



Federal Public Debt: Annual Borrowing Plan 2008

Number 8

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Message from the Minister of Finance

Once again in 2007, the hallmark of the Brazilian economy was stability. The inflation has been held in check, external vulnerability has been curbed and fiscal responsibility has become one of the major pillars underlying macroeconomic equilibrium, making it possible to continue the process of gradually reducing the Net Public Sector Debt (DLSP) as a ratio of GDP. These achievements have made it possible for the Federal Government to pave the way toward a process of sustained economic growth, as already reflected in expanding income and employment, coupled with improved income distribution. The major consequence of the success achieved in recent years is that Brazil has been incorporated into that select group of nations marked by high human development, meaning that, aside from GDP and income growth, the country has also attained consistent progress in improving the quality of this growth.

It is in this framework that I have the pleasure to announce the 2008 Annual Borrowing Plan - PAF. This is a fiscal management instrument designed to clearly express the objectives and guidelines of Federal Public Debt management. The PAF is the instrument through which the National Treasury states its commitment to reducing costs, monitoring risks and implementing strategic debt planning and, in this way, enhancing investor confidence.

Once again, it is important to reaffirm our commitment to fiscal responsibility and transparency, two of the fundamental principles that have permeated government action in recent years, contributing not only to the development of our institutions, but also reinforcing the country's credibility with undeniable positive impacts on social well-being.

**Guido Mantega
Minister of Finance**

Message from the National Treasury Secretary

It is with a sense of satisfaction that the National Treasury presents the 2008 PAF. The objective of this document is to provide a clear statement of National Treasury borrowing policy, without in any way hampering implementation of a flexible issuance strategy, capable of adjusting rapidly to the changes of the economy.

In 2007, the National Treasury achieved significant progress in Federal Public Debt - DPF management through responsible and transparent implementation of the fiscal policy. Despite international financial market volatility, the Brazilian economy demonstrated that its fundamentals are quite solid and managed to achieve all of the targets stated in the 2007 PAF.

Reflecting the improvement noted in the government's debt profile, coupled with sharp reductions in the major indebtedness indicators and strengthening of external vulnerability indicators, the major international rating agencies revised Brazil's classification upward.

In 2008, PAF strategies and targets will follow the long-term guidelines defined by the National Treasury: gradually substituting floating-rate securities for fixed-rate or inflation-linked securities, while expanding the investor base and developing the interest rate term structure for federal public securities on the domestic and external markets. Particular emphasis will be given to lengthening average debt maturities and smoothing the maturity profile, making it possible to steadily reduce refinancing risk.

**Arno Hugo Augustin Filho
National Treasury Secretary**

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INTRODUCTION

In keeping with public debt management guidelines, particularly with regard to enhanced transparency and foresee ability, the National Treasury presents its Annual Borrowing Plan - PAF for 2008.

The PAF is elaborated on the basis of wide ranging and highly detailed information used to guide strategic Federal Public Debt - DPF planning, in light of the objectives and guidelines defined for implementation of Brazilian public debt policy. This information is utilized to generate prospective scenarios and to elaborate alternative domestic and international market borrowing strategies.

The 2008 PAF is structured into an introduction and four sections. Section 1 presents the objectives and guidelines that orient DPF management, together with the various macroeconomic scenarios used by the National Treasury in elaborating the 2008 borrowing strategy.

Section 2 describes the National Treasury Borrowing Requirements for the 2008 fiscal year, coupled with the adopted strategy consistent with previously determined guidelines and objectives. Following that, detailed information is presented on the results desired for the major DPF indicators. These are expressed in the form of intervals or upper and lower limits within which the major public debt indicators are expected to close 2008.

Section 3 analyzes the risks to which DPF is exposed, while explaining the measures taken to minimize that risk. This analysis includes both refinancing and market risks, in light of expected changes in the public debt structure as presented in Section 2.

Finally, Section 4 discusses specific considerations on the progress already achieved in DPF management, particularly regarding its costs and risks.

I. FEDERAL PUBLIC DEBT PLANNING

I.1. DPF OBJECTIVES AND GUIDELINES

Considering the domestic and external debt for which the Federal Government is liable, the objective of the Federal Public Debt management is **to minimize long-term financing costs, ensuring the maintenance of prudent risk levels and contributing to the well functioning of the public bond market.**

In keeping with this objective and taking due account of market conditions, the general guidelines that orient DPF management are as follows:

- Lengthening of average DPF maturities and reducing the percentage of DPF maturing in 12 months;
- Gradual substitution of floating-rate securities for fixed-rate or inflation-linked securities;
- Improvement of the external debt profile through issuance of benchmark bonds, early redemption program and structured operations;
- Incentives to the development of the term structure of interest rates for federal public securities on domestic and external markets; and
- Expansion of the investor base.

I.2. SCENARIOS

Formulation of the 2008 borrowing strategy incorporated various issuance possibilities, based on the analysis of alternative scenarios, which suggested the upper and lower limits for DPF indicators. The major hypothesis adopted in all of these scenarios was the continued application of current economic policy guidelines, with the corresponding implications for responses to specific shocks.

The baseline scenario is quite close to 2008 market expectations¹ and is based on the premises of no significant external or domestic shocks and continued implementation of current economic policy guidelines or, in other words, fiscal and monetary responsibility, exchange rate stability and structural improvements in the Brazilian economy. This scenario includes growth quite close to the potential GDP, room for further interest rate declines and continued progress under fiscal and external solvency indicators.

On the one hand, alternative scenarios consider the convergence of positive factors that will generate greater space for further domestic interest rate cutbacks, coupled with sustained positive growth and an absence of relevant inflationary and exchange rate pressures, together with a

¹ According to the Market Report released by the Central Bank of Brazil.

continued benign external situation. On the other hand, a scenario was considered that incorporates negative external sector risks capable of reducing the pace of interest rate cutbacks and increasing uncertainties among economic agents. Scenarios of strong shocks or stress situations are not included among those used to define the parameters of this borrowing plan.

