) risk associated with PAF 2006 targets, which is estimated to be low because the targets established for 2006 ultimaly arise from the strategy implemented by the National Treasury since 2003.

Section 4 presents final considerations, including the contrast between expectations and the macroeconomic framework observed in early 2006 and those existing in 2002.

Section 1: Public Debt Planning

The Annual Borrowing Plan – PAF is based on a broad array of information used to guide the strategic plan for the Federal Public Debt – DPF. These data underpin the scenarios used to draw alternative domestic and international market borrowing strategies, in light of the objectives and guidelines established for the Brazilian public debt management.

1.1. DPF Objectives and Guidelines

The objective of the management of the Federal Public Debt – DPF, which comprises the domestic and external debt for which the Federal Government is liable, is **to minimize long-term financing costs, while ensuring the maintenance of prudent risk levels and contributing to the smooth operation of public security markets.**

Subject to market conditions, the guidelines underlying DPF management envisage to:

- Lengthen the average DPF maturity, primarily by increasing the average term of securities issued in public offerings;
- Reduce the percentage of the DPF falling due in 12 months, thus reducing its refinancing risk;
- Gradually replace Selic-indexed and exchange-indexed bonds with fixed-rate and price-indexed securities, thus reducing the volatility of outflows, among other goals;
- Smooth the external public debt profile;
- Stimulate the development of the yield curve for domestic and external federal public securities; and
- Broaden the domestic and external investor base.

"...to minimize long-term financing costs, ensuring the maintenance of prudent levels of risk..."

1.2. Scenarios

Formulation of the 2006 financing strategy incorporates several issuance possibilities, underpinned by an array of scenarios that yielded upper and lower bounds for indicative targets for the public debt. A major assumption in all scenarios was the maintenance of current economic policies.

The baseline scenario is close to the one outlined by market expectations for 2006[5]. It assumes no significant external or domestic shock and the maintenance of current trends in the Brazilian economy, i.e., further economic development and expansion of the external sector; maintenance of the fiscal policy; convergence of inflation to official targets; and gradual, though not necessarily continuous, drop in interest rates, resulting in a favorable outlook for fiscal and external solvency.

[5] According to the Market Report issued by the Central Bank of Brazil.

More specifically, market projections point to a steady decrease in the consolidated public sector net debt/GDP ratio, compatible with a drop in this ratio to around 40% by 2010. Most forecast also point to inflation around or below 5% in coming years. The sample standard deviation of expectations in the Central Bank FOCUS survey is of less than 0.5%, showing a tight convergence of expectations. Also, market futures interest curve, as well as surveys point to a further decline in the Selic rate.

"...market projections point to a steady decrease in the consolidated public sector net debt/GDP ratio..."

These factors suggested the interest in developing also a few optimistic scenarios in which a sharper decline in domestic interest rates might take place, in a context of a benign external environment, sustained non-inflationary growth and an uncompromising stand on economic policies by the authorities over the medium-term. Scenarios were also developed that incorporate negative risks into the external environment, which were capable of reducing international liquidity and hampering capital flows to Brazil. They also reflected pessimistic projections for market indicators in the run up to the elections.

Section 2: 2006 Borrowing Plan

This section presents the quantitative targets for the Domestic Federal Public Securities Debt – DPMFi[6] and the Federal Public Debt – DPF[7], as well as the underlying assumptions supporting the domestic and external financing strategy.

2.1. Assumptions and Borrowing Requirements

DPF borrowing requirements reflect primarily the amount of Federal Public Debt maturing in 2006. This debt is estimated at R$ 481.5 billion (Table 1). Of this total, R$ 451.4 billion refer to the DPMFi and R$ 30.1 billion to the External Federal Public Debt – DPFe. About R$ 6.5 billion in DPMFi maturities correspond to old Central Bank liabilities (NBCE)[8].

Table 1. DPF Maturities

R$ Million

	DPMFi	DPFe	DPF
Jan/06	56,236.50	5,334.23	61,570.73
Feb/06	14,366.63	1,616.36	15,983.00
Mar/06	27,607.05	2,382.58	29,989.63
Apr/06	62,512.06	3,843.28	66,355.34
May/06	41,578.02	783.48	42,361.49
Jun/06	42,627.79	2,649.61	45,277.40
Jul/06	49,753.40	1,821.79	51,575.19
Aug/06	17,818.74	1,203.27	19,022.01
Sep/06	14,904.91	1,503.00	16,407.91
Oct/06	51,711.45	3,166.68	54,878.13
Nov/06	44,938.10	3,020.57	47,958.67
Dec/06	27,393.66	2,763.30	30,156.97
Total	**451,448.31**	**30,088.16**	**481,536.47**

Position in 12/31/2005.
Source: National Treasury

"Approximately 35% of 2006 DPMFi maturities involve fixed-rate securities..."

Approximately 35% of 2006 DPMFi maturities involve fixed-rate securities, which payments are scheduled at the beginning of each quarter (Graph 1). The remainder of the DPMFi include interest-indexed paper, e.g.,securities linked to the Selic, TR and TJLP, which account for 58% of maturing DPMFi; exchange-indexed securities (3% of the total); and price-indexed securities (4%). The latter tend to have a lower share in the debt maturing within a year than in the

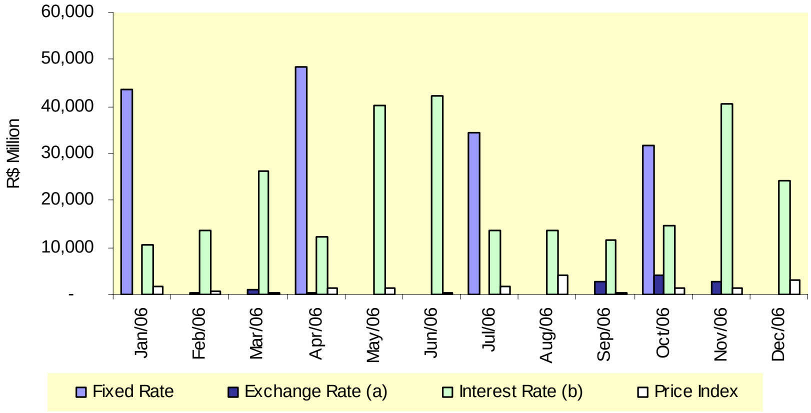
[6] DPMFi comprises the Domestic Federal Public Securities Debt issued by the National Treasury and the Central Bank (NBCE) that are in the market.

