



Ninth UNCTAD Debt Management Conference

Geneva, 11 - 13 November 2013

Effective Debt Strategies in the Current Macroeconomic Environment

by

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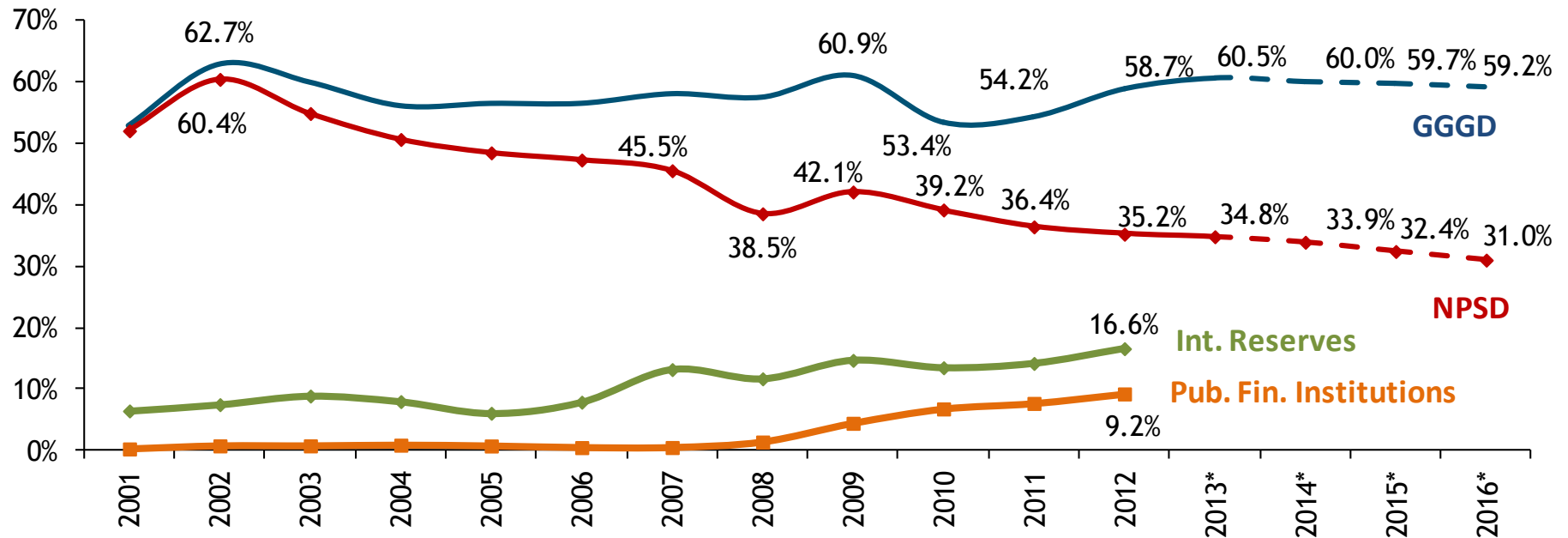
National Treasury Brazil

Effective Debt Strategies in the Current Macroeconomic Environment: the Brazilian Case



