Part I
Chapter 2

History of public debt in Brazil: 1964 to the present

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1 Introduction

The period from 1964 to the present has been marked by profound changes in the structure of public debt, both domestic and external. Not only have outstanding debts increased substantially, but their structures have also altered dramatically. Understanding them, along with the country's economic conditions, which affect the size and profile of debt, is needed to correctly evaluate Brazil's indebtedness.

This chapter focuses on the quantitative aspects of public debt and illustrates the institutional changes that have occurred over time.

From a macroeconomic standpoint, domestic and external debts are related, though they were influenced by different factors. The origin of the external debt in the early 1980s, for example, lies chiefly in exogenous factors, just as the substantial rise in outstanding domestic debt in the mid-1990s is linked to internal factors.

Section 2 describes the evolution of the domestic debt, relating it to macroeconomic events of the period. It also describes the institutional aspects related to the Domestic Federal Public Debt (DFPD). Based on the history, it is clear that some decisions made in this period have affected present economic policy constraints.

Section 3 notes the different stages of the external debt, which help explain the crisis of the 1980s, how the country overcame it and resumed voluntary issuances until it finally reached the relative calm it enjoys today.[1]

2 Domestic Federal Public Debt (DFPD)

According to the economic literature, four basic objectives justify the existence of public debt: (1) financing public deficit; (2) providing instruments for implementing monetary policy (in the case of domestic debt); (3) establishing long-term benchmarks for public sector funding, since public issuances, given their high volume and lower credit risk, serve as reference for private debt pricing; and (4) allocating resources among generations, insofar as (depending on the maturity of funding instruments) future generations will pay for today's expenditures (funded through debt). As will be discussed, the history of DFPD management in Brazil represents an evolution of all these objectives.

The first objective, set in the 1960s, was to create instruments to fund public investments without generating inflation. Once that was accomplished, the goal was to create an instrument that would be more suitable for implementing monetary policy. Standardization and the systematic placement of securities, occurring

[1] The Statistical Annex (at the end of the book) presents an historical series for the different Federal Public Debt indicators as well as the country's economic aggregates.

in the 1990s, accompanied the third objective, but, given the economic turmoil of that era, the goal was not achieved. The fourth was launched in 2000, with the issuing of 20- and 30-year bonds.

A turning point occurred when, in April 1964, Castelo Branco became president. Until then, issuances were designed to fund specific projects. After this time, however, the Government introduced a host of reforms that profoundly changed the capital market and sought to follow the previous objectives. In fact, the changes significantly affected the public debt, as it was the first time an attempt was made to create a structured public debt security market.

This section explains the reasons why DFPD has its current volume and profile; also, it examines the DFPD evolution since 1965 and how it was influenced by Government decisions as well as by macroeconomic conditions. It is divided into three parts. Part 1 covers the period starting in 1964, discussing the steps taken to develop the capital market and thus achieve the objectives mentioned above. Part 2 describes the evolution since the mid-1980s, when public accounts had deteriorated to the point where the Government had to focus more on fiscal issues, thus motivating institutional changes. Part 3 examines more recent years, describing efforts to better manage the debt and thus improve its profile.

2.1 1964-1986: building a debt market

In political and economic terms, 1964 was a critical year. The Castelo Branco administration was determined to produce a sustainable development model by introducing new economic policies: In 1965, the Government launched the Government Economic Action Plan to reduce the inflation of previous years through a restrictive monetary policy and fiscal adjustment. The scope of the change raised the need for reforms in the domestic financial system and, among these, actions that would make the public debt security market more efficient.

Plan objectives included, *inter alia*:[2] (1) raising additional debt to cover Federal Government deficits; (2) encouraging individual savings and (3) developing a voluntary market for public securities, which pointed up the need for an efficient public securities market. In this context, several changes were made to the economy, particularly with regard to public debt, such as reforms in the fiscal and financial systems. To this end, Law nº 4,357 of July 1964, which established the monetary correction, and Law nº 4,595 of December 1964, which reformed the banking system and created the Central Bank and National Monetary Council (CMN),[3] were particularly important.

As noted in Chapter 1, before these reforms, public debt was perceived as diversified public securities issued for varied purposes, with little credibility. Further, in the mid-1960s, inflation was running 30% a year. These factors made it abundantly clear that debt policy needed to be overhauled.

Interestingly, the measures adopted to develop Brazil's capital market, especially creating the Central Bank, included two objectives related to public debt management policies. Their main goals were to establish an efficient public debt security market so as to (1) spark demand for public deficit funding and (2) allow for monetary policy operations. Law nº 4,595, which defined the Central Bank's duties, established in Article 10 "…to carry out, as an instrument of monetary policy," the purchase and sale of federal public securities. In fact, the main measures that led to Brazil's large federal securities market were taken late in the 1960s. They aimed explicitly at:[4]

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[2] Campos, 1994.

[3] Despite the creation of the Central Bank as a monetary authority, Banco do Brasil, which already existed, also performed monetary policy-related duties as, in practice, it had the power to create currency.

[4] Central Bank – Public Debt Management, 1972 Activity Report.

- Raising non-inflationary resources to cover the Federal Government budget deficits as well as to make specific investments not included in the budget;[5]
- Consolidating open market operations;
- Ensuring turnover of the Domestic Federal Public Debt.

Thus, the Central Bank was responsible for using public securities to implement monetary policy and also finance the public debt.

One measure designed to improve the public debt security market was the monetary correction, created to protect investors from losses due to mounting inflation. In fact, if the goal to create a liquid public debt security market was to be achieved, this would require that securities should protect investors from losses in the currency's purchasing power. This led policy-makers to choose inflation-linked securities as a natural solution. Thus, the first public debt standard instrument was the *Obrigação Reajustável do Tesouro Nacional* (ORTN), legally established by Law nº 4,357/64 and Decree nº 54,252/64.

The introduction of indexed securities protected investors from losses due to inflation and was a major leap towards developing the public debt security market. As Garcia[6] notes, "the existence of indexed public debt held by private savers on a voluntary basis defined a bedrock for the development of financial markets in Brazil in the following years."

Given this environment, public debt had high growth rates, both in absolute volume and percentage of GDP: While DFPD represented 0.5% of GDP in 1965, it was close to 4% by the end of 1969.[7] This fact is quite impressive, since the economy grew at extremely high rates in that same period.

Despite the large growth of public debt during those years, the volume of issuances was not yet sufficient to cover the budget deficits. As shown in the table below, until 1968, the Central Bank was a major financer of the Government's fiscal needs.