[7] DPF corresponds to the consolidation of the DPMFi with the External Federal Public Debt – DPFe. The latter comprises restructured-debt securities (Bradies), new bonds (Global, Euro, etc.) and External Contractual Debt (IDB/IBRD, Paris Club and Government Agencies).

[8] All NBC-E fall due in 2006 and represent the balance of Central Bank securities in the market. They were issued prior to May 2001, as the Fiscal Responsibility Law prohibited the Central Bank from issuing securities on the market (of course, the Bank can sell securities that it holds, typically Treasury issued securities).

outstanding debt, because price-indexed securities typically have longer issuance terms.

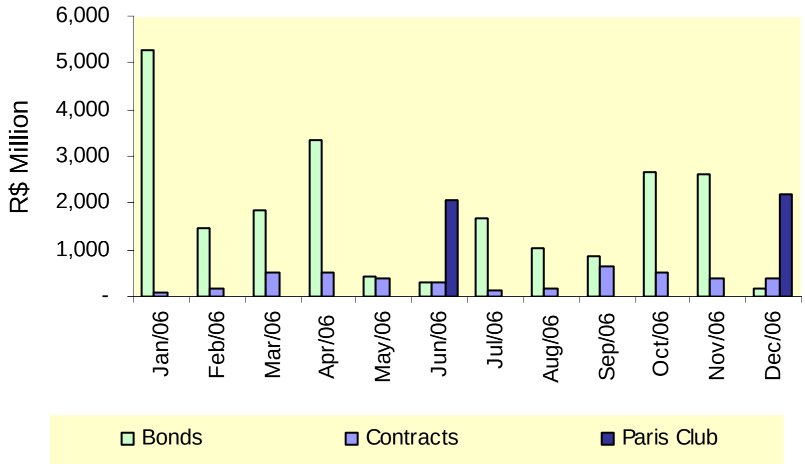
Graph 1. DPMFi Maturities by Type of Earnings



(a) Securities issued by the National Treasury and the Central Bank (NBCE)
(b) Securities linked to the Selic, TR and TJLP rates
Source: National Treasury

Projected external bond payments amount to US$ 9.37 billion in 2006 (equivalent to R$ 21.71 billion, of which R$ 8.95 billion in principal and R$ 12.76 billion in interest). Another US$ 3.56 billion correspond to payments of contractual debt, equivalent to R$ 8.38 billion, of which R$ 6.83 billion refer to principal and R$ 1.54 billion to interest. The largest share of these payments is concentrated in the first half of the year (Graph 2).

Graph 2. DPFe Principal and Interest Maturities



Source: National Treasury

"… the National Treasury has prefinanced a sizeable part of the external payments due in 2006."

It is noteworthy that the National Treasury has prefinanced a sizeable part of the external payments due in 2006. It had bought US$ 5.65 billion in the spot market and issued US$ 3.5 billion in sovereign bonds by the end of 2005. The total of US$ 9.15 billion obtained in this way represents approximately 70% of principal and interest payments in 2006, or roughly all external debt payments up to October.

Turning back to overall DPF financing needs, current projections consider that R$ 62.1 billion of budget resources will be available, resulting in net Federal Government borrowing requirements equivalent to R$ 419.4 billion (Table 2), including R$ 6.5 billion in remaining Central Bank securities.

Table 2. Federal Government Borrowing Requirements

R$ Billion

A	Estimated Outlays			**481.5**
		National Treasury	*Domestic debt*	444.9
			External debt	30.1
		Central Bank		6.5
B	Resources from the Budget			**62.1**
C	Financing Requirements (A-B)			**419.4**

Source: National Treasury

The evolution of the stock and composition of the debt in 2006 also envisages the securitization of up to R$ 13.0 billion[9] in contingent liabilities, composed basically of CVS[10]. Another factor given due consideration in the estimation of financing needs is the impact of Central Bank operations related to monetary and exchange policy, e.g., in open market operations and foreign currency purchases for purposes of international reserve management.

2.2. Issuance Strategy

Domestic Debt

The strategy guiding the issuance of DPMFi securities in 2006 aims at raising the share of fixed-rate and price-indexed securities, while reducing the share of Selic and exchange-indexed debt.

The strategy also aims at stimulating the development of the fixed-rate and price-index yield curves, which the Treasury consider fundamental to develop the market for these securities and the capital market in general. For this purpose, the National Treasury will be prepared to carry out simultaneous purchase and sale auctions involving selected securities, as a mean to ensure appropriate price parameters to fixed-rate securities in moments of low market liquidity.

"...efforts to broaden the investor base..."

[9] This is the amount forecast in the Appendix of fiscal risks of the 2006 Budget Guidelines Law - LDO.

[10] Securities issued by the National Treasury as part of the restructuring of debts associated with the housing insurance Wage Variation Compensation Fund - FCVS established in the 1960s.

The National Treasury will also continue its contacts with representative segments of the financial market as part of its efforts to broaden the investor base and ensure an adequate supply of public securities.

Fixed-rate Securities

The strategy reflects the goal of raising the share of fixed-rate securities (LTN and NTN-F) in the public debt, while lengthening the average tenure of these securities. A higher issuance volume of medium-term NTN-F notes will play an important role in achieving such a goal.

Currently, the National Treasury has been offering LTN with terms of 6, 18 and 30 months, helping develop a solid 6-months to 3-year nominal yield curve. NTN-F offers will continue to help make up the curve beyond three years. For this purpose, the workhorses will remain the 2010 and 2012 maturities, without excluding the possibility of issuing longer securities.

Price-Indexed Securities

The share of NTN-B securities referenced to the Broad National Consumer Price Index – IPCA are projected to rise in 2006, in the wake of the consolidation of a benign outlook for the medium and long-term interest curves. In principle, the terms and maturity dates in effect at the end of 2005 will be maintained without, however, excluding the hypothesis of introducing new tenures, if that is felt appropriate.

"..the share of NTN-B securities referenced to the IPCA is projected to rise in 2006..."

The existing two-stage auction system for the primary sale of IPCA-linked securities will be kept. The second stage will continue to allow buyers to offer short-term securities as means for purchasing long-term securities. Also, Selic-indexed and exchange-indexed securities will continue to be accepted as payment for price-indexed securities, with the objective of further improving DPF composition.