Fiscal Responsibility

Gross General Government Debt and Net Public Sector Debt as % GDP



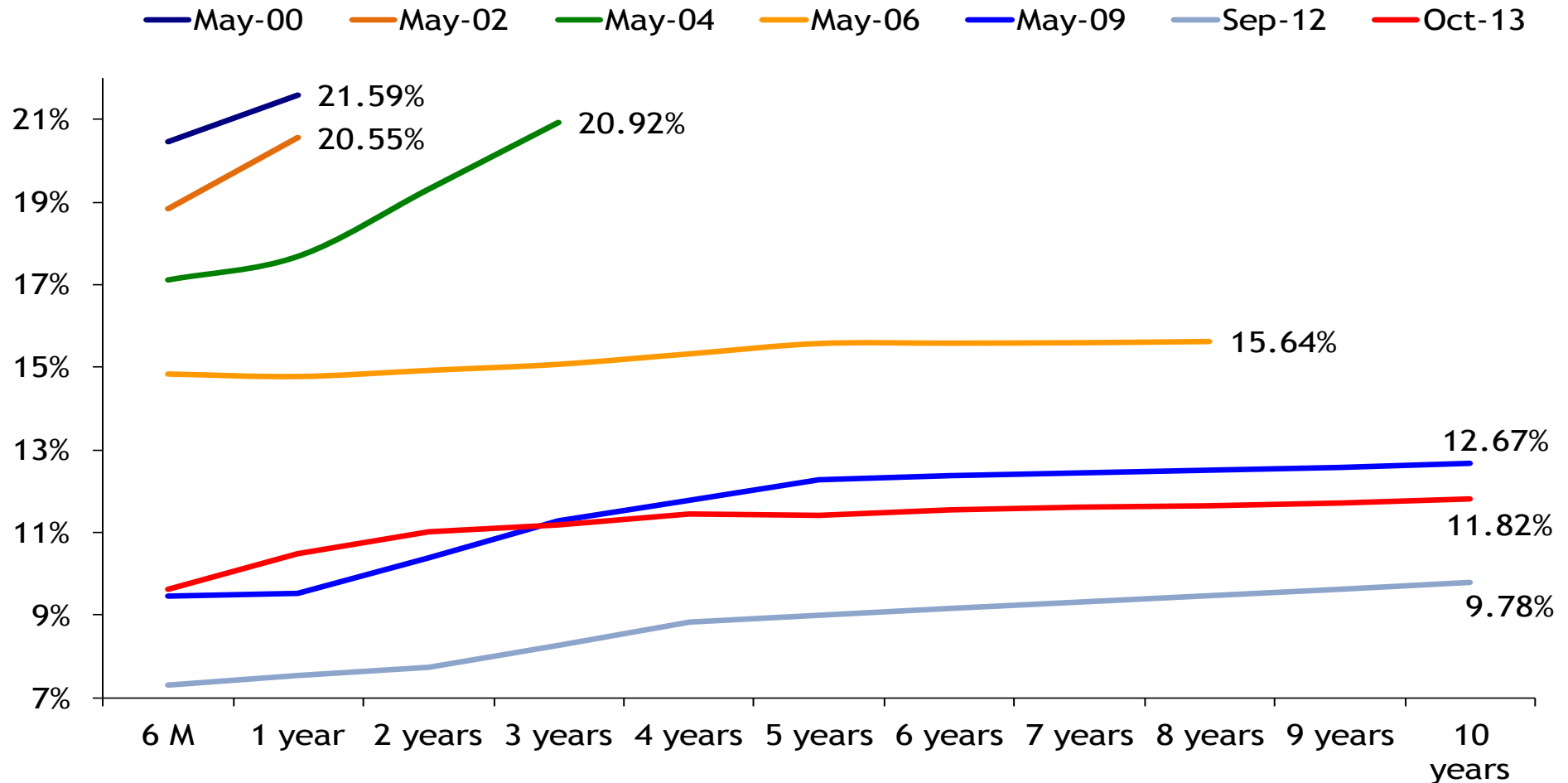
Source: Central Bank *Projections made for Draft Budget Law 2014.

» The commitment with positive primary fiscal targets promoted a consistent downward trend in public debt measures.

» **FX Reserves** (sterilized with Repo held at Central Bank) and **Loans to the Development Bank (BNDES)** explain the difference between NPSD and GGGD. These credits are respectively 18.8% and 9.5% of GDP in January 2013.