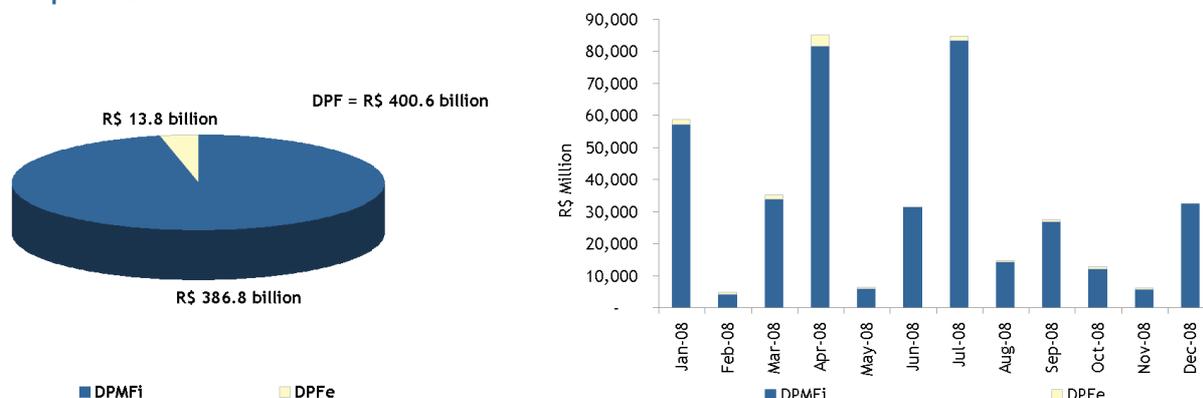
II. 2008 ANNUAL BORROWING PLAN

This section will provide detailed information on domestic and international market borrowing strategies, together with their underlying assumptions. Following that, the quantitative targets for the Federal Public Debt - DPF² will be explained.

II.1. ASSUMPTIONS AND BORROWING REQUIREMENTS

The first factor to be considered in strategy formulation are DPF borrowing requirements for 2008. This amount reflects the maturities of Federal Government debt held by the market projected for 2008, corresponding to approximately R\$ 400.6 billion, of which R\$ 296.7 billion correspond to principal payments and R\$ 103.9 billion to interest payments.

Graph 1. DPF Maturities



Position in 12/31/2007.

Source: National Treasury

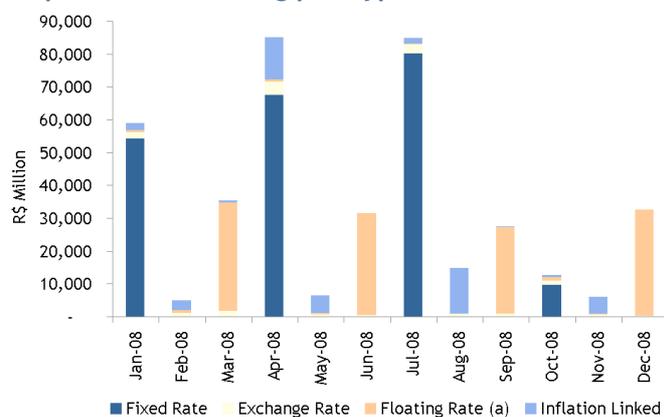
DPMFi maturities in 2008 amount to R\$ 386.8 billion, including R\$ 291.6 billion in principal and R\$ 95.2 billion in interest. It is important to observe that 54.7% of total maturities correspond to fixed-rate securities, which are always concentrated at the beginning of each quarter (see Graph 2). The remainder consists of 32.9% in floating-rate securities (Selic, TR and TJLP), 11.8% in inflation-linked bonds and 0.6% in exchange rate linked securities. The share of inflation-linked bonds in 2008 maturities is well below their participation in the public outstanding debt since their average maturities are considerably greater than overall average DPF maturity.

Among DPFe maturities, corresponding to R\$ 13.8 billion (US\$ 7.9 billion), 82.6% refer to the bonded debt estimated at R\$ 11.4 billion (US\$ 6.5 billion), including R\$ 7.7 billion in interest and R\$ 3.7 billion in principal. The remaining 17.4% correspond to payments of contractual debt, estimated at R\$ 2.4 billion (US\$ 1.4 billion), including R\$ 1.4 billion in principal and R\$ 1.0 billion in interest.

² DPF corresponds to consolidation of the Domestic Federal Public Securities Debt – DPMFi with the External Federal Public Debt – DPFe, including, in the latter case, the Bonded Debt and Contractual Debt. It is important to note that all of the data presented in this document refer to DPF held by the public and do not include the share of DPMFi held by the Central Bank.

With respect to DPFe maturities, it is important to underscore that the Treasury has already bought US\$ 2.3 billion³ in anticipated purchases of dollars, thus reducing the need for acquiring foreign currency to approximately US\$ 5.6 billion. This amount will be acquired on the local exchange rate market or, alternatively, through purchases of international reserves at the Central Bank.

Graph 2. DPFe Maturing per Type of Index



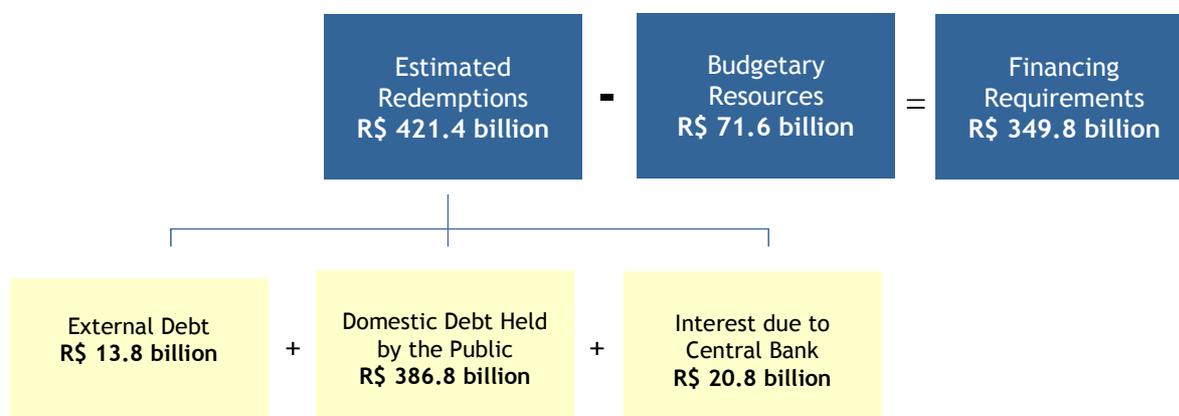
(a) Securities linked to Selic, TR and TJLP rates.

Source: National Treasury

Considering the DPFe maturities of R\$ 400.6 billion, adding R\$ 20.8 billion of charges on National Treasury bonds in the Central Bank's portfolio⁴, and deducting R\$ 71.6 billion of projected budget resources for debt payment, the net National Treasury borrowing requirements comes to R\$ 349.8 billion (Figure 1).

³ Up to December 31, 2007.

⁴ The charges on National Treasury bonds in the Central Bank portfolio, according to the article 39 of Fiscal Responsibility Law, cannot be refinanced with the Central Bank.

Figure 1. National Treasury Borrowing Requirements


Source: National Treasury

II.2. ISSUANCE STRATEGY

Domestic Debt

Issuance strategy for 2008 will follow the guidelines that have been successful in previous years, especially with respect to **lengthening the average DPF maturity** and reducing short-term maturities. Following the example of recent years, this strategy will also focus on issuance of fixed-rate, inflation-linked and floating-rate securities, particularly the first two. This strategy is aimed at continuing the process of expanding the participation of fixed-rate and inflation-linked bonds, while reducing the share of floating-rate bonds and, thus giving continuity to the ongoing process of improving the DPF profile.