Selic-Indexed Securities

The goal is to continue to redeem Selic-indexed securities (LFT) on a net basis, and to ensure that the LFT issued present longer tenure than in 2005. This strategy will aid reduce the refinancing risk to the National Treasury on the domestic market and improve the composition of the DPF.

"...net redemptions of Selic-indexed securities..."

Exchange-Indexed Securities

As has happened since 2003, no National Treasury issue of NTN-D exchange-indexed securitiy is planed for 2006. On the other hand, it is understood that the Central Bank will continue to be entitled to use exchange-rate derivative instruments for monetary and exchange policies purposes.

Other Measures

In order to reduce the concentration of maturities, the National Treasury will continue to buy-back short-term securities to anticipate their redemption and to accept short-term securities as payment for long-term secutiries. These policies are considered to contribute to help increase secondary market liquidity. Also, NTN-F exchanges for LTN with identical due dates will be maintained as yet another mechanism to facilitate the improvement in DPF composition.

The National Treasury will also keep the following maturities schedule:

- fixed-rate securities:

  - LTN – maturity on the first day of January, April, July and October (first month of each quarter);[11]

  - NTN-F – maturity on the first day of the year;

- price-indexed securities – NTN-B: maturity of principal in May for securities with maturities in odd years, and maturity of principal in August for those securities maturing in even years. Coupon payments for the former securities will be in May and November, while coupon payments for the latter will be in February and August. This combination makes it possible to achieve a quarterly payment flow based on a combination of NTN-B with maturities in even and odd years;

- Selic-indexed papers – LFT: maturity in the third month of each quarter, with new issues maturing in 2009 and beyond.

The National Treasury will continue its institutional work aimed at expanding the investor base and increasing liquidity in the secondary public debt market. It will, for example, continue to rely on its partnership with the Central Bank to stimulate asset managers of mutual funds and other vehicles to use diversified benchmark indices developed by the National Association of Financial Market Institutions – ANDIMA. In particular, the ongoing dialogue with pension funds open several venues to disseminate the use of those indices by this sector, as part of the preparation of the industry to a changing financial environment.

Efforts made abroad by the private sector to disseminate information on the Brazilian domestic financial market will continue to be supported by the Treasury. This work has been successfully conducted through BEST - **Brazil Excellence in Securities Transactions**, among other initiatives. Also, coordination with government agencies in order to facilitate the participation of foreign investors in the domestic public securities market and reduce the costs of such a participation will be in the forefront of Treasury activities in 2006. Investor Relations– a hallmark of Brazil recognized by international institutions - will deepen, while the access to the relevant Debt Management staff will be furthered, helping consolidate the position of Brazil as the emerging country with the most transparent market relations.[12]

"...integrated Federal Government asset and liability management …"

[11] These date coincide with the maturity of respective futures contracts
[12] This classification was presented in "Investor Relations: An Approach to Effective Communication and Enhanced Transparency - 2005: Assessment of Key Borrowing Countries", published by the Institute of International Finance – IIF in November 2005.

External Debt

In this second year of integrated domestic and external National Treasury debt management, efforts to take advantage of synergies offered by integrated Federal Government asset and liability management will go on.

Specific guidelines to the management of the External Federal Public Debt – DPFe, in addition to those adopted for the whole DPF, include:

- Creation of net benchmark securities in the major issuing markets;
- Maintenance of transparent relations with the international financial community; and
- Reduction of the external exposure of the Republic, in accordance with the 2006-2007 external borrowing program.

The Brazilian National Treasury external borrowing program for 2006-2007 calls for the issuance of up to US$ 9.0 billion in new securities, equivalent to the refinancing of approximately 76% of the principal maturities of Bradies, new bonds and contractual debt with the Paris Club standing by the end of 2005. These maturities added to US$ 11.8 billion by the end of 2005 (Table 3).

"..anticipated redemption operations, security exchanges and the issuance of derivatives..."

Table 3. DPFe Maturities in 2006/2007

US$ Billion

		2006	2007	Total
Bradies/ New Issuances/ Paris Club	**Principal**	5.8	6.0	11.8
	Interest	6.3	6.1	12.4
	Total	12.1	12.1	24.2
Total External Debt	**Principal**	6.8	7.2	14.0
	Interest	6.8	6.7	13.5
	Total	13.6	13.9	27.5

Source: National Treasury

DPFe management in 2006 will continue to be conducted under the framework provided by the Federal Senate Resolution n. 20/2004, which inter alia authorizes anticipated redemption operations, security exchanges and the issuance of derivatives by the National Treasury.

2.3. Expected Results

Following the example of previous years, indicative targets for the Federal Public Debt – DPF and Domestic Federal Public Securities Debt – DPMFi are set as ranges for these indicators at year end (Tables 4 and 5). The National Treasury believes that the use of ranges is more informative than the use of point estimates for those indicators, because it provides references to the room the Treasury may use in responding to possible market shocks. Hence, it is felt that the announcement of such ranges yields a good balance between transparency and the flexibility to react to shifting market conditions that is still crucial for the efficient management of the Brazilian public debt.

Table 4. Federal Public Debt – DPF Results

Indicators	Dec/05	PAF-2006	
		Minimum	Maximum
Stock of DPF held by the public (R$ billion)	1157.1	1280	1360
Average Maturity (month)	32.9	35	41
Average Life (month) *	56.3	60	70
% Due in 12 months	38.2	28	33
Share of DPF			
Fixed rate (%)	23.6	25	33
Price index (%)	13.1	16	22
Floating rate (%)	43.9	35	43
Exchange rate (%)	17.6	11	15
Others (%)	1.8	1	3

* These statistics are more comparable with those presented by most countries, since they consider only the payment of principal, the common practice in most markets[13].
Source: National Treasury

Table 5. Domestic Federal Public Securities Debt – DPMFi Results

Indicators	Dec/05	PAF-2006	
		Minimum	Maximum
Stock of DPMFi held by the public (R$ billion)	979.7	1130	1200
Average Maturity (month)	27.4	30	35
Average Life (month) *	40.3	44	52
% Due in 12 months	41.6	31	36
Share of DPMFi			
Fixed rate (%)	27.9	28	37
Price index (%)	15.5	18	24
Floating rate (%)	51.8	39	48
Exchange rate (%)	2.7	1	3
Others (%)	2.2	2	4

* These statistics are more comparable with those presented by most countries, since they consider only the payment of principal, the common practice in most markets13.
Source: National Treasury

[13] The average maturity presented in PAF 2006 is quite close to duration, since this indicator considers the current value of all cash flows (interest coupons and principal). Average life, on the other hand, considers only principal flows.