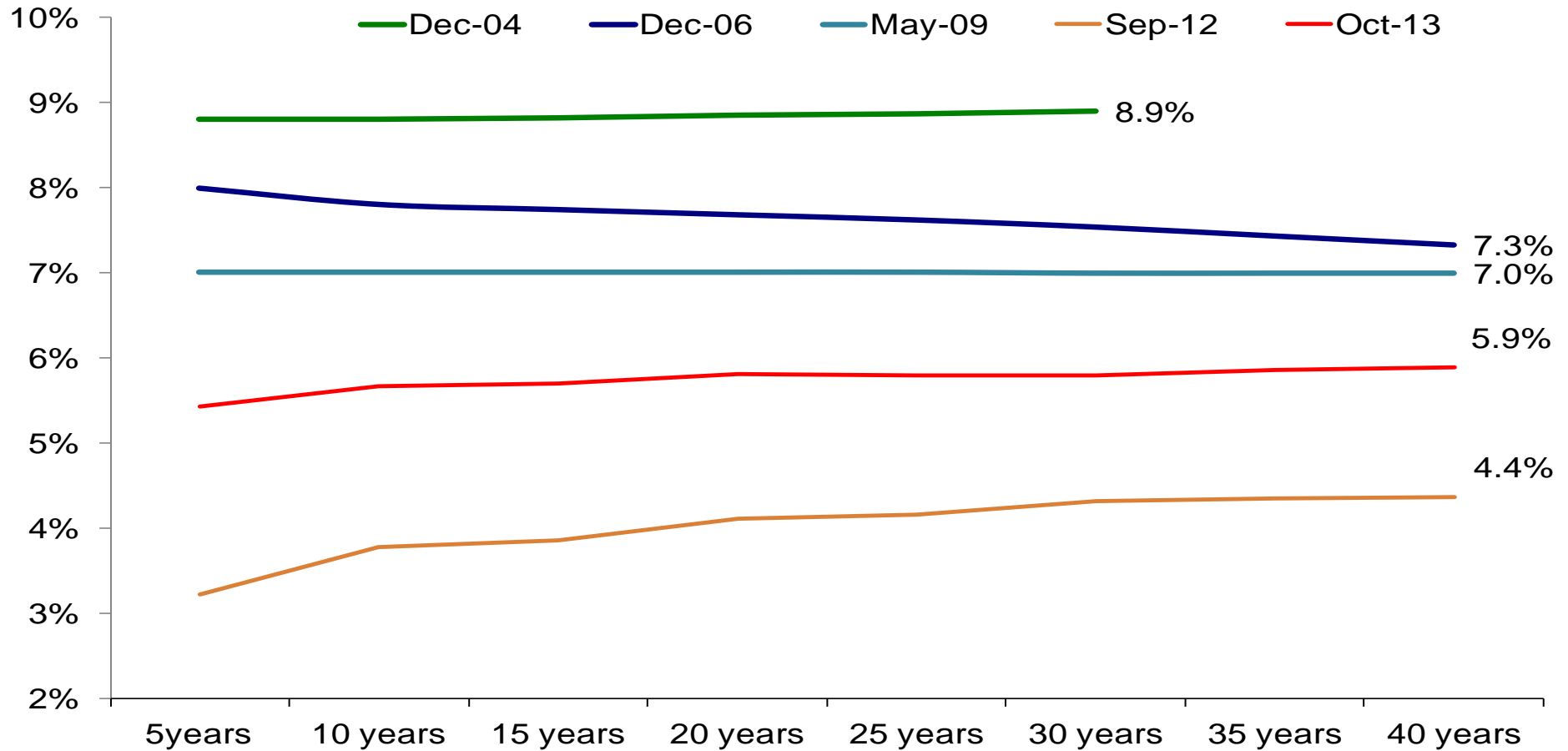
Lengthening the maturities and reducing the yields

Building and extending the local