Parallel to these goals, the strategy is also focused on developing of the term structure of interest rate for fixed-rate and inflation-linked securities, since these curves are fundamental to guiding market evolution for these specific securities and, in a broader sense, the capital market as a whole.

The National Treasury will also continue its ongoing dialogue with the various financial market segments, while taking other measures aimed at expanding the investor base and ensuring a more adequate supply of public securities.

Fixed Rate Securities

In 2008, the National Treasury will continue its policy of refining the rules for fixed-rate bonds issuance adopted in 2007, focusing on increasing the average issuance maturity of these securities.

In pursuing this objective, it will seek to consolidate the fixed-rate bond issuance structure, targeted to shorter term LTN, with benchmarks of 6, 12 and 24 months, while maintaining 3, 5 and 10-year NTN-F, with the possibility of longer-term operations depending on market conditions.

Inflation Linked Securities

NTN-B, which are indexed to the Broad National Consumer Price Index - IPCA, will play a major role in 2008 issuances. The maturities offered in 2007, with 3, 5, 10, 20, 30 and 40-year terms, will be maintained. Depending on market conditions, new maturity dates may be introduced with the objective of creating additional medium and long-term interest curve points.

Following the basic guideline of lengthening the debt maturity profile, the two-stage auction system will be maintained in public offers of NTN-B, allowing for exchanges of the securities with shorter average terms for others with longer terms in the second stage of the auctions. Floating-rate securities will continue to be accepted as payment for inflation-indexed bonds, thus further contributing to improvement in the DPF profile.

One should highlight that NTN-B issued in 2008 will mature in the month of May for bonds maturing in odd-numbered years, with coupon payment in May and November and maturity in August for bonds maturing in even-numbered years, with coupon payment in February and August. This combination allows for a quarterly flow of payments through association of NTN-B maturities in even-numbered and odd-numbered years.

With regard to NTN-C, which are indexed to the General Price Index Market - IGP-M, there will be no issuance according to the 2008 borrowing strategy.

Floating Rate Securities

Net redemptions of floating-rate securities - LFT are expected, with the new securities issued maturing in the third month of each quarter. The average issuance maturity of these securities is expected to be greater than the average 2007 maturity of DPF (approximately 40 months), thus contributing to reductions in the National Treasury refinancing risk.

External Debt

Federal External Public Debt - DPFe management in 2008 will be targeted at improving the external debt profile, while consolidating the external interest rate curve through maintenance of benchmarks on the major security markets. In doing so, the strategies announced by the National Treasury in August 2006 will continue as the basis for international market operations in 2008. These can be summarized as follows:

- Maintenance of the early security redemption program, together with structured operations, both aimed at correcting distortions in the external interest rate curve;

- Creating and improving benchmarks in the external market interest rate term structure; and
- The total issuance in dollars in 2008 will not be superior to the sum of the external debt principal maturing and the external debt principal repurchased in the early security redemption program.

DPFe management is backed by Federal Senate Resolution no. 20/2004, authorizing early redemption operations, security exchanges and utilization of derivatives for purposes of DPFe management. It is important to state that these operations will be carried out only under favorable market conditions.

Other Measures

Early Redemptions

In order to reduce the concentration of maturities, the National Treasury will continue the early redemptions of short-term securities, together with exchanges of short-term securities for longer-term bonds.

Aside from this, early redemption operations involving medium and long-term securities will continue, while early redemption of NTN-B interest coupons is also possible, if financial institutions express interest in this type of operation. The purpose would be to increase secondary market liquidity for these securities.

Secondary Market

The National Treasury will continue stimulating the development of the secondary market, while seeking to expand the investor base. In this context, it will act together with such institutions as the Central Bank of Brazil - BCB, the Securities and Exchange Commission - CVM, the Complementary Pension Fund Secretariat - SPC and the Private Insurance Authority - Susep, as well as other regulatory agencies, since these institutions play important roles in this process. One should also highlight the ongoing process of improving relations with domestic investors, including pension fund institutions, investment funds, commercial banks and investment banks, insurance companies and capitalization companies. These contacts are made through the entities that represent these market segments, including FENAPREVI, ABRAPP, ANDIMA, ANBID and FENASEG⁵.

Treasury Direct

The National Treasury will continue to stimulate the broadening of the Treasury Direct Program⁶, which, in its sixth year of existence, has over 100.000 registered investors. The exact number of

⁵ National Private Pension Fund Federation (FENAPREVI), Brazilian Association of Closed Pension Fund Institutions (ABRAPP), National Association of Financial Market Institutions (ANDIMA), National Association of Investment Banks (ANBID) and the National Federation of Private Insurance and Capitalization Companies (FENASEG).

⁶ Treasury Direct is a program that allows natural persons to acquire government bonds through the Internet.

102.993 of investors reached at the end of 2007, along with an increase of 28.5% in the outstanding stock between 2006 and 2007, reveal the great energy spent in the disclosure and propagation of this important instrument, that makes access to public debt bonds more democratic. Because of its noble objectives and the significant results, showing its consolidation, the program will enter a new stage in 2008, when the National Treasury will make efforts to increase its distribution and disclosure, through a closer communication with financial agents and improvements in institutional publicity.

BEST Brazil

Efforts made in cooperation with the private sector aimed at disseminating information on the Brazilian financial market abroad and, in this way, refining its operations, will continue as an essential element of the Brazil: Excellence in Securities Transactions - BEST program, together with other institutional initiatives.

II.3. EXPECTED RESULTS

Differently from previous years, the National Treasury will present 2008 projected results, in the form of upper and lower limits, exclusively for DPF data (Table 1). The goal is to provide a clear overview of National Treasury financing policy, which is aimed at achieving full integration between domestic and international market borrowing guidelines and strategies, without in any way limiting the flexibility of that strategy.

DPF data and breakdowns into DPMFi and DPFe can be monitored in the Monthly DPF Report, published according to the schedule announced on the National Treasury website⁷, and in the Annual Public Debt Report, released by the National Treasury.