It was only after 1969 that public funding reached a level that exceeded the Government's fiscal needs. Thus, growing indebtedness was basically responsible for establishing an efficient public debt security market that paved the way for conducting monetary policy. It should be noted that the portion of the fiscal deficit not covered by the issuance of securities to the market was financed by the Central Bank, which implied that the monetary authority operated as a source of Government financing. As will be seen, this particular aspect in the relations between fiscal and monetary authorities has evolved considerably since then.

At the end of that phase, the first of the four public debt objectives (public debt financing) had been met. Thus, authorities now needed policies to achieve the second objective, i.e., to provide appropriate instruments for implementing monetary policy.

At that time, the inflation-linked securities were the Government's only instruments to implement both monetary and debt policies. As the capital market gained considerable volume by the early 1970s, the Central Bank decided it was necessary to create another type of security, more useful for monetary policy. Thus, Executive Law nº 1,079 of January 1970 and CMN Resolution No. 150 of July 1970 were passed, establishing

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[5] Interestingly, the whole period was one of significant economic growth. Raising funds for public investment was thus a Government priority.
[6] Garcia, 1998.
[7] Andima, *Séries Históricas Dívida Pública*, 1993.

the *Letras do Tesouro Nacional* (LTNs) (National Treasury bills) for monetary policy purposes. These changes greatly advanced the country's public debt security market. According to Edésio Ferreira:

> *Nevertheless, there was still a need for complementary measures for the public debt security market to attain the objectives stipulated within the scope of monetary policy. There was therefore a need to establish a short-term security, not to make up for deficits on the handling of the debtor financing budgetary imbalances, but with necessary requisites to absorb possible surplus liquidity in the system, and even transforming it into a second-line reserve for the commercial banks through the mechanism of reserves exchange.*[8]

Table 1. Deficit funding 1964-1972
(In % of GDP)

Year	Outstanding debt	Federal deficit	Net placement of ORTN	Funding by the public (% of total funding)
1964	0.2%	3.2%	0.2%	10.3
1965	1.2%	1.6%	0.9%	54.5
1966	2.6%	1.1%	1.2%	132.4
1967	3.5%	1.7%	0.6%	32.3
1968	3.5%	1.2%	0.1%	12.1
1969	4.4%	0.6%	0.6%	235.6
1970	5.8%	0.4%	1.3%	212.9
1971	6.6%	0.3%	1.3%	600.6
1972	8.8%	0.2%	2.3%	1605.0

Source: Bacen/Gedip Activity Report, 1972

The late 1960s and the first part of the 1970s were particularly good for the country. Economic growth was at historically high levels, both for Brazil and internationally,[9] and inflation was still running below that of the second half of the previous decade. In this context, the spectacular success of the debt policy in the early 1970s was understandable, and a unique time for DFPD in Brazil.

During this time, the country began to issue fixed-rate securities and placed them through public offerings (auctions) at competitive prices. Still, the share of LTNs in total debt rose steeply; this was a response to the increased use of this instrument in monetary policy, which was linked to open market operations. In fact, while LTNs were just 5% of outstanding debt in 1970, they rose to 33.6% in 1972, and their share would continue to grow until the second half of the decade. It was during that period that public debt became not just a Government funding instrument but an important tool in monetary policy.

However, from the mid-1970s onwards, the country began to feel the effects of the first oil shock. In 1974, inflation rates doubled from the previous year. Growth rates also broke the pattern they had followed

[8] Ferreira, 1974. Originally written in Portuguese. Free translation by the author.

[9] From 1968-1974, Brazil's economy grew at an average rate of 10.8% a year. This period was called "Milagre Econômico," internationally known as "Brazilian Miracle".

until then, and dropped to 5% a year. As inflation rose, investors again preferred the inflation-linked ORTNs, to the detriment of LTNs, a pattern that persisted until the decade ended. As a result, the share of fixed rate instruments that had reached 52% in 1977 dropped to 41% by the end of the decade and would decline even further, afterwards.

In the 1980s, the problem was compounded by the second oil shock (in 1979). At that time, inflation reached unprecedented three-digit levels, and economic growth rates were drawn to dangerous grounds.[10] he so-called "lost decade" had just begun. From the DFPD standpoint, the consequence was the investors' preference for ORTNs - throughout the first half of 1980 - given the expectations raised by inflation. At the same time, a process was begun to reduce the maturity of fixed securities offered to the market. By the end of 1983, ORTNs which accounted for 96% of public debt, were once again the main public debt instrument, i.e., they had returned to 1960s' levels. A positive effect of this movement - the switch from fixed, shorter-term securities (LTNs) to longer-term, inflation-linked ones (ORTNs) - was to increase the average maturity of debt, which rose from 15 months in 1972 to 26 months at the end of 1983.

Solutions to the difficulty of refinancing securities in the market involved reducing their maturity and increasing the issuance of indexed instruments, mainly inflation and floating rate bonds. Alternative solutions to those traditionally used would not be introduced until 1986.

In 1984 and 1985, the country experienced steep growth, 5.4% and 7.8%, respectively. However, the public deficit was still out of control and rampant inflation forced the Government to introduce a restrictive monetary policy, raising real interest rates to historically high levels (around 10% a year). The failure to combat inflation through orthodox means was leading to alternatives to deal not only with inflation but also with public indebtedness. At the same time, the bad fiscal situation called for strengthening the governance, in order to curb high public deficits.

It should be noted that, in 1985, although the instruments offered in the market were the same as those auctioned earlier in the decade (LTNs and ORTNs), their maturities were reduced and their rates began to reflect the growing inflation. Even more relevant, data on the debt revealed that, by the year's end, ORTNs represented 96.6% of the overall debt, a huge rise from the 58.8% in 1979. Likewise, the average maturity that had reached 31.2 months in April 1983 fell to 10.4 months at the end of 1985, the lowest recorded to date.

This policy was only possible given the relatively reduced amount of outstanding debt.[11] If the level were higher, holders of public securities could have assumed the country was insolvent, further compromising the situation, since the dimension and length of the crisis were still unknown.

2.2 Domestic public debt after 1986 and institutional changes

The fiscal difficulties of the mid-1980s sparked the need to change the institutional framework of the fiscal sector. Indeed, 1986 was a landmark for public debt management, due to measures taken to improve fiscal controls, which included closing the *Conta Movimento* (operational account)[12] used by the Central Bank to fund the Banco do Brasil's imbalances. Also, the National Treasury Secretariat was created[13] to centralize and improve the effectiveness of public spending controls.