The projected ranges point to improvements in all DPF and DPMFi indicators. The average maturity of the debt is expected to lengthen at the same time in which the percentage of the debt falling due in 12 months declines. The ranges for fixed-rate and price-indexed securities reflect the goal of increasing the participation of these securities in total debt, while those for Selic-indexed and exchange-indexed securities capture the envisaged reduction in the share of these securities in DPF and DPMFi.

Outstanding Stock

"... improvements in all DPF and DPMFi indicators."

The outstanding stock of DPF was of R$ 1.16 trillion at the end of December 2005. This stock is projected to be in the range of R$ 1.28 trillion and R$ 1.36 trillion by the end of 2006. For DPMFi, the stock is projected to fall within the R$ 1.13 trillion-R$ 1.20 trillion range, against a figure of R$ 979.7 billion at the end of 2005.

The gross outstanding DPF stock growth is expected to exceed the magnitude of borrowing requirements because of the financing of Central Bank foreign exchange reserves and the purchase of foreign exchange currency by the Treasury, as well as the transformation of market liquidity. This includes final sales of Treasury securities by the Central Bank to replace standard repo operations. In the case of DPMFi, it also reflects the envisaged emphasis on domestic debt, rather than in the external debt.

Average Maturity and Average Life

The average maturity of the DPF was of 32.9 months at the end of December 2005. This indicator is expected to close 2006 in a range between 35 and 41 months. The year-end average maturity of the DPMFi is projected to be in the 30-35 month range, compared to an average maturity of 27.4 months at the end of 2005.

The alternative statistics of average life, which is the one used by most countries when reporting the maturities of their debt, would show that the average maturity of the Brazilian debt is longer than it is usually thought. In particular, the steady increase of very long-term priced-indexed securities such as NTN-B have contributed to a significant recovery in the average life of Brazilian securities. The average life of the DPF is expected to rise to a range of 60-70 months at the end of 2006. Equivalent data for the DPMFi points to a range of 44 to 52 months.

Percentage Falling Due in 12 Months

The percentage of the DPF and DPMFi falling due in 12 months projected for end 2006 reflects efforts to deconcentrate very short-term maturities of DPF and DPMFi. The percentage of DPF maturing in 12 months is expected to drop from 38.2% in December 2005, to 28%-33% at the end of 2006. In the case of the DPMFi, the percentage is projected to drop from 41.6% in December 2005 to 31%-36% at the end of 2006.

Debt Composition

The share of fixed-rate securities in the DPF is projected to close December 2006 between 25% and 33%, compared to 23.6% at the end of 2005. In the case of DPMFi, the share should be in the range of 28%-37%, against 27.9% in December 2005 and 16.1% at the end of 2004.

The share of price-indexed securities in the DPF should be in the 16%-22% range by the end of 2006, compared to 13.1% at the end of 2005. Their share in the DPMFi are projected in the range of 18%-24% by end 2006, from 15.5% at the end of 2005.

"...the National Treasury will intensify the process of reducing the share of Selic-indexed securities."

The share of the debt exposed to the exchange rate will come to 11%-15% of the DPF (as it includes the DPFe) and 1%-3% of the DPMFi by the end of 2006, compared with 17.6% and 2.7%, respectively, at the end of 2005. The proportion of exchange-indexed papers in DPMFi has declined systematically, after reaching 28.6% in December 2001[14].

With the sharp reduction in the share of exchange-rate debt achieved so far, the National Treasury will focus on the reduction of the share of Selic-indexed securities in public debt. This share is projected to drop to 35%-43% of the DPF, from 43.9% at the end of 2005, and to 39%-48% of the DPMFi, compared with 51.8% in December 2005.

[14] In 2002, the increase in Federal Government exchange exposure was mainly the result of Central Bank swaps.

Section 3. Risk Assessment

The management of the overall exposure of the debt to risk is a central goal of the public debt administration. The targets established in the PAF 2006 imply further improvement in the refinancing and financial risk of the DPF.

"...management of the overall exposure of the debt to risk..."

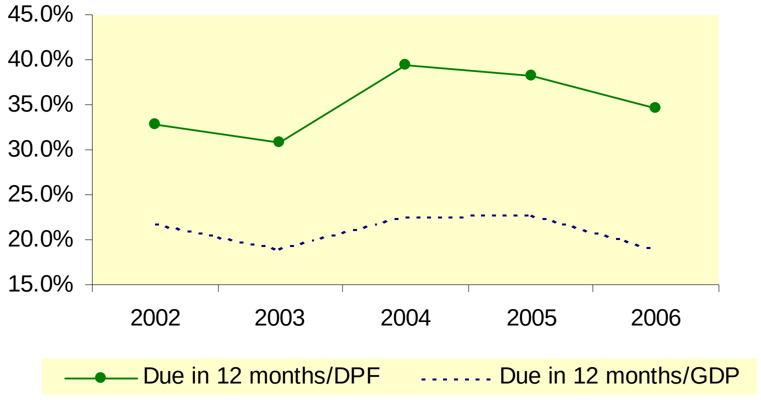
Refinancing risk refers to the possibility of the National Treasury to face higher costs in short-term financing or, in extreme cases, the failure in raising the resources required to support debt maturities. This risk is proportional to the volume of maturities, net of available cash resources. It is also a function of the sensitivity of financial outlays to shocks in underlying economic variables. The percentage of debt falling due in 12 months and measures of the volatility of expected payments such as the Cashflow-at-Risk (CfaR) statistics are useful indicators of that risk.

Market risk, on the other hand, is linked to changes in the prices of the whole stock of public securities generated by changes in short-term interest rates, exchange rates, inflation or the forward interest rate structure. Because securities with different maturity, duration, or indexation react in specific ways to each of these factors, the composition of the public debt is often one of the most relevant parameters in determining the magnitude of market risk.

Refinancing Risk

The proportion of DPF falling due in 12 months declined in 2005, after rising in 2004. This proportion is projected to drop further in 2006. Similarly, the volume of maturities as a percentage of GDP is projected to drop below 20% in 2006 (Graph 3).

