TESOURO NACIONAL

Public Debt Report

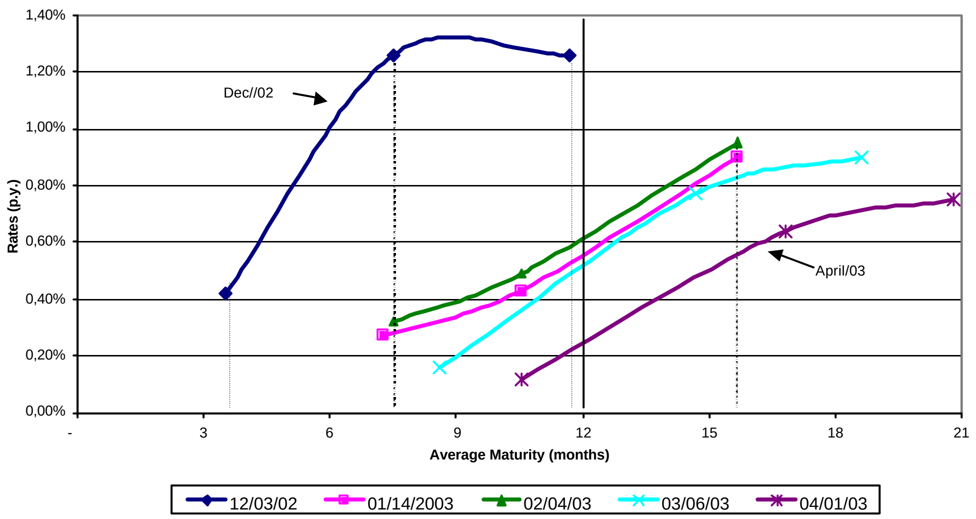
April 2003

THE IMPACT OF THE NEW GOVERNMENT ECONOMIC POLICIES ON THE BRAZILIAN FEDERAL PUBLIC DEBT

The policy decisions taken on the first 100 days of the government have been translated into a steady and significant decrease in the premiums required by markets to hold public debt. The turbulence of the second semester of 2002, reflected in a sharp deterioration on the exchange rate and debt indicators, is giving way to a new scenario of increasing stability, as key aspects of the economic policy announced before elections are being implemented. Market response to these developments has been favorable, being translated into the success of the Treasury in lengthening the maturity of newly-issued debt and lowering issuing costs.

The maturity of new floating-rate bonds (LFT) has been gradually increased since January, while the discount rates required by markets have dropped (chart 1). At the end of 2002, no LFT of more than 12 months were being issued, and the discount vis-à-vis the SELIC exceeded 1% a year. By contrast, the National Treasury issued LFTs of up to 21 months of maturity within 100 days of the new government. On their parts, the discounts on the 12-month-bonds declined to almost 1/10 of their levels in late 2002. In early April 2003, the National Treasury started auctioning LFT maturing in 2005, to which there has been a quite strong demand. This process also resulted in a significant decline of the "discount curve" in the secondary market, as published by the dealers and brokers association ANDIMA.