Table 1. Federal Public Debt Results - DPF

Indicators	2007	PAF-2008	
		Minimum	Maximum
Outstanding (R\$ Billion)			
	1,333.8	1,480.0	1,540.0
Profile (%)			
<i>Fixed Rate</i>	35.1%	35.0%	40.0%
<i>Inflation Linked</i>	24.1%	25.0%	29.0%
<i>Floating Rate</i>	30.7%	25.0%	30.0%
<i>Exchange Rate</i>	8.2%	7.0%	9.0%
<i>Others</i>	1.9%	1.0%	3.0%
Maturity Structure			
<i>Average Maturity (Months)</i>	39.2	42.0	46.0
<i>Percentage Maturing in 12 Months</i>	28.2%	24.0%	27.0%

⁷ http://www.tesouro.gov.br/hp/relatorios_divida_publica.asp

Source: National Treasury

Expected 2008 results also include expectations of securitization of up to R\$ 4.5⁸ billion in contingent liabilities, most of which involve CVS securities⁹. Among the other factors considered are the possible impacts of Central Bank policies on DPF statistics in the framework of monetary and exchange rate policies, open market operations and foreign currency purchases for purposes of international reserve management.

The indicators projected for the end of 2008 are compatible with the Treasury financing strategy, which is aimed at lengthening the average debt maturity, obtaining greater efficiency in its distribution over time, emphasizing issuance of fixed-rate and inflation-linked bonds, with consequent reductions in the proportion of floating-rate bonds.

DPF Outstanding

At the end of 2008, expectations indicate a DPF stock between R\$ 1.48 trillion and R\$ 1.54 trillion, compared to R\$ 1.33 trillion in December 2007.

It is important to stress that a considerable share of the increase projected for the 2008 stock is based on expectations of net issuance of National Treasury securities, resulting in creation of strategic reserves in local currency and in foreign exchange resources and cutbacks in excess market liquidity, without impacting the Net Public Sector Debt¹⁰.

DPF Profile

According to the established guidelines, the participation of fixed-rate securities¹¹ in the DPF stock will rise to between 35% and 40% in December 2008. The share of these securities in DPF stood at 35.1% as of December 2007.

The participation of inflation-indexed securities in DPF is expected to close 2008 between 25% and 29%, compared to 24.1% at the end of 2007.

The limits proposed for the share of floating-rate securities were set at 25% and 30% of DPF, against 30.7% at the end of 2007.

⁸ Amount forecast for 2008 in the Budget Guidelines Law – LDO (Law no. 11,514, dated August 13, 2007), in its appendix on fiscal risks.

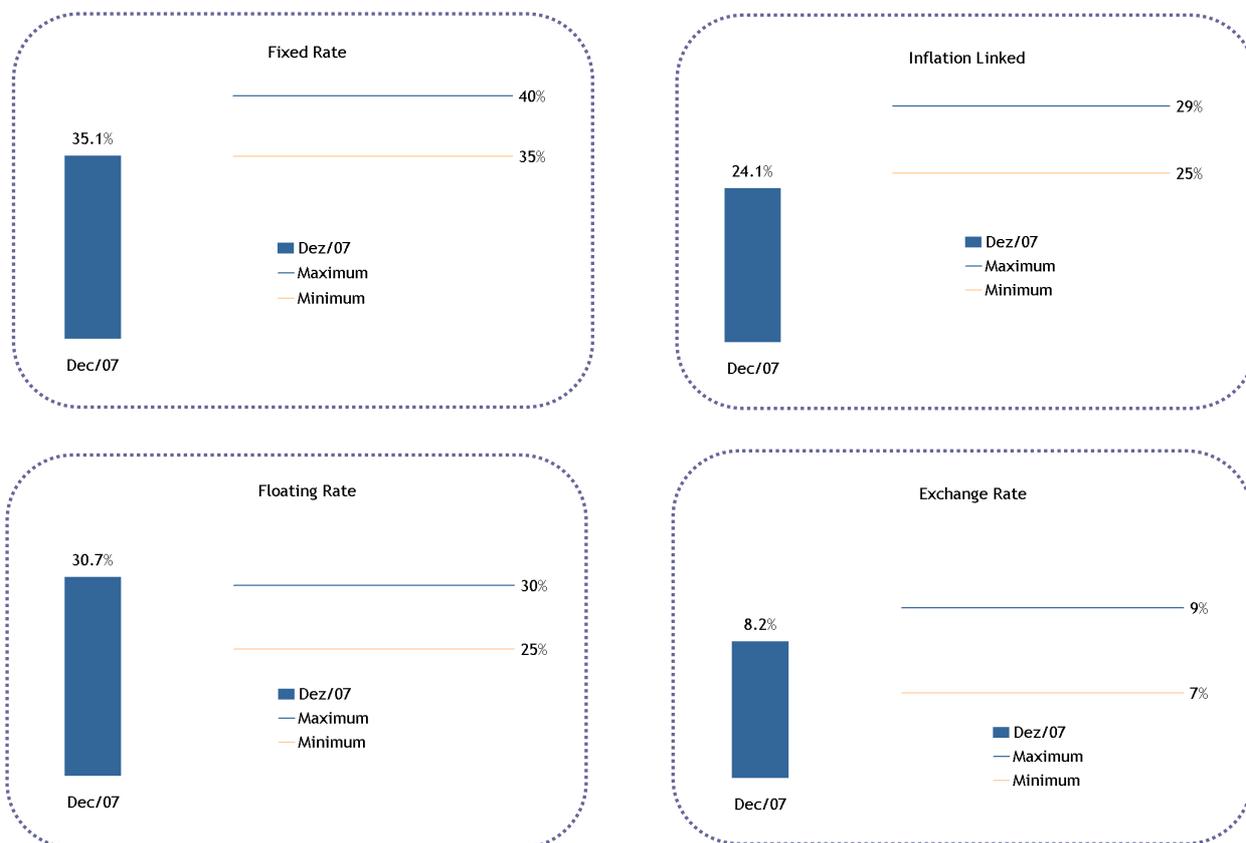
⁹ Securities issued by the National Treasury in the framework of the renegotiation of debts originating in the Wage Variation Compensation Fund – FCVS, remaining after settlement of housing finance contracts.

¹⁰ Indicator used as reference for monitoring fiscal policy sustainability.

¹¹ From the point of view of the DPF profile by indexing factor, securities issued on the external market in BRL are considered fixed-rate securities, since they are issued at fixed-rates with no sensitivity to exchange rate variations.

Finally, the participation of FX-indexed securities in DPF is expected to close 2008 between 7% and 9%, compared to 8.2% in 2007. In this regard, one should underscore the fact that the National Treasury issues FX-indexed securities exclusively on the external market.