Graph 3. Concentration of Short-term DPF Maturities



Source: National Treasury

The National Treasury will also maintain several practices it has used to reduce refinancing risk. Among these practices is the maintenance of a comfortable "liquidity cushion"[15]. Also, anticipated redemptions and exchanges of short-term

[15] Budget resources available exclusively for DPF payments.

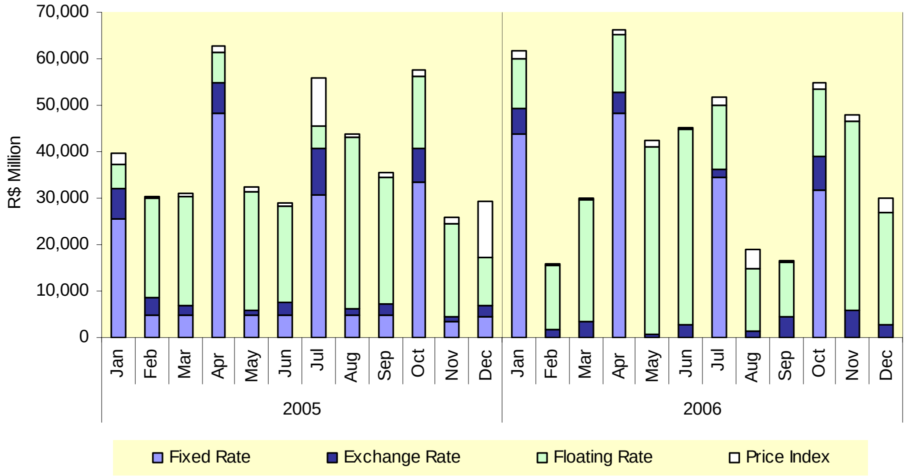
securities for longer term papers will continue to be offered, helping smooth out the payments due by the Treasury.

The prefinancing of a substantial part of the 2006 external commitments achieved so far has also helped reduce the refinancing risk of the external Federal Public Debt – DPFe[16]. That measure complements the rebuilding of International Reserves conducted in 2005, which made it possible to triple the level of net international reserves (i.e., excluding IMF loans) comparing with 2002.

"...prefinancing of a substantial share of 2006 external commitments ..."

The volatility of Treasury outlays to service the debt has also dropped. This result is captured by the Cashflow-at-Risk (CfaR) statistics. These statistics measure the magnitude of deviations in the value of debt outflows caused by stochastic shocks on interest, exchange and inflation rates, for a given probability level (risk level) assigned to the occurrence of such shocks[17]. Changes in the DPF maturity profile and composition (Graph 4) have yielded a falloff in those deviations. In other words, the projected average volatility of DPF payment flows for 2006 has dropped relative to 2005 (Graph 5).

Graph 4. DPF Maturity Profile by Type of Earnings

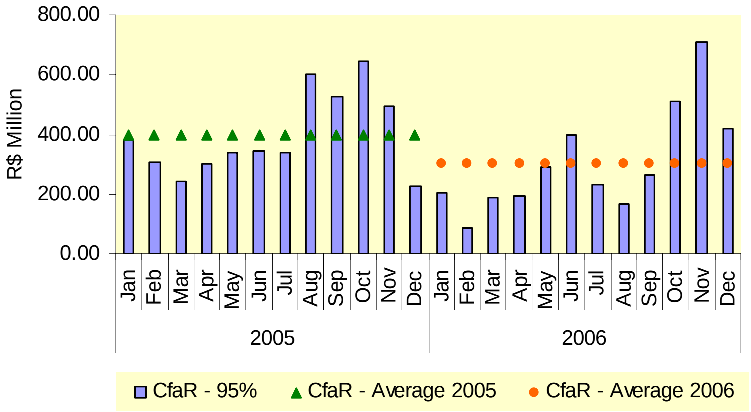


Source: National Treasury

[16] The National Treasury has already issued US$ 3.5 billion on charge of the 2006/2007 external funding program and bought US$ 5.6 in the spot market, raising a large part of the resources needed to service the external debt in 2006.

[17] Cashflow-at-Risk (CfaR) measures the payment risk of a cash flow, given the stochastic parameters of the indexing factors that determine earnings and a specified level of error. This indicator corresponds to the maximum addition that may occur in DPF outflows for a given month in relation to the expected value of such maturities, considering a 95% risk level.

Graph 5. Cashflow-at-Risk in 2005/2006



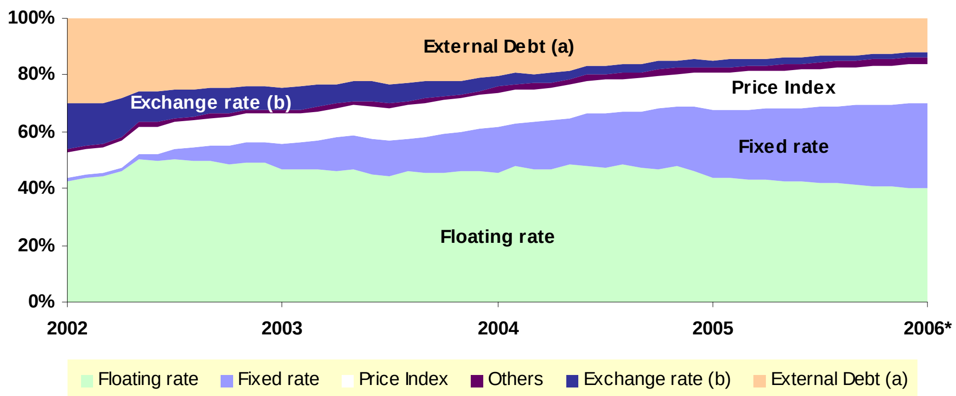
* CfaR corresponds to the maximum increase in DPF maturities each month with a probability threshold of 95%.
Source: National Treasury

Market risk has diminished substantially…

Market Risk

Market risk refers to changes in the value of the DPF stock owed to changes in market conditions such as shifts in interest, inflation and exchange rates. This risk has diminished substantially with the changes effected in the DPF composition in the last few years. It will further decline with the drop in the share of Selic-indexed LFT debt projected to happen in 2006 (Graph 6).

Graph 6. DPF Composition



* Projected composition for 2006 reflects the mid point for the target range established in PAF 2006 for each type of security in the composition the DPF.
(a) Sovereign foreign-currency external debt
(b) NTN-D exchange rate linked domestic debt
Source: National Treasury

The benefits of the new DPF composition are particulary relevant in situations of extreme financial tension. The exercise shown in Table 6, defined as a stress test, is a simulation of the impact on the value of DPF due to strong and persistent pressure on real interest and exchange rates[18]. These pressures are transmitted primarily through upward changes in the nominal stock of exchange-indexed and Selic-indexed securities.