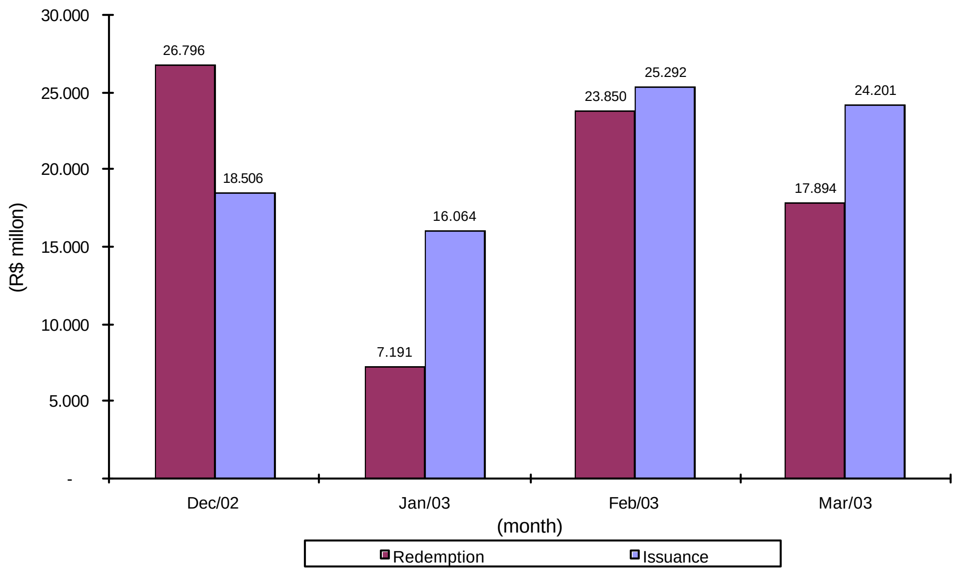
Chart 1
DISCOUNTS ON LFTs AT THE REGULAR PRIMARY AUCTIONS
Dec/02 to Apr/03



The strengthening of the public debt market on the heels of the fiscal measures adopted by the new government has also been evidenced by a net issuance of more than R$ 16 billion in the first three months of 2003 (Chart 2). The target of the primary surplus for 2003 was established at 4.25% of the GDP, i.e., ½ percent of GDP above the target agreed with the IMF in August 2002 and set in the 2003 LDO. The Treasury outturn of January and February of 2003 showed primary surpluses stronger than those registered in early 2002, even if the quite substantial level of extraordinary revenues recorded in early 2002 was not repeated in 2003. The accumulated primary result of the public sector (R$ 16.1 billion) in the first two months of the year exceeded the target established with the IMF for the first quarter of the year (R$ 15.5 billion). Importantly, states and municipalities contributed significantly to that result, in line with the firm and consistent support by the new government to the faithful application of the Fiscal Responsibility Law. The confidence generated by these results has contributed to the net issuance observed till March, which contrasted with the difficulties found by the government to roll over its debt during most of the second half of 2002.

Chart 2

REDEMPTIONS AND ISSUANCES



The new government has also succeeded in dealing with the concentration of redemptions in the second quarter of 2003. Despite the policy of the National Treasury in effect since 2001 of attempting to reduce the amount of debt maturing in early 2003, market uncertainties in 2002 still resulted into a significant concentration of redemptions after March 2003. This potential problem, however, has been addressed not only by net issuances in Jan-March 2003, but by repurchase auctions aimed at decreasing the debt stock maturing in 2003 Q2. A repurchase auction with an amount of R$ 1.5 billion and three exchange auctions totaling R$ 6.8 billion were carried out in the first quarter of 2003, allowing the exchange for bonds maturing in May and in August 2004 (Chart 3 and 4).