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[10] In 1981, when recession reached its peak, economic growth fell by 4%.

[11] At that time, the debt-to-GDP ratio was below 10 percent.

[12] The *Conta Movimento* allowed Banco do Brasil to create currency and therefore turned the institution, in practice, into a monetary authority alongside the Central Bank.

[13] By Decree nº 92,452 of August, 1986.

The major concern with controlling and monitoring domestic debt - which had increased in previous years due to the precarious fiscal situation coupled with the perceived need for an institutional distinction between monetary and debt policies – lead to the transference of the debt management from Central Bank to the Ministry of Finance. The Decree nº 94,443 of June 1987 transferred activities related to the placement and redemption of public debt to the Ministry of Finance, where the function was assigned to the National Treasury Secretariat. Among the Secretariat's duties[14] were:

> [...] maintaining physical/financial control over the debt issued
>
> [...] determining the securities and volumes of Public Offers, including preparing and publishing public notices, in close cooperation with the Central Bank of Brazil [...] and
>
> [...] managing bond issuance limits [...]

In this context, in order to curtail further distortions between fiscal and monetary policies, the Government[15] created measures to control the public debt, which could only be raised to cover deficits in the Federal Government Budget (OGU) through legislative authorization, as well as the debt service share not included in the OGU. Despite the segregation of functions and the creation of the National Treasury Secretariat, the same Executive Law established that: "[...] if the National Treasury fails to issue bonds to the public in an amount equivalent to that of redeemed securities, the Central Bank of Brazil may underwrite the share of securities not placed." In other words, although this represented an institutional advance over the previous practice, whatever the need to roll over the debt, the amount could be financed through the Central Bank once the market refused to provide financing.

The failure of anti-inflation policies led the Government to more "heterodox" approaches, which influenced debt management strategies in subsequent years. In early 1986, the country had the first heterodox anti-inflation experience: Early that year, the rise in inflation and public indebtedness were cause for concern; thus, on February 28, the Government introduced the Cruzado Plan, which froze prices, abolished monetary correction and reduced real interest rates. These measures, coupled with the need to reduce fiscal deficits, led the Central Bank, and not the market, to absorb new debt issuances, as stipulated in the new laws.[16]

Because it was difficult to place LTNs and impossible to place ORTNs (now called OTNs) in the market, and the economy was de-indexed (due to the end of monetary correction), the Central Bank chose to create a bond under its responsibility. Then, in May 1986, due to the lack of instrument options, the National Monetary Council authorized the monetary authority to issue securities of its own (for monetary policy purposes); this introduced the *Letra do Banco Central* (LBC), whose unique characteristic was that it was linked to floating rates (the Selic rate) and indexed on a daily basis.[17] The idea was to limit the issuance of LBCs to the volume of National Treasury securities held by Central Bank. Given the characteristics of the new security and the economic environment, the market welcomed it enthusiastically.

Since (1) the LBCs were successfully placed, (2) no other options existed with respect to funding instruments, and (3) there was a new guideline separating fiscal and monetary activities, the National Treasury created the *Letras Financeiras do Tesouro* (LFTs). These new National Treasury bills had the same characteristics as the Central Bank LBCs, except they were designed to fund budget deficits, not for monetary policy purposes.

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[14] Originally written in Portuguese. Free translation by the author. The Decree was regulated by Administrative Rule nº 430, of December 1987.

[15] Executive Law nº 2,376, of November 1987.

[16] In 1986 and 1987, the debt in the Central Bank portfolio reached 68% and 72% of the total outstanding debt, respectively.

[17] The Selic rate is the average interest rate on overnight repo operations of inter-bank loans collateralized by Government bonds.

What was the impact of issuing daily interest rate-backed securities? As will be noted, these securities represented a considerable share of DFPD and were an important instrument by which the Government could maintain its funding capacity.

The failure of the Cruzado Plan in 1987 marks the beginning of even greater difficulties in conducting economic policy: Public deficits were out of control, and the external debt was problematic. In fact, the external debt moratorium in February of that year led to a greater need for funding via domestic debt.

Once the 1988 Constitution was adopted, the Central Bank, which at that point was not allowed to issue securities, was also prevented from funding the Government: Instead, the Central Bank could only purchase securities from the National Treasury in an amount equal to the principal falling due in its portfolio. The classic relationship between the monetary and fiscal authorities had finally been achieved. Later, in 2000, the Fiscal Responsibility Law imposed even stricter controls; thus, placements for the Central Bank's portfolio could only be made at the average rate of the auction held on that particular day (in the market). This rule still holds.[18]

Despite the successive economic shocks since 1986, inflation rates remained at very high levels, as did the uncertainty about the near future. As a result, in 1988 and 1989, virtually no LTNs were placed, not even with regard to the Central Bank portfolio, illustrating the country's difficulties. Public funding, in turn, began to be provided through LFTs and, for those two years, this security was practically the only way for the Government to raise funds (via security issuances). Interestingly, this originally heterodox instrument became fundamental for the country's solvency. Without it, the country would have needed to issue LTNs with increasingly shorter maturities, which would have led to a considerable increase in the debt refinancing risk.

The creation of LBCs and subsequently, LFTs, points up the search for non-traditional solutions for economic problems. Nonetheless, debt maturity was not changed by the daily renegotiation instrument and at the end of the decade the debt average maturity was still reduced, while the debt to GDP ratio represented the highest value recorded until then, indicating the country's growing vulnerability.

When the new Government took office[19] in 1990, the public debt situation was critical, with outstanding securities in the market accounting for 15% of GDP - a historical record. The debt was formed basically by LFTs, with an average maturity of just five months. Further, inflation rates were above 1,000% a year and the primary deficit had reached 1% of GDP the year before.[20]

Against this backdrop, President Collor took office with the explicit goal of ending the inflationary process and lack of fiscal control. The economic policy strain and crisis with the public debt led to the drastic measures included in the 1990 Collor Plan: Among other things, it froze 80% of the country's financial assets, producing an unprecedented effect on public debt. Through this measure, the Government swapped the debt in the hands of the market into another debt held by the Central Bank for 18 months, yielding BTN[21] + 6% a year. In other words, the outstanding debt that had been remunerated at the Selic rate was now repaid at a much lower rate, generating considerable gains for the Government. However, the measure so greatly reduced liquidity that the Central Bank was forced to re-purchase the LFTs still in the market. These two moves, coupled with the primary surplus obtained

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[18] During the first years, the Central Bank submitted sealed proposals to the auctions, as if it were a financial institution. Later, the system was changed and the Central Bank was allowed to receive, in securities, the difference between the volume offered in auction and the volume actually placed in the market.