Table 6. Stress Test for Interest and Exchange

Indicators	Share of DPF (%) 2002	2003	2004	2005	2006*	Stress Impact (R$ Billion) 2002	2003	2004	2005	2006
Floating rate	42.4	46.5	45.7	43.9	39.0	29.63	32.49	31.91	30.68	27.25
Exchange rate	45.8	32.4	24.2	17.6	13.0	302.20	213.92	159.67	116.13	85.78
Total	88.2	78.9	69.9	61.5	52.0	331.83	246.40	191.59	146.81	113.03

Indicators	Share of DPMFi (%) 2002	2003	2004	2005	2006*	Stress Impact (R$ Billion) 2002	2003	2004	2005	2006
Floating rate	60.8	61.4	57.2	51.8	43.5	35.97	36.32	33.86	30.68	25.74
Exchange rate	22.4	10.8	5.1	2.7	2.0	125.13	60.11	28.71	15.08	11.17
Total	83.2	72.2	62.4	54.5	45.5	161.11	96.43	62.57	45.76	36.91

* The composition of DPF and DPMFi for 2005 corresponds to the midpoint of the indicative limits of PAF/2006.
Source: National Treasury

The table underscores the reduction in the sensitivity of the public debt to large shocks achieved because of improvements in the composition of the DPF and DPMFi. Considering the DPF stock at the end of 2005 and the mid-point of the 2006 targets for the DPF composition, a stress scenario involving interest and exchange rate shocks would raise DPF stock by R$ 113.0 billion. In case the DPF composition were the same as in 2002, that increase would have been of R$ 331.8 billion. That means that the impact of stress situations on the DPF was reduced by more than 65%. For the DPMFi, the impact of those shocks was reduced more than 75%, dropping from R$ 161.1 million, considering the 2002 composition, to R$ 36.9 billion, considering the 2006 mid-point target composition.

"...a reduction of more than 65% in the impact of stress situations on the DPF."

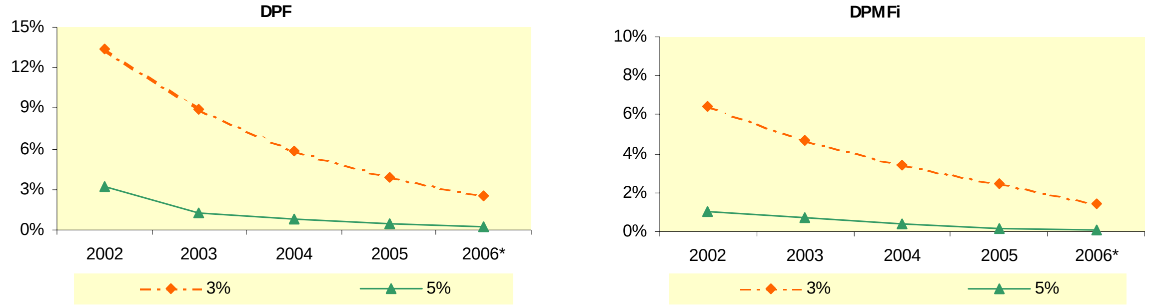
Another way to estimate the reduction in DPF and DPMFi financial risk is to calculate the probability of the value of these stocks to increase by 3% and 5% of GDP.

The likelihood of a 3% increase in the DPF stock was, at the end of 2005, of just about a third of that estimated for late 2002 (Graph 7)[19]. The reduction in risks will be even more significant at the end of 2006 – when this likelihood will be less than 20% of that in 2002. Considering shocks of greater amplitude (i.e., 5% of GDP), the reduction is perhaps even more significant: at the end of 2005, the decline in this vulnerability was estimated at 85%, becoming rather residual.

[18] Stress represents a shock of 3 standard deviations on the average real Selic rate and average real cumulative exchange devaluation over 12 months (between Jan/00 and Oct/05), applied to the DPF stock on Dec/05 (R$ 1,157.1 billion) . The stress scenario assumes a sustained increase in the interest and exchange rate, and its effect over a one-year period.

[19] This exercise consists of a simulation, for each DPF and DPMFi composition hypothesis, of the probability distribution of the stock of Selic-indexed and exchange-indexed securities after a one-year period. The initial stocks of these securities are given by their share in the DPF and DPMFi in each year. For 2006, the midpoint of the indicative limits of the PAF 2006 is used. The baseline stock for the DPF and DPFi at end 2005 was of R$ 1,157.1 billion and R$ 979.7 billion, respectively.

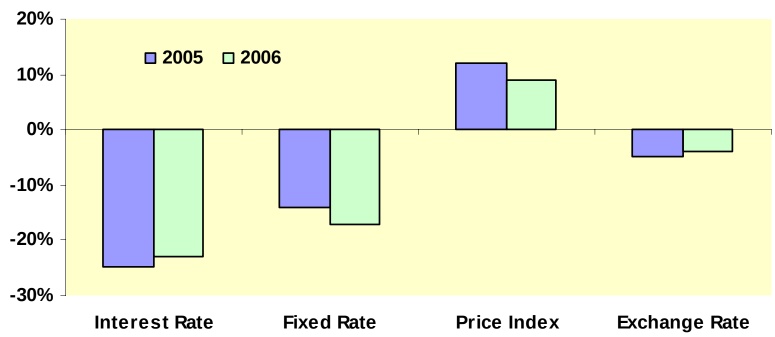
Graph 7. Probability of DPF and DPMFi Stock Increases of 3% and 5% of GDP as a Result of Interest and Exchange Rate Shocks



* Estimates for 2006 use midpoint values of the PAF 2006 target ranges for the DPF and DPMFi composition.
Source: National Treasury

The targets proposed in PAF 2006 will also result in improvement in the Federal Government asset and liability structure. When the midpoints of the indicative limits for the share of each type of debt for 2006 are considered, DPF composition targets project an increase in net fixed-rate liabilities and a cutback in the net stock of interest and exchange-linked liabilities. Also the net asset position of price-indexed assets will be reduced, increasing the immunization level of the overall debt (the Federal Government has net positive holdings of price-indexed debt because of its IGP-indexed claims against states in municipalities due to the refinancing of the debt of these entities by the central government in the 1990s and early 2000s).