yield curve – Fixed Rate Bonds



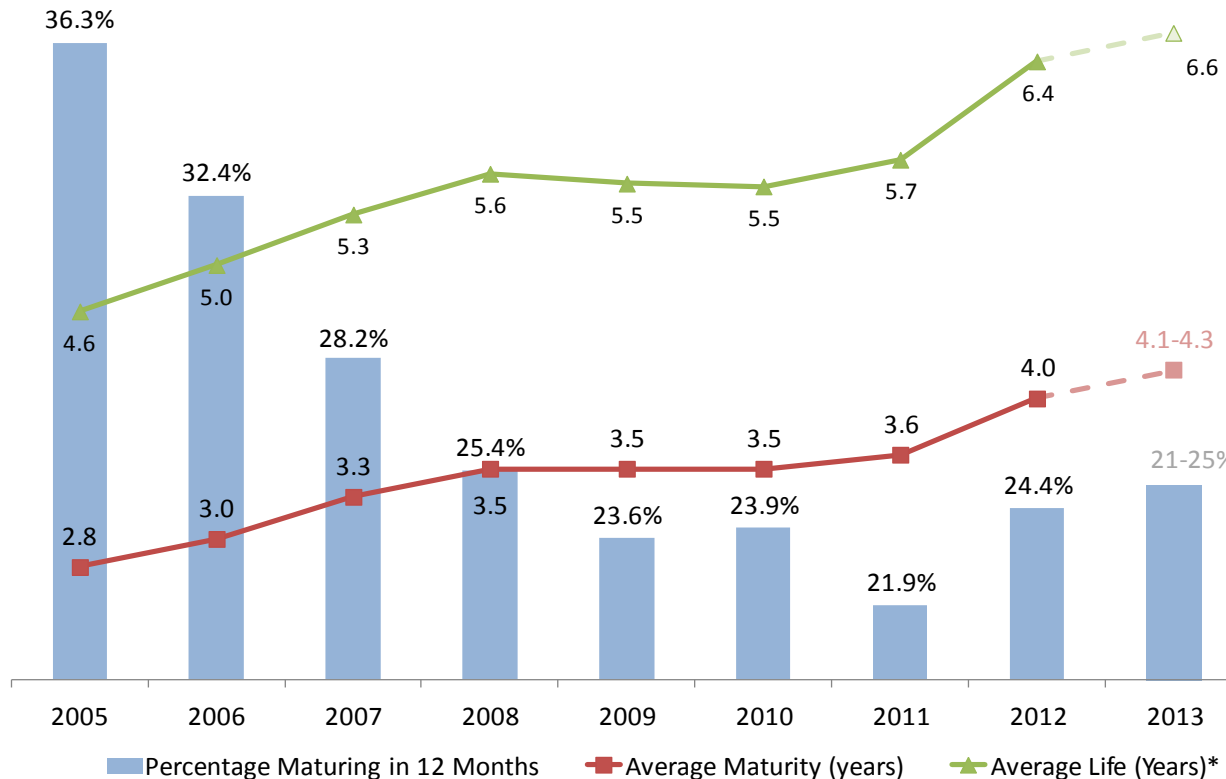
Lengthening the maturities and reducing the yields