[19] In March 1990, the President handed the presidential sash over to Fernando Collor de Melo, the first president to be elected by popular vote in nearly 30 years (the last was Jânio Quadros, who took office in January 1961), following a long period of indirect elections of military rulers.

[20] For further details on the evolution of macroeconomic statistics during that period, see the Statistical Annex at the end of the book.

[21] BTNs were created in 1989 as an economic indexing instrument and were adjusted by an IBGE inflation index known as Con-

in the first year of the new government (over 4% of GDP), caused a historic downfall of 82.5% in the outstanding debt held by the public in 1990.

In 1991, with inflation rising and difficulty in issuing LTNs (due to the loss of Government credibility after the asset freeze in the Collor Plan), the Central Bank chose to create an identical instrument for monetary policy purposes - the Central Bank Bonus (BBC),[22] in December 1990. In the first months of 1991, this was the only security offered to the public.

In September of that year, the values related to frozen assets began to be returned and, as of October, funds to repay them were obtained from new security issuances. By the end of that month, another decree[23] created a new financial instrument, *Notas do Tesouro Nacional* (NTNs), with different series depending on the index factor: Among the most common were the US dollar (NTN-D), IGP-M (NTN-C) and TR (NTN-H). The idea was to diversify the instruments in order to expand investor base and obtain funds to pay off the BTN-Es falling due. The creation of such varied instruments reflects the turmoil in the domestic economy in the 1980s and early 1990s, as well as the heterodoxy in the macroeconomic scenario.

Seeking another step to curtail the remaining distortions between fiscal and monetary activities that had begun in the previous decade, some measures were proposed in 1993, which became known as "*Operação Caixa Preta*:" These sought greater transparency to National Treasury-Central Bank relations by, among other strategies, restructuring the security portfolio under National Treasury responsibility in the Central Bank, thus providing the monetary authority with instruments more suitable for conducting monetary policy. Another measure was the early redemption of National Treasury securities in the Central Bank portfolio, with funds obtained by issuing Treasury bonds in the market. This was one of the factors responsible for the 24% decline in the Central Bank's portfolio of outstanding securities that year.

During the 1990s, the Government continued to fight inflation which was now over 1,000% a year. Meanwhile, economic growth remained very low, with negative average real growth of 1.3% from 1990-1993. Seeking to end this situation, the Government launched another heterodox program in 1994, this time known as Real Plan. Although based on the same principles as its predecessors, i.e., the existence of an inertial component in Brazilian inflation, the plan sought to reconcile this aspect with some components of the orthodox formula, such as maintaining high real interest rates. This time the formula succeeded and the country would, after many years, experience reasonable and falling inflation rates. As of 1995, the economic scene became more predictable, but the move would affect the structure of domestic public debt.

Despite the relative success in stabilizing inflation, from that year onwards, debt spiraled upwards, which could be explained by (1) a strict monetary policy, which included an extremely high average real interest rate, (2) a reduced primary surplus, which was even negative for some Government entities, and (3) greater transparency of public accounts, when several liabilities previously unrecognized were acknowledged, such as the state and municipal financial adjustment program and the capitalization of some federal banks.[24] In fact, in the second half of the 1990s, DFPD in the market increased in real terms at an average of 24.8% a year.

Also during that period, the reduction in the debt average maturity became a key part of the debt strategy. For this reason, despite the successful economic stabilization, the change in the debt strategy mainly reflected the turmoil within the global economy.

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sumer Price Index (CPI).

[22] Established by Resolution nº 1,780.

[23] Decree nº 317, of 1991.

[24] The Box at the end of this section provides a brief description of the program.

During the first years of the Real Plan, the Government substantially improved its debt profile. With economic stability, it increased the volume of LTNs issued and gradually increased their maturities (offered in auctions) from two to three months. In 1996, only six-month LTNs were offered; their maturities continued to lengthen until 1997, when the National Treasury finally placed two-year, fixed bonds in the market. When the Asian crisis erupted, the immediate option was to reduce maturities; as a result, three-month LTNs returned to the market. Until then, the Government had resisted offering LFTs and it was only after the Russian crisis that the Treasury decided to return to issuing them and temporarily stopped issuing fixed-rate securities.

Throughout that period, the share of LTNs, which stood at less than 1% at the end of 1994, jumped to 27% in 1996, while outstanding LFTs disappeared that same year. However, starting in 1997, as a result of the Asian crisis and despite the success in maintaining economic stability, the advances were reversed in such a way that, late in 1998, outstanding fixed-rate bonds did not exceed 20% of the total, and LFTs soon accounted for nearly half.

As debt grew considerably, its share of fixed-rate securities was small, largely due to the increased perception of the refinancing risk, which caused the average maturity to be lengthened, and thus not jeopardize the market perception about sustainability. This prevented fixed-rate securities with maturities below six months from being placed, thus giving preference to longer-indexed instruments (especially LFTs). One factor that contributed to this process was the 1999 change in the exchange rate; as this reduced the volatility of interest rates, the public debt market risk – from the Government perspective – was also reduced. In fact, as of 1999, the maturity of LFTs offered in auction increased to two years, while LTNs returned to three- and six-month maturities.

It should be noted that, despite the advances gained by economic stabilization, they did not affect the public debt profile as much as might have been expected. The substantial bond issuances due to the assumption of contingent liabilities (crucial for a definitive adjustment of Government accounts), coupled with the high interest rates required to consolidate stability, caused outstanding public debt to reach extremely high levels. This fact meant the average maturity needed to be lengthened, so as to prevent the refinancing risk at each period from being too high.

Also in 1999, the Government began again to issue inflation-linked securities (IGPM), so as to strengthen the public debt lengthening process and take advantage of the high potential demand from pension funds. Since then, an effort has been made to regularly improve the profile of domestic federal debt, both by increasing its maturity and by reducing the share of Foreign Exchange (FX) rate-indexed and floating-rate securities. This course has successfully been followed since 2003.

2.3 Efforts to improve the debt profile

Starting in 2003, investors' perceptions about the direction of the economy improved. This was due to the new administration's efforts to maintain fiscal responsibility and the monetary and exchange policies started in the second half of the previous administration. This contributed to considerable advances in public debt management.

In fact, by the end of 2002, the share of floating-rate securities in the domestic debt had reached 60.8%, while the share of fixed securities was just 2.2% and FX-indexed securities were 22.4%. Since then, debt managers began to adopt different practices aimed at market development.[25] One such practice was to concentrate maturities on specific dates, so as to increase the instruments' liquidity; this reduced the number of maturities and increased the volume issued.