Graph 8. Asset-Liability Mismatch of the DPF by Type of Debt as a Percentage of GDP



Source: National Treasury

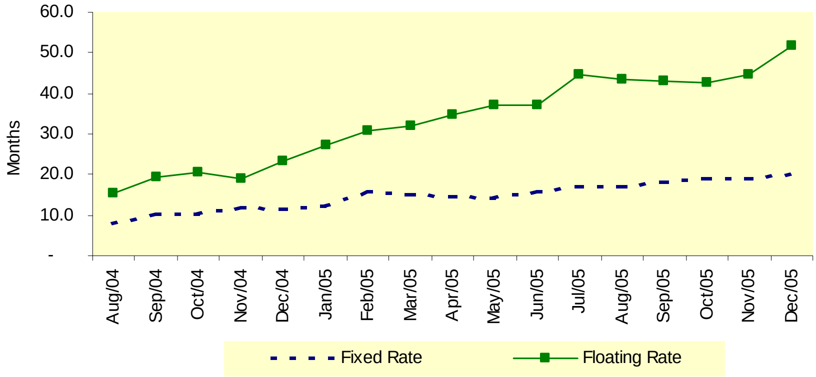
"... improvement in the Federal Government asset and liability structure..."

Strategy Risk

Strategy risk is related to the capacity to comply with the targets chosen. This is the first time this type of risk is discussed in the PAF. In the event, this risk is estimated to be low, because the targets proposed in PAF 2006 are mostly a natural outgrowth of the strategy implemented by the National Treasury in the last few years.

The projected lengthening of the average DPMFi term and the projected reduction in the percentage of the debt falling due in 12 months are compatible with the average issue term of fixed-rate securities (LTN and NTN-F) and Selic-indexed papers (LFT) verified in recent months. These average terms rose to 20 months and 52 months, respectively (Graph 9). Also, the average term at issuance of price-indexed securities was of approximately 37 months in the second half of 2005.

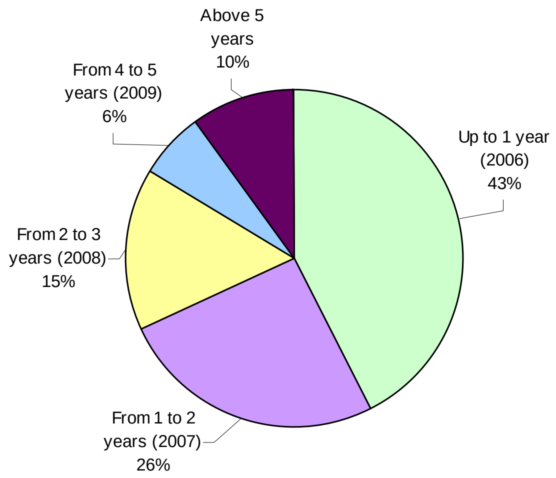
Graph 9. Average Issue Terms of Fixed-rate and Selic-Indexed Security Issues



Source: National Treasury

The projected reduction in the percentage falling due in 12 months is based on the observation that, at the end of 2005, a relatively small amount of debt was due to mature in 2007 (about 26% of the DPMFi, according with Graph 10), as well as on the expectation that most debt issued in 2006 will mature beyond 2007. Hence, the target of reducing the percentage falling due in 12 months to the 31%-36% range by end-2006 will not require radical shifts in the dynamics of the debt roll over in the period.

Graph 10. DPMFi Maturity Structure in December 2005

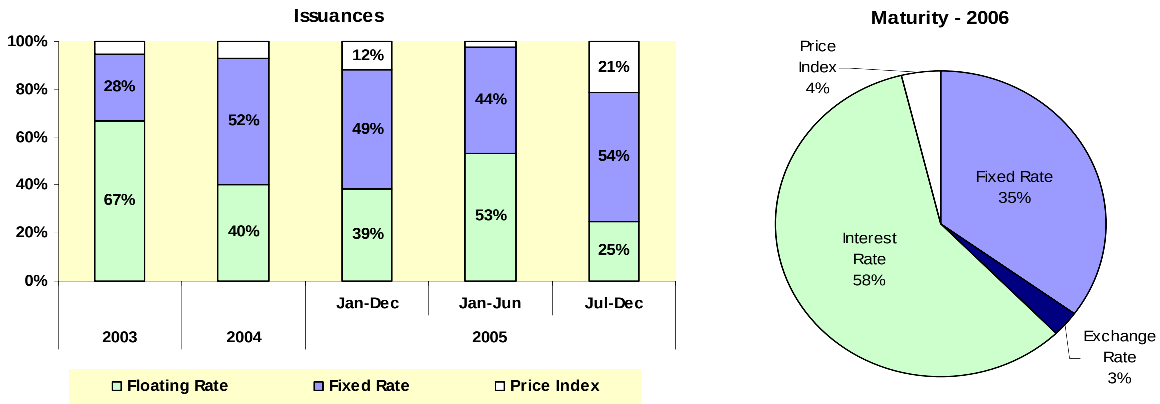


Source: National Treasury

"...fixed-rate and price-indexed securities account for approximately 60% of total issues..."

The projected evolution of DPMFi composition – a question raised by various commentators – also reflects mostly the unfolding of the strategy established back in 2003 and implemented on a consistent way since then. Issues of fixed-rate and price-indexed securities account for approximately 60% of total issues on the domestic market in the last two years, resulting in the net redemption of Selic-indexed securities[20]. When considering the replacement of Selic-indexes securities with other securities, it is noteworthy that 58% of DPMFi maturities in 2006 involve Selic-indexed secutiries (Graph 11). As already noted in the PAF 2005, this fact provides considerable room to proceed with the process of a natural reduction of the weight of interest-rate linked securities in the DPF.

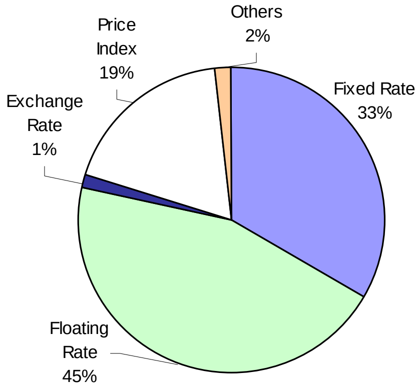
Graph 11. Composition of DPMFi Issues and Maturities



Source: National Treasury

Also, it is interesting to note that by simply replicating the 2005 issue pattern in 2006 the debt composition achieved would be quite close to the targets established in the PAF 2006 (Graph 12). For example, the participation of fixed-rate securities would be projected at 33%, a level compatible with the 28%-37% range proposed in PAF 2006. The share of Selic-linked LFT in the DPMFi by end 2006, resulting from extending the trend observed in 2005 into 2006, would be of just 45%. This latter figure is well within the 39% - 48% range established in section 2 of the present document.