Figure 2. DPF Profile - PAF 2008 Limits



Source: National Treasury

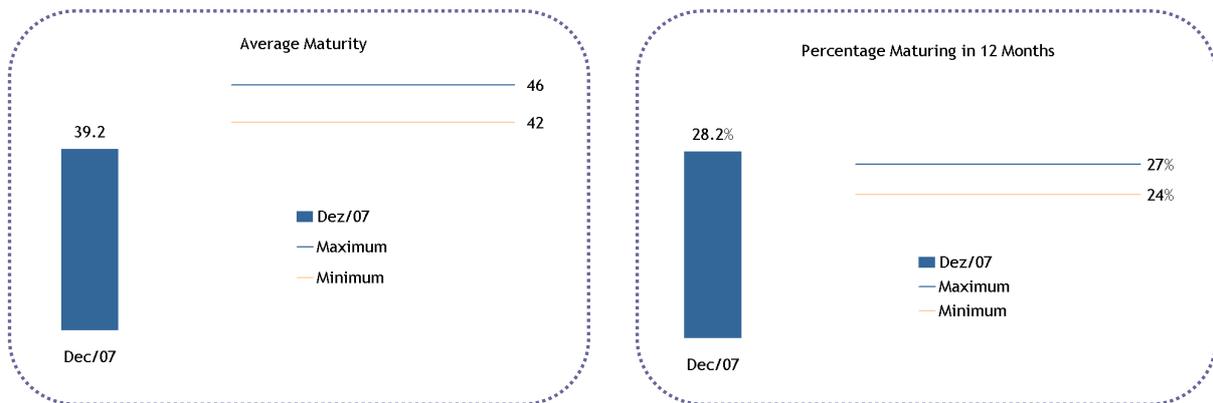
DPF Maturity Structure

The **average maturity of the DPF stock**¹² closed December 2007 at 39.2 months. It is expected that this indicator will close the year between 42 and 46 months. Among the factors contributing to this result, mention should be made of greater participation of inflation-linked bonds and the lengthening of fixed-rate bond maturities.

¹² It is important to note that Average Life, which indicates only the remaining maturity of the public debt principal, without taking interest due into account, is the indicator adopted by many countries in the place of Average Maturity. In this context and in order to provide more homogeneous criteria for purposes of comparison with international statistics, we have stressed that the Average Life of DPF reached 63.7 months in December 2007, as compared to Average Maturity of 39.2 months.

With respect to the **percentage maturing in 12 months**¹³, 2008 projections reflect the efforts made to reduce short-term DPF maturities. The upper limit for this target indicates a decline in the proportion of debt maturing in 12 months over the course of the year, dropping from 28.2% in December 2007 to a figure between 24% and 27% at the close of 2008. Expectations of a rise in the average maturity of the debt and reductions in the percentage maturing in 12 months reflect consolidation of various measures aimed at developing the long-term public securities market, including diversification of the investor base, opening of the capital market to nonresident investors and consolidation of benchmarks for the fixed-rate securities curve.

Figure 3. Concentration of DPF Maturities - PAF 2008 Limits



Source: National Treasury

¹³ It should be stressed that, on calculating the percentage of their debts maturing in 12 months, many countries consider only the flow of principal while excluding interest due, without updating this flow to current value. In order to gain a clearer perception of methodological differences and provide more homogeneous criteria for purposes of comparison with international statistics, if we were to adopt that measurement, the percentage maturing in 12 months would drop from 28.2% to 22.2% in December 2007. Parallel to this, the percentage maturing in up to two years would shift from 49.5% to 39.9%. Consequently, the percentage maturing in more than two years would be 62.4% and not 51.0%.

III. DPF RISK ASSESSMENT¹⁴

When one considers that the main objective of DPF management is to minimize long-term financing costs while ensuring prudent risk levels, permanent evaluation and monitoring of risk exposure play a fundamental role in strategic public debt planning. In this framework, this section will describe the principal risks¹⁵ that are constantly assessed and for which the National Treasury has developed mitigation strategies.

III.1. REFINANCING RISK¹⁶

Refinancing risk is understood as the possibility of the government having to bear high costs in order to finance its operations or, in an extreme case, of not being able to honor its obligations. This risk is associated to the public debt maturity profile, as well as to its sensitivity to shocks in economic variables. Evaluation of this risk utilizes such indicators as percentage maturing in 12 months, average maturity and volatility measurements of the expected payments by the Cashflow-at-Risk (CfaR) technique¹⁷.

An analysis of the DPF maturity structure (Graph 3) shows that the debt maturing in 12 months declined in the period extending from 2005 to 2007, both as a proportion of GDP and as a percentage of total debt. The reduction in short-term maturities can be viewed as the principal sign of the falloff in refinancing risk. In keeping with the guideline of steadily improving maturity structure indicators, one can also observe a reduction in the percentage of debt maturing in up to 2 years, with the consequent increase in the percentage maturing in more than two years. Analysis further demonstrates that the financing strategy forecast for 2008 follows the same lines and is expected to further reduce refinancing risk.

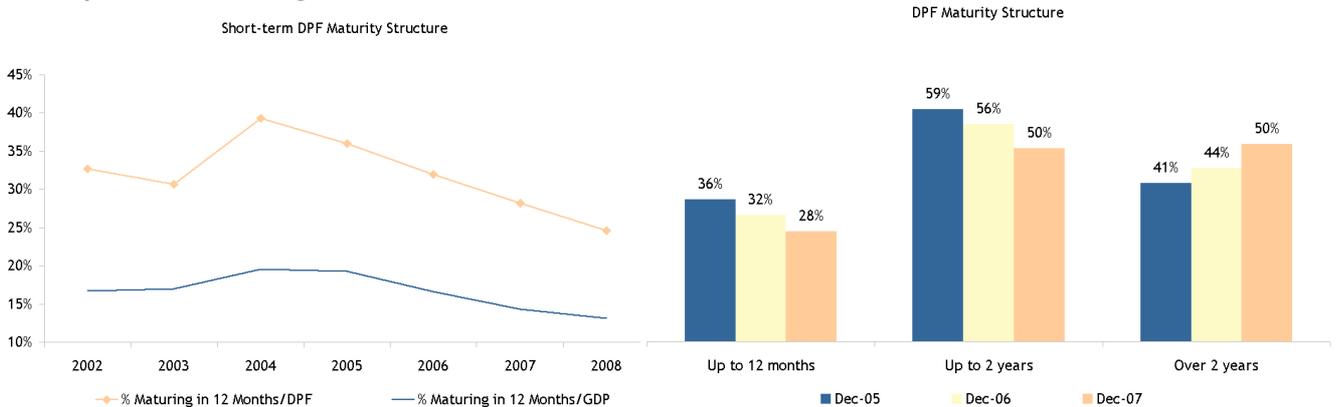
¹⁴ In this chapter, the midpoint of the indicative limits in this PAF is utilized for purposes of calculating 2008 indicators.

¹⁵ Aside from refinancing and market risks which are carefully analyzed in this chapter, operational risk, credit risk and legal risk are also considered relevant to public debt management.

¹⁶ All of the debt payment flows, including principal and interest, updated to present value by the respective domestic rates of return (at issuance of each security) are considered for all the refinancing risk indicators presented in this chapter, as well as for DPF statistics. This methodology makes it possible to correctly analyze and monitor DPF refinancing risk.