[25] These policies are described further in Part 3, Chapter 1.

Box 1. Securitization of government debts

Early in the 1990s, the Government started to restructure debts through a securitization process. Debt stemming from the assumption of state-owned companies and sub-nationals liabilities was renegotiated and transformed into public securities issued to original creditors.

This process benefited the Government, insofar as it adjusted payment flows to its payment capacity, and also contributed to the public sector debt credibility recovery. To creditors, it meant transforming a contractual debt, with no liquidity, into an instrument that could be negotiated in the secondary market.

The National Treasury recorded the securities issued to refinance the states' debts in the Central Bank's Special Settlement and Custody System (SELIC) and those related to the assumed debts of state-owned companies, known as Securitized Credits, in the Center for custody and financial settlement of securities (CETIP). These securities are freely negotiated in the secondary market.

Also in the 1990s, securitized credits were used, together with other public debt securities, as currency in the privatization of state-owned companies - part of the instruments known as "privatization currencies."

In 1999, and within the process to standardize public debt instruments, the National Treasury began to accept these securities as payment in the second phase of NTN-C auctions and, more recently, in NTN-B auctions. Nevertheless, the outstanding volume of securitized debts expanded, due mainly to the regular issuing of CVS, a type of security whose origin is the securitization of debts arising from the Salary Variation Offsetting Fund (FCVS).

To minimize the refinancing risk attached to this measure, the National Treasury began to hold auctions for the early redemption of fixed-rate securities. It also held auctions for the repurchase of inflation-linked securities, as a way to increase market liquidity. In other words, holders of these securities could leave their positions if they wished. NTN-Bs also began to be issued: This CPI-indexed security now accounts for a significant share of the public debt profile.

Longer-maturity, fixed-rate securities with periodic payments of interest coupons (NTN-Fs) were issued for the first time in 2003, so as to lengthen the fixed-rate debt. This course was consistent with procedures adopted by countries with more developed markets.

In the same year, the dealers' system - previously under the Central Bank - was changed, so as to match rights and duties to the objective of developing a public bonds market. Two "primary" and "specialist" groups were established, with the main objectives, respectively, of purchasing securities in auctions and negotiating them in the secondary market.

In 2004, changes were made in order to match the guidelines in the Annual Borrowing Plan - particularly introducing the Investment Account and lowering taxes. In 2006, the Government lengthened the debt and fixed its rates by issuing Provisional Measure nº 281,[26] which exempted foreign investors from income tax levied on capital gains in public debt bonds. As these investors prefer to buy longer maturity NTN-Fs (fixed-rate bonds) and NTN-Bs (inflation linked bonds), the exemption hastened the movement to extend the domestic debt profile.

In 2007, due to foreign investors' demands, the National Treasury issued its first 10-year fixed-rate security, the NTN-F 2017, which was a landmark in Brazil's public debt management. Over the year, the security was issued at weekly auctions (except during higher volatility periods due to the international scene).

[26] Later converted into Law nº 11,312 of June 27, 2006.

In 2008, as the international crisis deepened, Brazil's debt management policies became more conservative (in terms of debt profile), so as to reduce the market's volatility. Thus, the share of fixed securities decreased and that of floating-rate securities increased. However, despite the volatility, refinancing risks were reduced and the indicators of average maturity and the share falling due in 12 months, increased.

The table below shows the huge advance these practices represented in improving the structure of public debt.

Table 2. Recent evolution of the Federal Public Debt

Indicators	2003	2004	2005	2006	2007	2008
Outstanding FPD* in the market (R$ billion)	965,8	1.013,9	1.157,1	1.237,0	1.333,8	1.397,0
Average maturity of FPD**	3,3	2,9	2,8	3,0	3,3	3,5
% due in 12 months	30,7	39,3	36,3	32,4	28,2	25,4
Share in outstanding FPD (%)						
Fixed	9,5	16,1	23,6	31,9	35,1	29,9
Price Index	10,3	11,9	13,1	19,9	24,1	26,6
Floating rate	46,5	45,7	43,9	33,4	30,7	32,4
FX rate	32,4	24,2	17,6	12,7	8,2	9,7
TR and others	1,4	2,2	1,8	2,0	1,9	1,4

* Includes the domestic and external debts under National Treasury responsibility.
** In years

From the microeconomic perspective, the history illustrates how difficult it was for the Government to lengthen debt maturity and increase the share of fixed-rate instruments to replace floating-rate securities. Most analysts agree that the reason lies in the culture of daily indexation, due to the country's track record of high inflation. However, Brazil had to break this cycle if the structure of its domestic public debt was to mirror that of developed countries.

The big challenge, besides maintaining fiscal surpluses to reduce the debt, is to enhance the domestic debt profile (so as to improve investors' perception and consolidate the move towards reducing interest rates). This structural change has allowed public debt to be seen as an efficient source for channeling resources to public investments, and a benchmark for issuing private bonds.

3 External public debt

Just as domestic debt management policies responded to domestic macroeconomic events, external debt policies reflected events in the international economy, which went through various phases since the 1960s. From 1964 to the first oil shock in 1973, and even afterwards, the international economy enjoyed abundant liquidity, which helped the country maintain its external indebtedness. However, in 1979, due to the second oil shock, international interest rates rose abruptly, squeezing external resources and prompting the developing countries' external debt crisis in the 1980s. Since then, Brazil has worked hard to manage the external debt issue, which has included the adoption of the successful Brady Plan and the recent sovereign bond issuances in the international capital market, along with building the external curve in Brazilian real.

The history of Brazil's external debt during those years can be divided into four phases: (1) from 1964 to the end of the 1970s, when a great deal of debt was accumulated due to the country's growth and the oil shocks; (2) from the 1980s until the Brady Plan (early in the 1990s), with successive attempts to correct the imbalances caused by the previous policy; (3) the return of sovereign issuances in 1995 and the relative calm in the management of external liabilities, despite the international crises in the late 1990s; and (4) the new qualitative issuance policy, begun in 2006.

3.1 The external debt policy

Launched during the 1960s, the Government Economic Action Program (PAEG) sought to respond to the main economic bottlenecks. For example, its projects sought to enhance the infrastructure sector and restore the country's credit abroad, mitigating short-term pressures on the balance of payments. As already mentioned, despite innovations in the capital market structure promoted by the PAEG, the new administration still had fiscal deficits in its early years, which were also funded through external loans.