Graph 12. Simulation of DPMFi Composition at end-2006



DPMFi Stock Composition	PAF-2006 Minimum	PAF-2006 Maximum
Fixed Rate (%)	28	37
Price Index (%)	18	24
Floating Rate (%)	39	48
Exchange Rate (%)	1	3
Others (%)	2	4

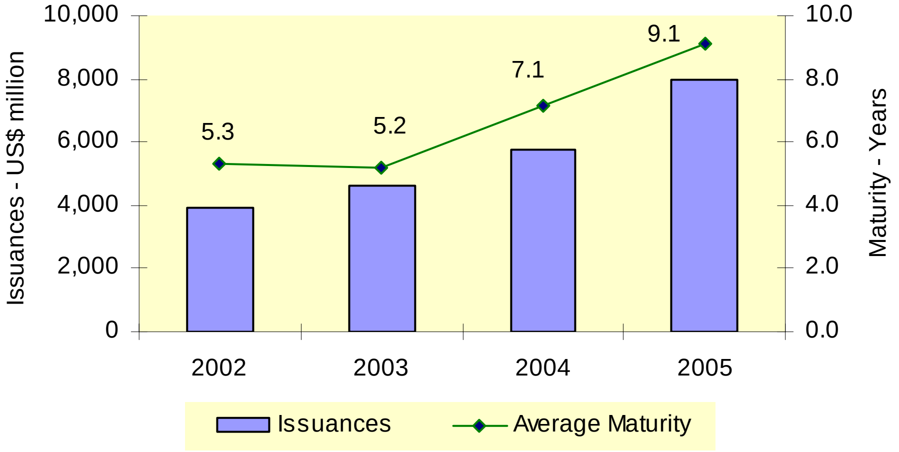
Note: This result reflects only the extrapolation of the composition of issues in 2005 and, therefore, has no direct relation with any specific issue strategy set down in PAF 2006.
Source: National Treasury

[20] In 2004/2005, Selic-indexed security gross issuance totaled R$ 276.0 billion, against redemptions of R$ 358.5 billion, resulting in a net redemption of about R$ 80 billion.

No significant problems are perceived in complying with external borrowing targets either. This is due particularly to the international financial environment that has supported reccent issuances by the Republic, as well as to the performance of the Brazilian current account, which has helped the National Treasury to buy foreign currency on the spot market, as observed in recent months. A favorable outlook also applies to the goal of extending the external debt maturity. The average DPFe maturity at issuances has gradually increased in recent years, taking advantage also of favorable international market conditions (Graph 13). Finally, considering that US$ 3.5 billion of the US$ 9 billion programmed in the 2006-2007 period have already been issued, the issuance of the remaining US$ 5.5 billion over a period of up to two years represents a potential schedule that is very much in line with the past performance of the Republic in international primary markets.

"No significant problems are perceived in complying with external borrowing targets..."

Graph 13. Brazilian External Funding Operations



Source: National Treasury

Section 4: Final Considerations

The targets announced in PAF 2006 reflect the unfolding of the strategy announced in PAF 2003. These targets are also consistent with the consolidation of fiscal accounts and the strengthening of general macroeconomic conditions that have steered government policies in recent years.

Success achieved in improving public debt composition.

The success achieved in reducing the exchange-rate exposure of the DPF and DPFMi has been reflected in the sharp decline in the sovereign debt risk premium (which dropped from around 1400 bp at the end of 2002 to less than 300 bp in January 2006), as well as in the incipient upgrading of the public debt ratings by Rating Agencies. The process of reducing the share of Selic-indexed securities, already announced in previous PAFs, was accelerated in 2005. It is remarkable that the increase in the share of fixed-rate securities proceeded throughout 2005, even in months when the short-term interest rate was being raised.

The ongoing process of net redemptions of LFT will make it possible to reduce the share of these securities in the DPF probably to less than 40% by end-2006. In contrast with the situation in the mid-90s, the debt profile will benefit not only from a larger share of fixed-rate securities in the DPF, but also from the longer duration and maturity of these securities achieved in the last two years. This increase in duration helps to enhance the transmission of monetary policy, resulting in a lesser need of drastic Selic shifts to respond to inflation threats.

Looking forward, the risks to the public debt in the current electoral year are much lower than in past run ups to presidential elections. More specifically, today the market projects twelve-month ahead inflation, interest and exchange rate variations well below those forecast in early 2002 (Table 7). Also, confidence in the government's fiscal commitment and in the external sector performance is more robust, as illustrated by the reduction in the standard deviation of market expectations as collected by the FOCUS survey.

Table 7. Market Expectations Gathered by FOCUS/Central Bank

Macroeconomic Indicators (%)	2002* Mean	2002* Standard Deviation	2006** Mean	2006** Standard Deviation	Forecast 2006
IPCA	4.81	0.58	4.49	0.24	+
IGP-M	6.33	1.36	4.50	0.52	+
SELIC end of period	16.71	0.97	15.10	0.58	+
***Real* Devaluation**	12.07	-	4.94	-	+
Net Debt/GDP	54.56	2.38	50.61	0.77	+
Primary Balance/GDP	3.46	0.16	4.34	0.12	+
GDP	2.28	0.52	3.44	0.35	+

*** Expectations for the end of 2002 in 01/02/2002**
**** Expectations for the end of 2006 in 01/06/2006**
+ indicates a more favorable position in 2006
Source: Central Bank

Other factors helping reduce the risks surrounding the DPF include the progress achieved and projected in broadening the investor base. A key ingredient toward this objective is the increase in the participation of foreign investors in the DPMFi market. The experience of most emerging market countries has been that the participation of foreign investors facilitates the lengthening of the public debt term and the reduction of Treasury financing costs, as long as solid and predictable economic policies are kept. Growing external demand for securities denominated in reais suggests the potential for a similar process supporting the Brazilian public debt in 2006.