Building and extending the local yield curve – Inflation Linked Bonds



Improving Public Debt Profile

Lengthening and Smoothing the maturity profile



Source: Brazilian National Treasury

*Average Life is different from the Average Maturity indicator because it does not consider intermediate coupon payments.

The National Treasury has two “liquidity cushions” to efficiently manage its debt refinancing risk:

- » US\$ 9.7 billion already purchased, enough to cover 61% of the external debt maturing until 2015; and
- » A liquidity-cushion in BRL equivalent to approximately five months of the domestic debt service (principal plus interest). Given the current structure of the Federal Public Debt, the minimum level of liquidity-cushion is equivalent to three months of debt service.

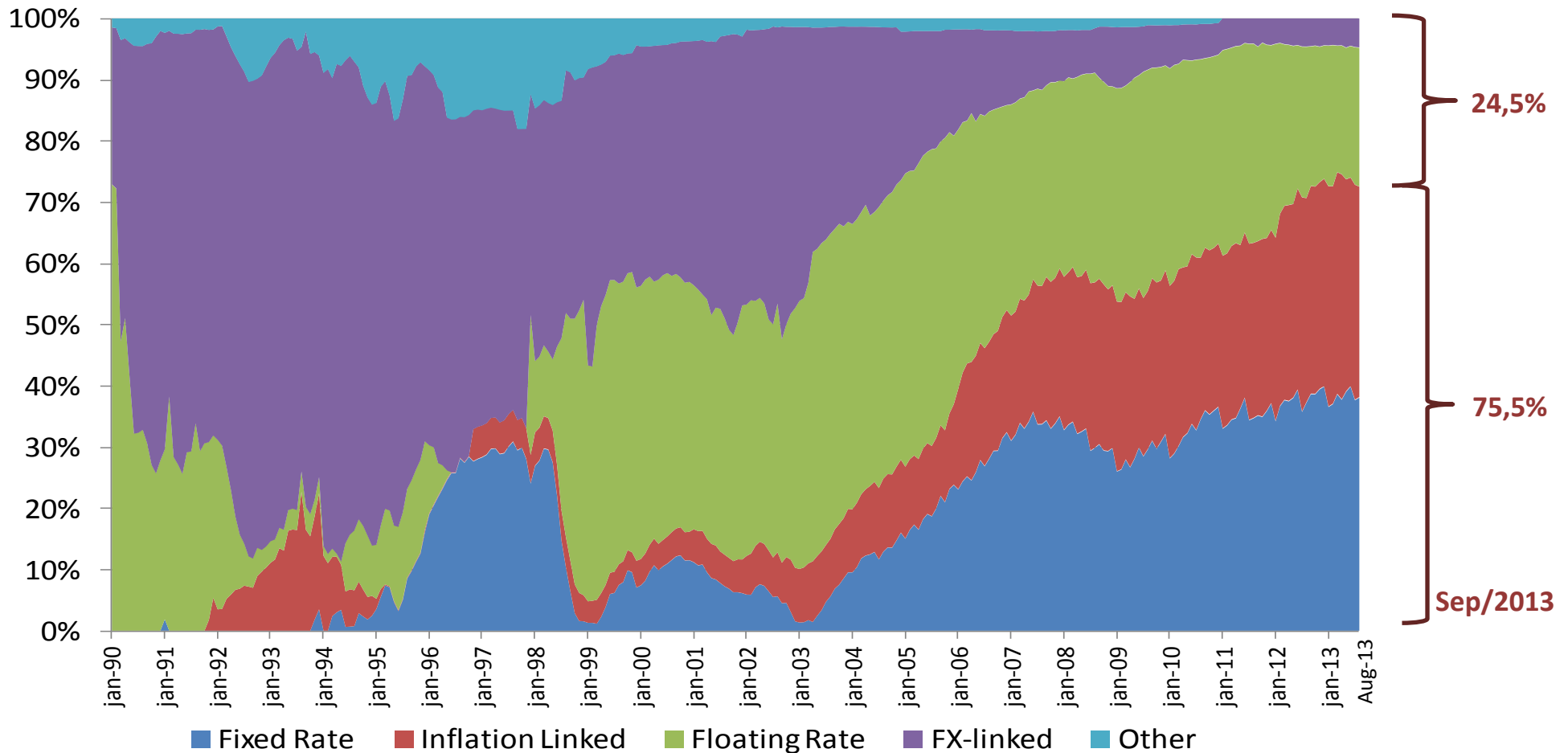
Non Regular Buyback Auctions

- » In periods of high volatility, the National Treasury holds simultaneous buy and sale auctions aimed at providing market participants with price parameters and also with additional liquidity to the more affected instruments;
- » This strategy was put in practice in 2006, 2008 and 2013 (example below). The liquidity-cushion is fundamental to hold it.



Improving Public Debt Profile

Public Debt Composition



Source: National Treasury.

Note: Federal Public Debt, which includes both domestic and external liabilities.

Stress scenario impact over Net Public Sector Debt (% GDP)

Type of Index	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Interest Rate	1.8%	2.1%	1.9%	1.8%	1.5%	1.6%	1.7%	2.1%	1.9%	1.9%	1.7%
Exchange Rate	15.0%	11.4%	1.9%	2.1%	-0.9%	-4.6%	-5.3%	-5.0%	-5.2%	-7.1%	-7.5%
Total	16.8%	13.5%	3.7%	3.9%	0.6%	-3.0%	-3.6%	-2.9%	-3.3%	-5.2%	-5.8%