The PAEG reforms and, more precisely, high economic growth and stable inflation rates, generated a positive outlook for the country's economy. However, the very fact that economic growth was high meant external resources had to be obtained to finance it. Thus, during the second half of the 1960s, the external capital inflow rose dramatically: Brazil was the fourth largest recipient of external resources from 1964-1967.[27] This represented an increase in external debt (public and private), which rose from $3.2 billion in 1964 to $4.4 billion at the end of 1969, i.e., a 37.5% increase in just six years.[28]

In fact, in the early 1970s, the country searched for resource inflows through sovereign indebtedness in the international market. This was significant since the last time Brazil used this type of funding was in 1931. Even before the first oil crisis in 1972, the country placed Government bonds in foreign markets: Three issuances were completed that year in European and US markets and, in 1973, another was completed in the Japanese market. After this, despite the first oil shock, the country not only continued to access that market, but large Brazilian companies built on the success of the Government placements and issued securities in external markets.[29]

High growth rates with abundant international economy liquidity caused outstanding external debt to grow considerably[30] without bringing risks to the Brazilian economy. But the situation would begin to reverse in 1973, due to the sudden rise in oil prices. In 1974, given the deteriorating balance of payments, the country began to remove restrictive measures to foreign capital. Obviously, the strong capital inflow until that year had, as a side effect, increased the outflow of resources in the form of interest and amortizations.

At that time, indebtedness was already a potential problem. Any setback in international liquidity or in the growth rates of the global economy would have a strong negative effect in Brazil's external accounts. According to Mollo,[31]from 1973 onwards, indebtedness would hamper growth, since capital outflows in the form of interest and amortizations already exceeded inflows. As a result, inflation returned to the domestic front, and externally, indebtedness increased; thus, "in 1973, inflation and indebtedness were seen as areas with potentially growing problems to be faced by the next administration".[32]

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[27] Resende, 1989, p. 219.
[28] Mollo, 1977.
[29] Corporate issuances started with Vale do Rio Doce and continued with Light, BNDE, Eletrobrás, Petrobras, CESP and Nuclebrás. For details, see Gomes, 1982.
[30] From 1965-1975, external debt rose by more than 400%, soaring from $3.9 billion to $21.2 billion.
[31] Mollo, op. cit.
[32] Lago, 1989.

The country adopted policies to overcome the crisis, but these did not slow growth. In fact, as Garrido noted,[33] since the increased oil prices did not reduce international liquidity (the transfer of resources to oil-exporting countries involved deposits in European and US Banks), these banks still had abundant resources to lend to developing countries (a process known as "recycling of petrodollars"). As a result, from 1974 to 1980, even more external debt accumulated, which would lead to the debt crisis early in the next decade. It should be noted that, during that time (1974-1980), the share of public debt in total external debt soared from about 50% to nearly 70%.

The second oil shock, between August 1979 and October 1980, sparked a high increase in the cost of loans mainly due to the rise in interest rates promoted by the US Federal Reserve, in an attempt to curb inflation in that country. As a result, indebted developing countries could not attract international investors to finance their economic activities: The countries quickly lost their reserves (which declined for the first time in the decade) and Brazil's balance of payments changed dramatically, from a $4.3 billion surplus to a $3.2 billion deficit.

As Brazil's situation was becoming critical, a new dark phase began in which external constraints were dictating the direction of the domestic economy: The bottleneck generated by external debt would no longer be a potential problem but an actual constraint.

3.2 The search for solutions

Against this backdrop, external financing began to dry up in the early 1980s. Reduced international liquidity combined with increased international interest rates made it harder to renew loans, at a time when financing the balance of payments was critical. These facts, along with external recessions, provoked a domestic recession that strained the entire decade (it became known as "the lost decade"). At that time, the country had not yet turned to the International Monetary Fund (IMF).

Despite a small surplus in the 1981 balance of payments, the situation would become dire in 1982. In August of that year, Mexico declared a moratorium on its external debt, which aggravated the crisis in Brazil: The balance of payments deficit would skyrocket to a record $8.8 billion.

Under such conditions, there seemed to be no alternative but to seek international cooperation. In September 1982, the country began talks with the IMF and the international financial community; also, it negotiated bridge loans of about $3 billion, to close the balance of payments. Given the size of the external constraint, renegotiating the external debt became the country's hot subject. Late that year, the Government announced its policies were in line with IMF recommendations.

As it became vital to design measures to overcome the crisis, authorities developed the Program for the External Sector in 1983: To meet external commitments, it focused mainly on increasing exports and decreasing imports. For several months, negotiations were conducted and several letters of intent were signed with the IMF, which contained targets for the domestic economy. In the two years after August 1983 (the date of the first letter), seven letters of intent were signed to the IMF, whose promised targets were never achieved.

Negotiations were also held to reschedule the country's debt. Thus, from 1983-1987, Brazil's external debt was restructured several times; this involved maintaining short-term credit lines, rescheduling the principal of debts falling due in the following years, and arranging for the inflow of new money. By the end of 1982, a first package was developed, which included, besides the inflow of new money to honor short-term commitments,

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[33] Garrido, 2003.

the rescheduling of medium and long-term bonds. In 1983 and 1984, negotiations were held to solve balance-of-payments problems; and it was only in 1985 that a proposal for multi-annual restructuring materialized, for 1985-1991. However, these measures didn't solve the country's balance of payments deficits. As a result, international reserves dropped to worrisome levels in 1986.

The grim situation both in Brazil and other developing countries prompted a search for global solutions that would be backed by the international financial community. However, despite the recovery of the US economy and loosening of external constraints in 1984, developing countries faced great difficulty adjusting to the policies recommended by the IMF.

During those years, the international financial community promoted the concept of "payment capacity," in which countries would repay their loans in ways that would not compromise them, thus moving in a direction opposite to that prescribed by the IMF, which required strict monetary and fiscal policies that were causing serious economic side effects in the countries that adopted them. A new government took office in 1985, with President José Sarney,[34] whose administration chose not to enter into an agreement with the IMF, fearing it could compromise the country's growth.

In this context (where foreign banks required some sort of agreement with the Brazilian Government to continue paying the debt and the Government didn't sign an agreement with the IMF) a conciliatory attempt emerged, defended by James Baker, Secretary of the US Treasury, known as the Baker Plan: It stated that agreements should not compromise the country's economic capacity and growth, and that creditor banks would keep providing new resources to debtor countries. However, each bank wanted other banks to assume the task, preferring not to increase its own exposure to those countries, in order to reap the benefits of the renegotiation without bearing the risks (known in economic literature as the "free rider"). The Baker Plan failed to obtain the expected benefits[35] and external indebtedness remained a serious issue for developing countries over the next years.