Chart 3

AMOUNTS MATURING – FEDERAL DOMESTIC PUBLIC DEBT TREASURY
April/03 – March/04

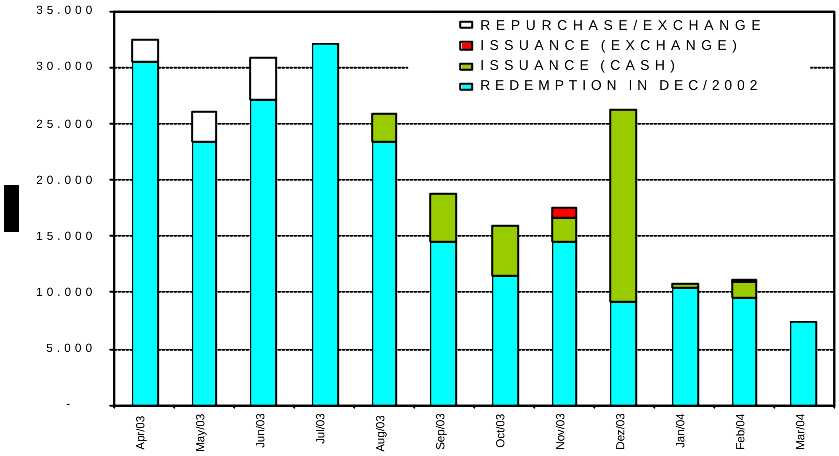
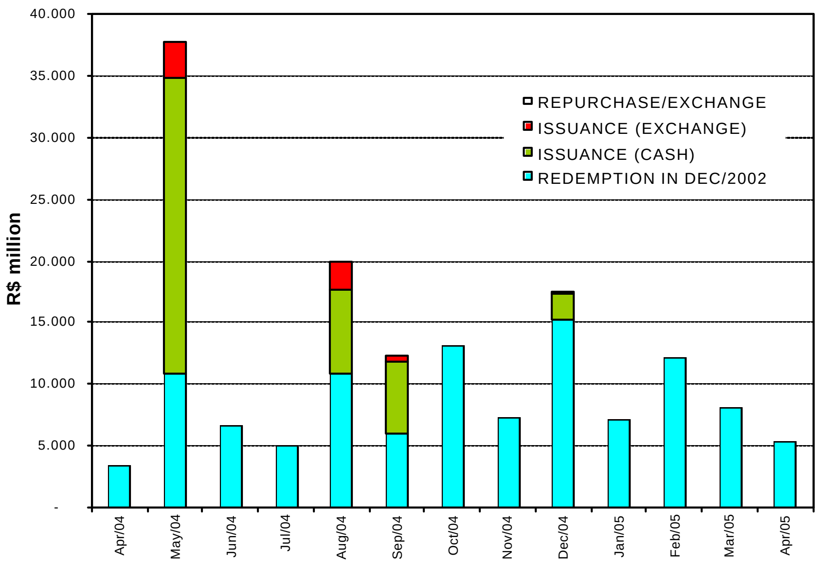


Chart 4

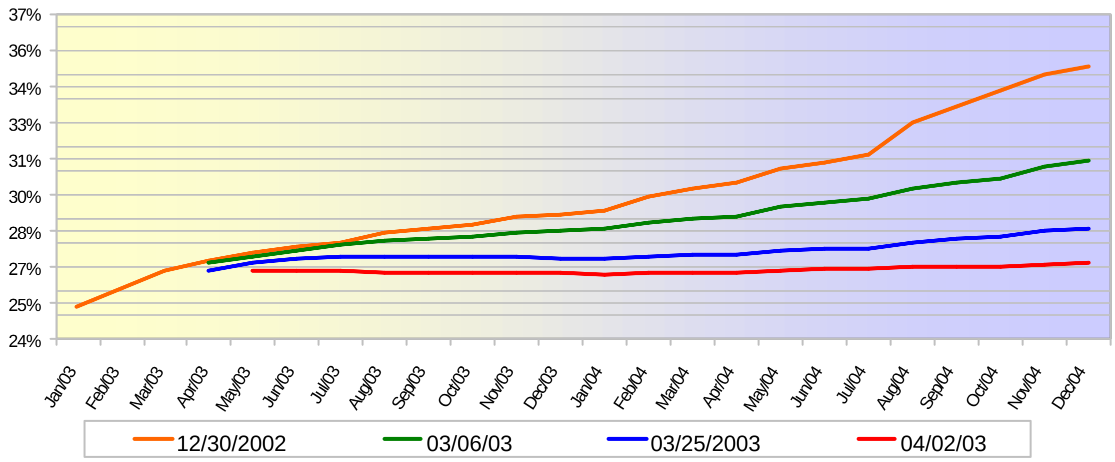
MONTHLY TOTAL MATURITY – FEDERAL DOMESTIC PUBLIC DEBT TREASURY
April/04 – Apr/05



The Central Bank policies against inflation are benefiting the public debt dynamics. The firm policy stance of the Central Bank, in the exercise of its *de facto* autonomy (reiterated by the new government), is gradually shaping inflationary expectations. Since the beginning of the year, the highly positive slope of interest rate curves in the futures market has declined, despite the increase in 100 basis points of the basic interest rate (Selic) adopted in the first two meetings of the COPOM (Monetary Policy Committee) of the year and the more recent upward bias (Chart 5)[1].