¹⁷ Additional information of importance to analyzing refinancing risk includes budget resources available exclusively for DPF payments (known as the "liquidity cushion"). In the Brazilian case, the strategy adopted since 1998 consists of permanently maintaining resources equivalent to at least three months of DPF maturities in the "cushion".

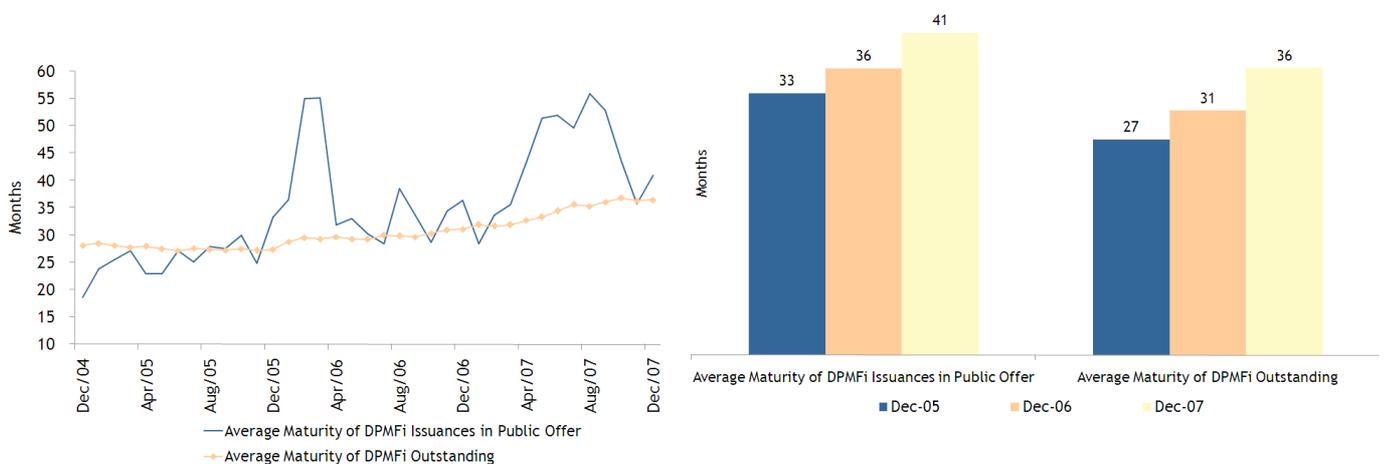
Graph 3. Refinancing Risk



Source: National Treasury

One of the factors that has contributed to reducing short-term maturities is lengthening of the average DPF maturity. In the graphs below, one observes that public securities in DPMFi¹⁸ have been issued with terms longer than or quite close to the average maturity of the outstanding debt at the moment of issuance, thus generating a permanent process of lengthening that indicator.

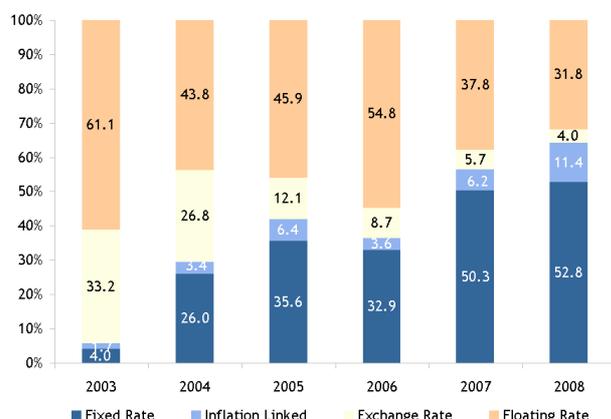
Graph 4. Average Issuance Maturity vs Average Maturity of the DPMFi Stock



Source: National Treasury

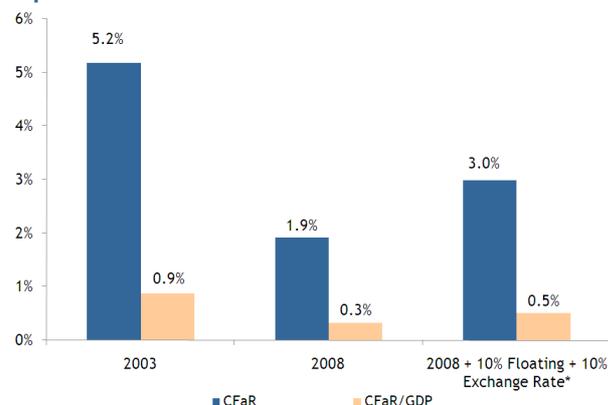
Aside from the reduction in the proportion of short-term debt maturities, evolution of the maturity profile has also contributed to reducing risks. In this sense, the increase in fixed-rate debt, coupled with the reduction in floating-rate debt and, principally, FX-indexed debt, have resulted in lesser volatility in debt flows maturing in 12 months. As shown in Graph 5, less than 5% of short-term DPF maturities in 2003 corresponded to fixed-rate securities, compared to a level that should reach approximately 53% in 2008.

¹⁸ DPMFi represents more than 90% of the DPF stock on the market.

Graph 5. Short-Term DPF Maturity Profile by Type of Index


Source: National Treasury

The reduction in the volatility of DPF maturities resulting from changes in its composition can be measured through the use of relative Cashflow-at-Risk (CfaR)¹⁹, presented in Graph 6. This is an indicator of the magnitude of deviations in the the expected value of debt maturities, consequent upon stochastic shocks on interest rates, exchange rates and inflation, given a specific level of statistical significance of these shocks occurring.

Graph 6. Relative Cashflow at-Risk of DPF


* Considers the 2008 maturity profile for Floating and Exchange Rates plus 10 percentage points.

Source: National Treasury

Relative CfaR analysis demonstrates that one of the benefits of increased participation of fixed-rate securities in DPF is the curbing of volatility in maturities, meaning that the National Treasury will not only be less exposed to the effects of fluctuations in such variables as interest and exchange rates, but will also have a higher level of predictability in calculating borrowing requirements for each financial year.

¹⁹ This exercise consists of stimulating the distribution of probabilities of these maturities at the end of each month of 2008 for each hypothesis of the DPF maturity profile, based on stochastic scenarios for interest, exchange and inflation. Total benchmark maturities is the amount currently projected to mature in 2008 (R\$ 400.6 billion). The volumes of maturities of each group of securities (fixed-rate, floating-rate, inflation-linked or FX-variations) are calculated according to their participation in DPF maturities in each year, as shown in Graph 5.