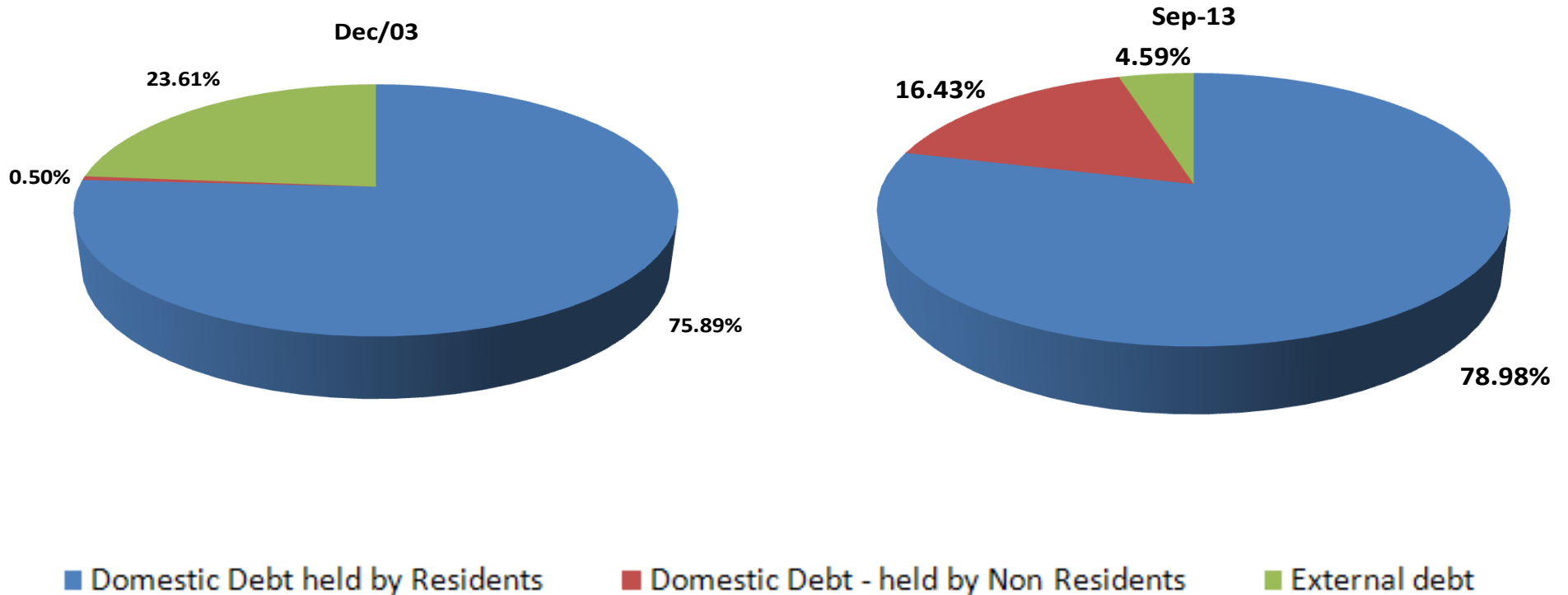
Source: National Treasury / Feb 2013

Note: Stress scenario considered of 3 standard deviations over the medium interest and exchange rate observed at 2002, equivalent of an overshooting of 56.6% on exchange rate and an increase of 7.8 on the Selic rate.

- » The impact of a stress scenario of exchange and interest rates over the Net Public Sector Debt/GDP) outstanding was reduced in **22 .6 pp** of GDP between 2002 and 2012, due to changes at the Public Debt composition.
- » In particular, the protection created by the fact that the Government has more FX assets than liabilities compensates the interest rate risk, shielding the NPSD.

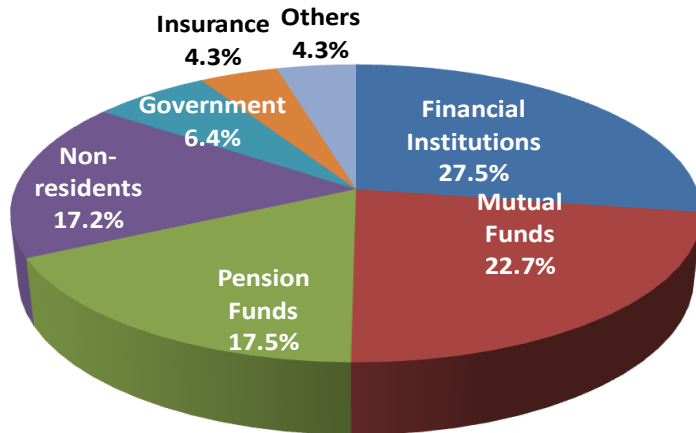
Non-Resident Share in Overall Public Debt

Recent Evolution (as % of FPD)



Domestic Federal Public Debt (DFPD) - Holders

Holdings (Sep 2013)