Chart 5

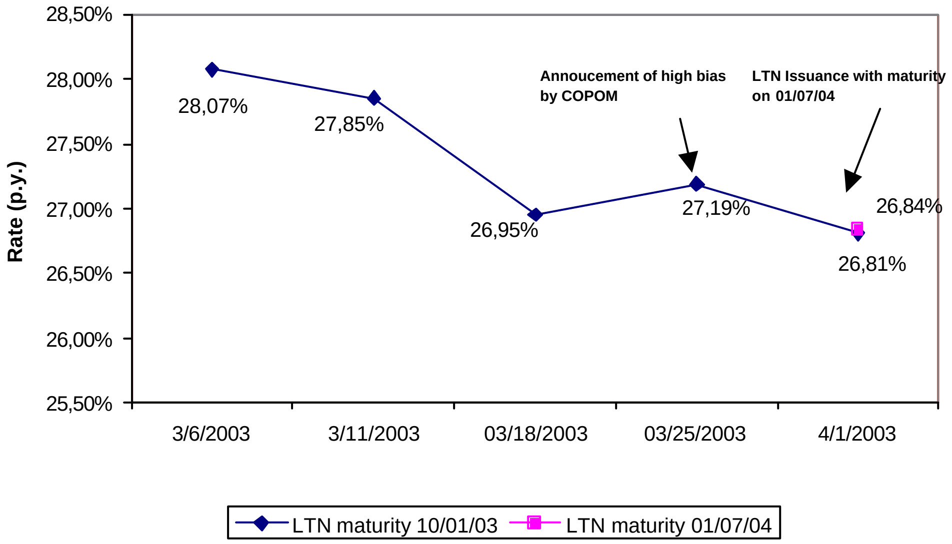
YIELD CURVE (December 2002-April 2003)



The success of the strategy in fighting inflation and the outturn of fiscal policies have already been translated into a <u>decline in the nominal interest rate</u> yielded by the auctions of public debt. In early March, the Treasury restarted to issue fixed-rate bills (LTN), for which it had identified a strong demand. The issuances, of which maturities have increased from seven to nine months through March, have been auctioned at decreasing interest rates. These rates dropped from 28.07% p.y., to 26.81% p.y. in March, and below in April (Chart 6).

[1] After the conclusion of this note, the slope of the curve became negative.

Chart 6
ACCEPTED RATES IN THE LTN
(Fixed-Rate Treasury Bills) AUCTIONS



In short, the transparency and consistency of the new government economic policy have allowed the National Treasury to successfully implement its objectives announced in the 2003 Annual Borrowing Plan (PAF). The National Treasury has advanced towards its objectives of reducing rollover risks, revitalizing the fixed-rate bond market, and lowering the cost of the public debt. Indeed, the proportion of debt due in the next twelve months has fallen from 40.3% in January to 37.4% in March (Chart 7). The sale of price-indexed bonds of maturities of 5 up to 30 years has also met with strong demand, especially by pension funds. The government is also counting on initiatives from the private sector to help implement the objectives stated in the 2003 PAF. In particular, the launching of a clearing mechanism for the public debt to be implemented by the Futures Exchange (BMF) in the first half of 2003 will play an important role in improving efficiency and helping the development of the secondary market for the fixed-rate public debt. In line with this objective, the National Treasury and the Central Bank made another step in March to overhaul the system of dealers, inter alia distinguishing primary dealers from specialists in the secondary market and providing incentive mechanisms in line with those adopted by the Treasuries of leading issuers among developed countries.

Chart 7

% OF FEDERAL DOMESTIC PUBLIC DEBT MATURING IN 12 MONTHS