Estimated relative CfaR for 2008 is in the range of 2% per year (equivalent to 0.3% of GDP). This figure would rise to 3% if 2008 maturities hypothetically encompassed 32.8% in fixed-rate securities instead of the current level of 52.8%, with increases in the participation of floating-rate securities from 31.8% to 41.8% and of FX-indexed securities from 4% to 14%. As another reference point, if the maturity profile were equal to that registered in 2003, with 61.1% in floating-rate securities and 33.2% in FX-indexed securities, the relative CfaR would be 5.2% per year (0.9% of GDP). In other words, the risk of fluctuations in DPF maturities would be 2.7 times greater with the 2003 profile, compared to the current maturity structure.

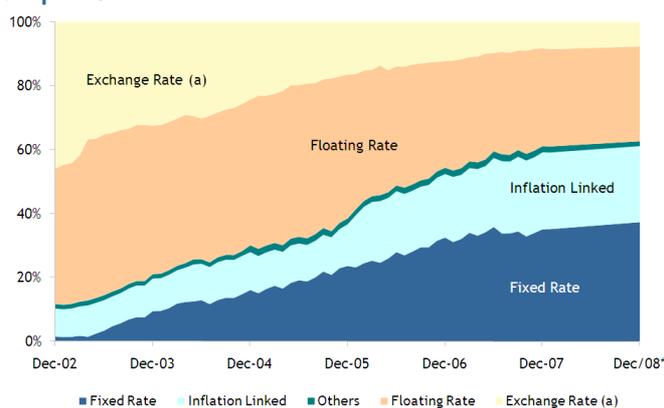
Other factors that have contributed to lesser refinancing risk are maintenance of comfortable liquidity cushion balances and management of foreign currency liabilities. With respect to the latter point, it is important to underscore that, since 2006, the National Treasury has carried out an early redemption program involving a share of the external debt maturing between 2006 and 2040, thus smoothing the DPF maturity profile²⁰.

III.2. MARKET RISK

Market risk results from changes in the financing costs of public securities resulting from changes in short-term interest rates, exchange rates and inflation or in the interest rate term structure. Since each type of National Treasury security reacts in a specific way to changes in these factors, the public debt composition is considered one of the most significant parameters for purposes of market risk management.

Public debt market risk has diminished substantially as a consequence of changes in the DPF composition, in the sense of increasing the DPF share of fixed-rate and inflation-linked bonds. In 2002, the sum total of fixed-rate and inflation-linked corresponded to 10.3% of the DPF, compared to 59.2% in December 2007. At the end of 2008, this share is expected to rise to a record level of 69% of DPF.

Graph 7. DPF Profile



* The 2008 projected composition is estimated as the midpoint value of the target ranges of the PAF 2008.

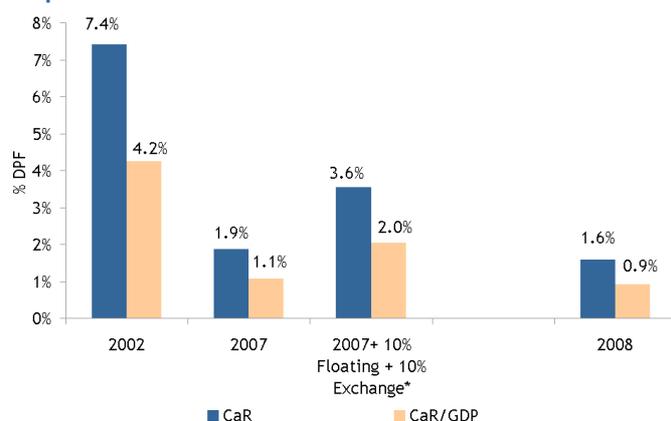
²⁰ The volume repurchased in 2006 came to US\$ 6.0 billion, compared to US\$ 5.4 billion in 2007.

(a) Sovereign foreign-currency external debt and NTN-D exchange rate linked domestic debt. The BRL bonds issued in external markets are not included, which are part of the fixed rate share.

Source: National Treasury

Graph 8 presents the results of the relative Cost-at-Risk (CaR)²¹ utilized here in order to measure the reduction in market risk generated by improvement in the DPF profile. Relative CaR is an indicator of the volatility of the value of the DPF stock which seeks to determine how much the outstanding debt can exceed its expected value in a specific year, given a level of statistical significance²², due to fluctuations in the economic variables that define the cost of that debt.

Graph 8. Relative Cost-at-Risk of DPF



* Considers the 2007 share for Floating and Exchange Rates plus 10 percentage points.

The 2008 projected composition is estimated as the midpoint value of the target ranges of the PAF 2008.

Source: National Treasury

As the simulations demonstrate, the greater the participation of floating-rate debt, particularly the Selic-indexed debt and the exchange rate-indexed debt, the greater the relative CaR will be. In hypothetical terms, if the DPF profile at the end of 2007 had shown 15.1% in the participation of fixed-rate securities instead of the current level of 35.1%, with an increase in the weight of the share indexed to the Selic rate from 30.7% to 40.7% and of that indexed to exchange from 8.2% to 18.2%, the relative CaR would be almost twice the current level, increasing from 1.9% of DPF (1.1% of GDP) to 3.6% of DPF (2.0% of GDP).

This demonstrates the importance of debt composition with respect to managing the risks of abrupt increases in the DPF stock. In this regard, viewed under the prism of CaR, one notes that exposure

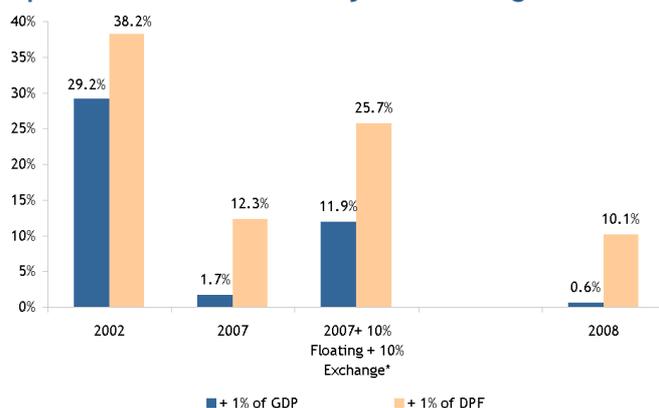
²¹ Based on stochastic scenarios for interest rate, exchange rate and inflation, this exercise consists in simulating the distribution of probabilities of the value of this outstanding debt at the end of 2007, for each DPF profile hypothesis. The initial stock of each group of securities (fixed-rate, floating-rate, price-linked or FX-indexed) is given in terms of its participation in DPF in each year (for 2008, the midpoint of the indicative limits of the PAF is utilized). The total reference stock is that observed at the end of 2007 (R\$ 1,333.8 billion).