After hot debates between the Central Bank and the Ministry of Finance,[36] in February 1987, the Brazilian government finally declared a moratorium on interest payments on medium and long-term debts, based on the principle that the external debt was not just an economic but also a political issue. This did not resolve the country's balance of payments problems; on the contrary, it contributed to the weakening of the economic team, which in April of that year, was changed, with Minister Dilson Funaro replacing Bresser Pereira.

The new team sought a negotiated solution to the crisis and an agreement that ended the moratorium was signed in September 1988: It provided for the inflow of new money ($5.2 billion), the rescheduling of some medium and long-term bonds, the maintenance of short- term credit lines, and the swap of $1.05 billion in old debt into bonds (Brazil Investment Bond Exchange Agreement). Nonetheless, due to lack of payment capacity, at the end of 1988 and in July 1989, the country stopped honoring its external commitments (a *de facto* – although not declared – moratorium).

At that time, the financial community was introduced to a new plan that attempted to solve developing countries' indebtedness problems, conceived by another Secretary of the US Treasury, Nicholas Brady: The US government would participate in negotiations to avoid the free rider problem, and previous loans would be exchanged for new bonds (known as Brady Bonds), which could subsequently be negotiated in the market, extending maturities and reducing debt service. As described by Garrido, "despite hurting individual interests, the

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[34] The president elected by the electoral college (formed by National Congress members) was Tancredo Neves, the first civilian to be elected since 1960. However, he fell sick and was hospitalized the day before his inauguration. Vice-President José Sarney was then inaugurated and remained in office until the end of his term, as Tancredo Neves died a few days later.
[35] It was never actually implemented by any country.
[36] These debates are described in Paulo Nogueira, *Da crise internacional à moratória brasileira*, 1988.

collective interest of the banks was secured, since the plan enabled debtors to remain in the capital market".[37] In 1989, Mexico was the first country to sign an agreement based on the Brady Plan.

In that international context, Fernando Collor[38] took office as Brazil's President in March 1990, advocating a liberalizing policy in which critical credit lines to the country were resumed. As a result, Brazil began new negotiations that year with the international financial community to regularize the country's credit. In December, the Federal Senate passed a resolution (Resolution nº 82), which set guidelines for negotiating the external public debt. At the same time, part of the payments still owed to creditors was disbursed. In April 1991, an agreement was signed to regularize the interest due; some of these amounts were paid in cash and others ($7 billion) were exchanged for a new bond issued by the Government – Interest Due and Unpaid (IDU) Bonds – in November 1992.

Negotiations continued and a new agreement was signed, which became known as the 1992 Brazilian Financing Plan, and approved by the Federal Senate.[39] In January 1993, the document was submitted to the international financial community so it could approve it. In November, several agreements were signed with creditors.

The Brazilian "Bradies" (Discount Bonds, Par Bonds, Front-Loaded Interest Reduction Bonds, Capitalization Bonds, Debt Conversion Bonds, New Money Bonds and Eligible Interest Bonds) were issued in April 1994, after values were reconciled and bonds were distributed to creditors.

The table below shows the securities issued during the external debt renegotiation process, which started in the late 1980s and ended in the mid-1990s. The first two instruments became known as "Pre-Bradies", while the others are the "Brady Bonds".

Table 3. External debt renegotiation: securities issued

Instrument	Amount issued ($ billion)	Maturity date
BIB or Exit Bond	1.06	09/15/2013
IDU (Interest Due and Unpaid)	7.13	01/01/2001
Discount Bond	7.28	04/15/2024
ParBond	8.45	04/15/2024
Flirb (Front-Loaded Interest Reduction Bond)	1.74	04/15/2009
C-Bond	7.41	04/15/2014
DCB (Debt Conversion Bond)	8.49	04/15/2012
New Money Bond	2.24	04/15/2009
EI (Eligible Interest Bond)	5.63	04/15/2006

The agreements also provided for transferring responsibility for the external debt from the Central Bank to the Federal Government, which became the debtor of external securities; this meant responsibilities would be more appropriately shared between the monetary and fiscal authorities. The Central Bank then began to operate as a National Treasury agent, issuing securities in the foreign market.[40]

[37] Garrido, op. cit.
[38] President José Sarney passed the presidential sash to Fernando Collor de Melo, the first to be elected by popular vote in nearly 30 years (the last had been Jânio Quadros, in 1961), after a long period of indirect elections of military presidents (with the exception of Sarney).
[39] Through Resolution nº 98, in December 1992.
[40] The responsibility remained within the Central Bank for nearly a decade. In 2003, a transition agreement was signed, in which the National Treasury became, starting in 2005, the sole agent responsible for managing the Brazilian external securities debt.

Two of the agreement's features that would help solve the external indebtedness contention (described more fully in the next section), were (1) the existence of collateral (through the purchase of US Treasury bonds) for three of the bonds issued and mainly (2) the possibility for Brazil to do structured operations with the new bonds issued.[41]

3.3 The resumption of voluntary issuances

The existence of Brazilian securities in the international market, a situation promoted by the Brady Plan, created the new indebtedness model adopted by the country, which is still in effect: The securities' debt structure, with assets freely negotiated in the secondary market with relative liquidity (which investors can resell in the market), provided the conditions for the new phase of external liabilities, which today can be managed with much more flexibility.

With the inception of the Real Plan in 1994 and its "anchor" via the exchange rate, an inflow of capital became essential. A new phase of external indebtedness began that involved raising funds in foreign currencies by issuing securities in the international market.[42] In the new context, the country could choose the best combination of maturities and costs and also the market in which it wanted to raise funds.[43]

In fact, even in times of global crises (for Mexico, Asia, Russia and Argentina), the country was able to raise funds overseas. At the very beginning of this new phase of "sovereign issuances" in 1994, the world experienced the first truly global international financial crisis,[44] mainly within emerging countries; e.g., the Mexican crisis negatively affected Brazil's access to the US market. However, Brazil's flexibility in managing external liabilities allowed it to operate in other markets, so that in June 1995, Brazil resumed its voluntary issuances in the Japanese market. The success of the first issuance was so large and demand so great that the country raised its originally planned volume of Y$20 billion to Y$80 billion, with no corresponding cost increases.[45] Another issuance was made soon after, in German marks, in the European market, which contributed to about $1.7 billion the first year, nearly exhausting the $2 billion limit authorized by the Federal Senate.