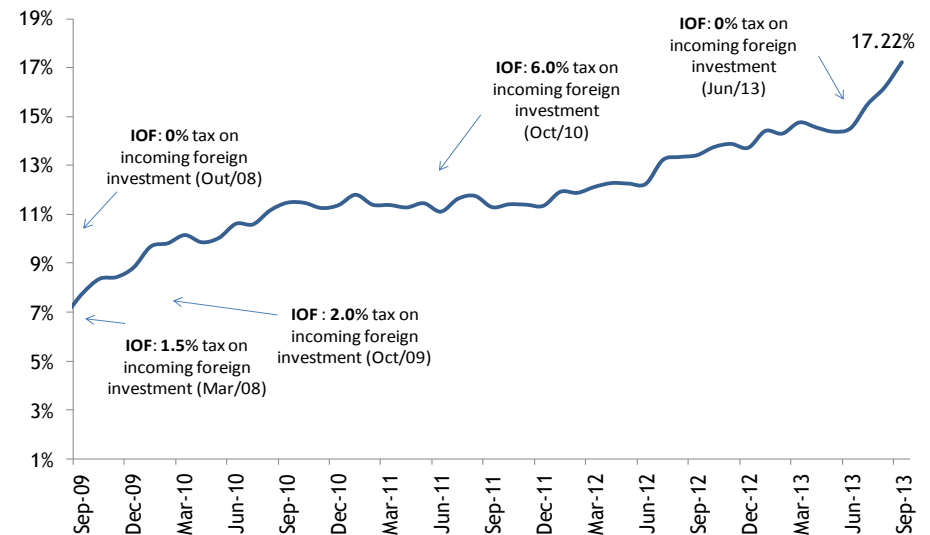
Source: National Treasury

Note: "Pension Funds" includes both open and closed pension funds. "Government" comprises funds that are managed by the public sector, including those whose assets are not public.

» The share of Non Residents in Domestic Federal Public Debt has been kept stable.

» This is the result of a strategy adopted by the National Treasury aimed at diversifying the investor base.

Share of Non Residents



Source: National Treasury

Main Documents Released

Transparency as a Guideline

- » In 2001, an Institutional Relations Unit within the Middle Office was created: direct channel with the press, rating agencies and market agents in order to provide information about the public debt
- » Main Publications:
 - » The [Annual Public Debt Borrowing Plan](#), since January 2000, which presents the National Treasury's objectives, guidelines, financing needs, strategies and targets to the end of the year;
 - » The [Annual Debt Report](#), which offers a retrospective analysis of PDM for previous year, describing the goals and targets, and its results.
 - » The [Monthly Debt Report](#), which presents information and statistics on issuances, buybacks, outstanding debt and its average maturity and life, maturity profiles and average costs for the FPD, including domestic and external federal debt, for which the Treasury is responsible.
 - » The [Yearly Issuance calendar](#), which, at the start of each year, list the dates of auctions, as well the types of bonds to be offered in each auction.
- » **Transparency itself is a powerful enforcement mechanism to allow the DMO to implement debt strategies according to its preferences and analytical work**

Objective and guidelines released since the first ABP, in 2001

The objective of the Federal Public Debt Management is that of efficiently meeting the National Treasury Borrowing Requirements, at the lowest possible long-term financing costs, while ensuring the maintenance of prudent risk levels. Additionally, the aim is to contribute to the smooth operation of the Brazilian government securities market.

To achieve this objective, the guidelines underlying FPD management are as follows:

Increase the average maturity of the outstanding debt

Smooth the maturity profile, with special attention given to short-term maturities

Gradual replacement of floating-rate securities by fixed-rate and inflation-linked instruments

Improvement of the External Federal Public Debt (EFPD) profile through issuance of benchmark securities, buyback program and structured operations

Development of the yield curve on both domestic and external markets and growth in the liquidity of federal government securities on the secondary market

Broadening of the investor base

Annual Borrowing Plan – Main Information Disclosed

Benchmark - Optimal Composition Provides Quantitative Guidelines

Indicators	Long Term Limits	
	Target	Range
Profile - %		
Fixed Rate	45	+/- 2
Inflation Linked	35	+/- 2
Floating Rate	15	+/- 2
Exchange Rate	5	+/- 2
Maturity Structure		
% Maturing in 12 months	20	+/- 2
Average Maturity	5.5 years	+/- 0.5

» In its first release, in 2011 Annual Borrowing Plan, only composition targets were published. The maturity targets were disclosed latter (2012 and 2013 ABP).

Annual Borrowing Plan – Main Information Disclosed

Benchmark Securities to be Offered in the Current Year

Yield	Bond	Benchmark	Maturity
Fixed rate	LTN	Short and Medium-Term Up to 4 years (4 vertices)	January, April, July and October
		Long-term Between 5 and 10 years (2 vertices)	January
Floating rate	LFT	Maturity greater than average for FPD	March and September
Price indices	NTN-B	Group I – Short and Medium- Term / Up to 10 years (2 vertices)	May and August
		Group II – Long-Term 20, 30 and 40 years (3 vertices)	

At its discretion, the National Treasury may hold off-the-run securities auctions with the objective of correcting possible distortions in government bond prices.