In 1996, following other issuances in the Japanese, Italian and British markets, and with the effects of the Mexican crisis already diminished, Brazil finally had access to the dollar market (more liquid, thus allowing for issuances in higher volumes), with a five-year bond.

By 1997, when the Asian crisis exploded, the country had accessed the international market eight times, with issuances in Europe and the United States. One, in the US market, involved a 30-year bond, the longest maturity ever issued (called Global 2027). This showed that the market readily accepted the Brazilian debt. Also, for the first time, the country exchanged securities, which allowed $2.2 billion in Bradies to be repurchased.

Despite the successive international crises, the country took advantage of financial assistance packages from the IMF and continued to access external markets. Three operations were carried out in 1998, in the European and US markets, until the Russian crisis erupted. In 1999, even after the exchange devaluation (early in the year), Brazil returned to the market doing debt exchange operations. Despite the 2002 election and the uncertainties it fueled in the debt market, Brazil still had access to the markets, through the flexibility

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[41] These included the anticipated purchase, which allowed for future restructurings of external liabilities, based exclusively on market parameters, without the need for political and/or diplomatic negotiations.

[42] The Statistical Annex to this book features a table with all Federal Government issuances since 1995.

[43] The main ones were the US, European and Japanese markets.

[44] For a discussion of the contagious effect of the crises on the debt market of emerging countries, see Botaro, 2001.

[45] It is worth noting that this issuance was also chosen by the International Finance Review as the best one in 1995.

of choice in relation not only to the right moment to carry out an operation but also to the market itself and the instrument to be used. With the return of economic stability in 2003, Brazil was able to access external markets without major impediments, for the next years.

A turning point in Brazil's indebtedness occurred in 2005, when the C-Bond was changed into a bond with similar characteristics, known as A-Bond. This operation was the kick-off for retiring the outstanding Brady Bonds and was completed the following year. Also that year, the indebtedness strategy began to focus on defining benchmarks, reopening the same security many times, thereby increasing its market liquidity. This strategy was intended to build a more efficient external yield curve.

A third and crucial aspect in the recent history of external debt was the first issuance, in the international market, of a real-denominated bond due in 2016 (the BRL 2016). Further, in 2006, the country would take the first step towards consolidating an external yield curve in domestic currency.

3.4 Current stage: qualitative issuances

In 2006, due to the considerably decreased need for external borrowing to reduce the debt and the strong inflow of dollars, the country no longer depended on external issuances as a source of funds. Since then, several operations were carried out to prepay the external federal debt, totaling \$35.7 billion. As for the contractual debt, the country bought back the remaining debt with the Paris Club for \$1.7 billion and, in 2005, prepaid its \$20.4 billion debt to the IMF.

The 2006 operations to reduce the securities' debt included the early redemption of outstanding C-Bonds (begun the previous year) and the country re-purchased the other Bradies, totaling \$6.5 billion. Thus was ended an important phase in Brazil's external indebtedness. Also, early in 2006, the Treasury started an external debt repurchase program through the Central Bank trading desk to improve the debt profile, and initially redeemed securities due by 2012. Over the year, \$5.8 billion were repurchased at face value.

Regarding the debt profile, the country issued another real-denominated instrument in 2006 with a 15-year maturity (BRL 2022), creating a second part of the external curve in the local currency. This security was issued twice during the year, and its outstanding volume reached R\$3 billion. The BRL 2028, a real-denominated bond with a 20-year maturity, was issued four times the next year. As a result, Brazil ended 2007 with an outstanding volume of some R\$10.2 billion in external bonds issued in the local currency, thus helping set a reference in the external market for a yield curve in domestic currency.

A permanent program to repurchase external debt bonds along the entire curve was introduced in 2007, whose aim was to construct an efficient and liquid external curve. In 2007, \$5.4 billion was repurchased, which represented 12.2% of the outstanding external debt at the end of 2006. In 2008, with market liquidity reduced as a result of adverse international conditions, repurchases occurred at a lower volume (\$1.5 billion), but continued to reflect the strategy to retire less liquid instruments and exchange them into benchmark securities.

Given its recent actions, the country's external debt structure has not only been reduced but also diluted, compared to the beginning of the decade.[46] Thus, one of Brazil's major economic problems over the past 30 years has turned into an issue whose management is fully within a comfort zone.

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[46] The share of external debt in the volume of outstanding Federal Public Debt held by the public is below 10%. Also, when the volume of this debt reaches approximately \$60 billion, international reserves exceed \$200 billion in a floating rate regime.

Box 2. Brazil and the rating agencies

The first rating agency to evaluate Brazil's credit risk was Moody´s, in 1986. Lacking negotiable debt instruments for some years, the evaluation by such agencies was the only way to rate the country's credit. With the process of external debt securitization and the consequent market development through these instruments, especially after the return of voluntary issuances, it was no surprise that other rating agencies began to assess the risk of the country's credit instruments. Since 1994, Standard & Poor's and Fitch have also published credit ratings for the country.

In the first years of the Real Plan and at the beginning of the voluntary issuance phase, there were some upgrades by the rating agencies (Moody's in 1994 and S&P, in 1995 and 1997). However, the deterioration of macroeconomic conditions in 1998 led Moody´s to lower the rating. Other agencies followed in 1999, when the real was devalued. After the perception that the country dealt with the crisis better than expected, the three agencies increased their rating by one notch.

In 2002, due to the uncertainties produced by the elections and their impact on economic and financial conditions, the three rating agencies lowered their ratings again. It was the last time Brazil was downgraded. Since 2003, constant improvements in the country's economic foundations have ensured a process of continuous upgrades leading to the current situation in which Brazil is rated investment grade by S&P, Fitch and Moody's.

In this credit rating category assets are no longer considered risk investments and demand tends to increase as there are some investors prohibited from buying bonds issued by non-investment grade countries. In other words, earning the investment grade means not only market recognition of the quality of the issuer's credit, but also market access for a significant share of investors.

4 Conclusions

The history of Brazil's public debt shows advances and setbacks, and the debt profile has experienced considerable variations, reflecting changing economic conditions. Nonetheless, improvements are indisputable.

With respect to the domestic debt, the country adopted a more efficient structure in terms of profile and maturity that allows for easier and smoother debt management as well as for growth in the domestic capital market. As for the external debt, the present structure offers considerable certainty that exchange rate instabilities (produced by the large share of public sector liabilities in foreign currency) are increasingly ancient history.

Thus, the country's stable macroeconomic policy improved the structure of both the public domestic and external debt, contributed to consolidate economic stability, and ensured the debt would be managed efficiently.

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