Annual Borrowing Plan – Main Information Disclosed

Frequency of auctions to be held by the National Treasury in the Current Year

Bond	Traditional		Exchange		Early Buyback	
	Periodicity	Selection Criterion *	Periodicity	Selection Criterion	Periodicity	Selection Criterion
LTN	Weekly	Best Price	Half-yearly	Best Price		
NTN-F	Fortnightly	Best Price			Monthly	Best Price
LFT	Monthly	Best Price				
NTN-B	Fortnightly	Uniform	Monthly	Best Price	Monthly	Best Price

* Criterion for selecting proposals in the auctions: In the uniform criterion, all proposals with quotes equal to or greater than the minimum quote will be accepted. This will be applied to all winning proposals. In the best price criterion, the proposals accepted pay the price presented in the bid.

- » **Traditional Auctions:** have the main purpose of refinancing the Federal Public Debt through issuances of fixed rate, floating rate and inflation-linked public bonds;
- » **Exchange Auctions:** consist of exchanges of shorter-term securities for longer-term securities, with the objective of lengthening or improving the debt profile; and
- » **Buyback Auctions:** ensure liquidity to the bondholder.

Disclosure of the annual calendar of public offerings, ensuring more predictability for the National Treasury operations.

An auction schedule is now released at the beginning of each quarter, including maturity dates for each security to be offered along the following three months.

Annual Borrowing Plan – Main Information Disclosed

Auctions of Domestic Public Bonds

» Calendar and results published on Treasury website:

- <https://www.tesouro.fazenda.gov.br/en/federal-public-debt/auctions-results>

» in 2013, the Treasury launched:

- [Year Auction Schedule](#)
- [Quarter Auction Schedule \(including the maturities offered in each auction\)](#)

AUCTION	TIME	TYPE	SECURITY*	MATURITY
3 rd (Thursday)	11:00-11:30	Traditional Auction	LTN	4/1/2014; 7/1/2015; 7/1/2017
			NTN-F	1/1/2019; 1/1/2023
8 th (Tuesday)	12:00-13:00	Traditional Auction	NTN-B	8/15/2018; 8/15/2022 8/15/2030; 8/15/2040; 8/15/2050
		Early Redemption	NTN-B	8/15/2030; 5/15/2035; 8/15/2040 5/15/2045; 8/15/2050
09 th (Wednesday)	12:00-13:00	Exchange Auction	NTN-B	8/15/2018; 8/15/2022 8/15/2030; 8/15/2040; 8/15/2050
10 th (Thursday)	11:00-11:30	Traditional Auction	LTN	10/1/2014; 7/1/2015; 7/1/2017
			LFT	3/1/2019

Annual Borrowing Plan – Main Information Disclosed

Main Targets to the End of the Year

Indicators	2012	Limits for 2013	
		Minimum	Maximum
Stock (R\$ billion)			
FPD	2.008,0	2.100,0	2.240,0
Profile (%)			
Fixed Rate	40,0	41,0	45,0
Inflation Linked	33,9	34,0	37,0
Floating Rate	21,7	14,0	19,0
Exchange Rate	4,4	3,0	5,0
Maturity Structure			
% Maturing in 12 months	24,4	21,0	25,0
Average Maturity (years)	4,0	4,1	4,3
Average Life (years)	6,4	–	–

» The choice of presenting the targets in terms of limits gives some flexibility to the debt manager without losing the previsibility stance that should guide the financing strategy. This element is especially important in countries with no long economic stability record.

Lessons Learned

Effective debt strategies in the current macroeconomic environment

Debt management should be anti-cyclical and care for dynamic sustainability

- » Build buffers against shocks;
- » Stability of the debt structure.

Development of the local market

- » Construction of efficient yield curves, based on liquid benchmarks;
- » Nourishes the market with regular primary issuances;
- » Requires sound local scenario and stability.

Why?

- » Helps in reducing long-term financing costs and maintaining prudent risk levels;
- » Reduces the impact of volatility over public debt in the case of a stress scenario.

Lessons Learned

Effective debt strategies in the current macroeconomic environment

What else?

- » Establish regular auctions, associating a calendar to that;
- » Widen the investors base: approach the local banks, pension funds, non residents and other agents;
- » Try to form a dealership system;
- » Make sure you message is understood by:
 - » Investors' (domestic and foreign);
 - » Rating agencies;
 - » Government;
 - » Financial Media.

For additional information access the National Treasury website:

www.tesouro.fazenda.gov.br/en

Or contact Institutional Relations area:

brazildebt@fazenda.gov.br

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