²² The relative CaR presented in this document is defined as the ratio between 99% (level of significance of 1%) and the average of the simulated distribution for the DPF stock value at the end of one year.

to market risk has been declining systematically in recent years. If the DPF profile were equal to that registered in 2002, relative CaR would be substantially greater than in 2007, rising to 7.4% of DPF (4.2% of GDP). With the debt structure projected for end-2008, this indicator is expected to decline to 1.6% of DPF (0.9% of GDP).

The following graph shows the probabilities of an increase greater than the average projected DPF cost equivalent to 1% of GDP and to 1% of DPF, as a result of each year's composition. Just as occurred when viewed under the prism of relative CaR, analysis of this graph reveals that the greater the proportion of floating-rate DPF, the greater will be the chances of interest and exchange rate shocks substantially increasing DPF costs. This further strengthens evidence that, to the extent that the DPF composition involves greater participation on the part of floating-rate or inflation-linked bonds in total volume, the risk of shocks to the debt stocks declines as would happen if DPF had remained at the same composition as in 2002. Market risk measured by these probabilities would be significantly greater for the composition observed in 2002, compared to the risk implicit in the composition projected for the end of 2008.

Graph 9. Variation in the Projected Average DPF Cost vs Probability of Occurrence



* Considers the 2007 share for Floating and Exchange Rates plus 10 percentage points.

The 2008 projected composition is estimated as the midpoint value of the target ranges of the PAF 2008.

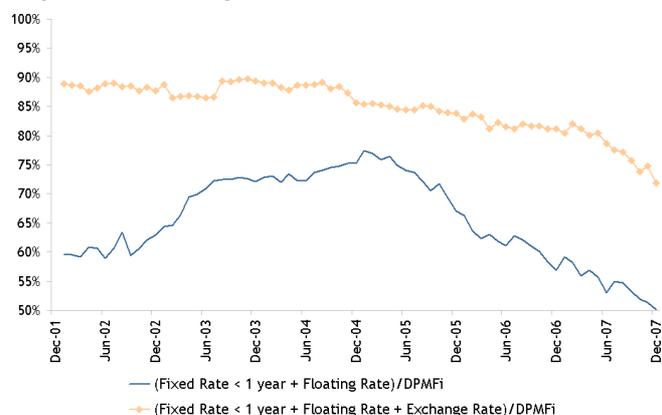
Source: National Treasury

At the same time, if we were to adopt the sum of the floating-rate debt and fixed-rate debt with maturity of less than one year as a conservative indicator for the risk of interest rate fluctuations, we would observe that, even in this more rigorous approach to risk evaluation, Treasury exposure has diminished since early 2005, as shown in Graph 10. This movement is also observed for the sum of the Selic rate-indexed debt, the fixed rate debt with maturity of less than one year, and the FX-indexed debt. The results of this graph demonstrate that the Treasury has implemented a composition change with the benefits of reducing market risk, though this process initially meant growth in the concentration of some short-term securities, such as fixed-rate bonds.

Furthermore, if one were to adopt the sum of Selic-indexed and fixed rate debt maturing in less than one year as a conservative indicator for the risk of interest rate fluctuations, we would observe that, despite the more rigorous risk assessment approach, Treasury exposure has diminished since early 2005, as shown in Graph 10. This decline is also noticed if we add to this indicator the exchange rate-indexed debt. These results argue that the National Treasury has made

changes in the debt composition and reduced market risk but, initially, it meant concentrating maturities in the short-term.

Graph 10. Floating-Rate Risk



* This sensitivity analysis does not include the inflation linked bonds because of their high average maturity (approximately twice the total debt average maturity) and reduced percentage maturing in 12 months.

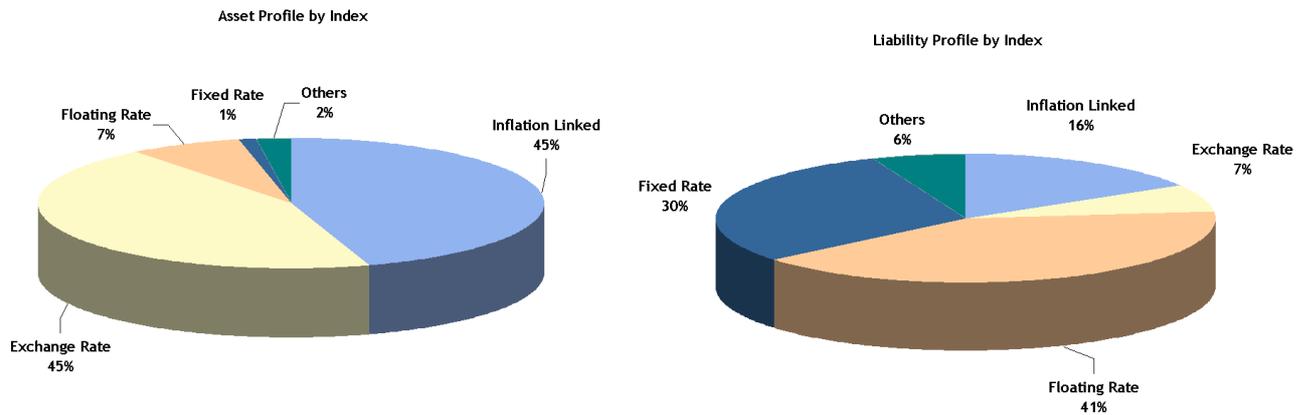
Source: National Treasury

Asset and Liability Management

The targets proposed in the 2008 PAF will also improve the Central Government’s financial asset and liability structure, aiding in further reducing vulnerability to macroeconomic shocks.

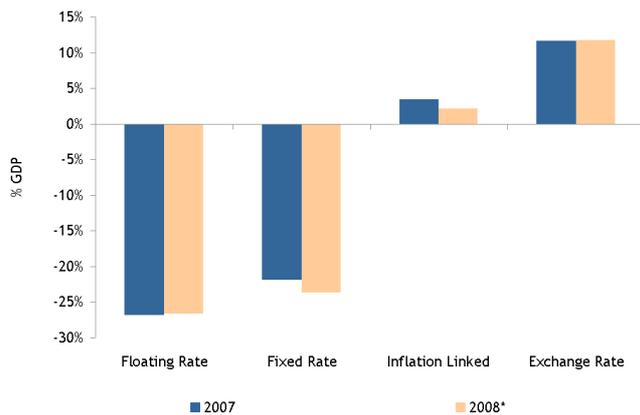
With respect to Central Government assets, they are strongly tied to inflation and exchange rate indices. In the case of assets indexed to exchange rate, the most important items are the international reserves, plus the active part of exchange rate swaps. Regarding price indices, the most representative items are renegotiations carried out with states and municipalities (Law 9,496/97, Law 8,727/93 and Provisional Measure 2,185/01).

In the case of liabilities, those tied to floating rate (Selic, TR and TJLP) have the highest share in total government liabilities. However, if we were to add fixed-rate liabilities and inflation-indexed liabilities that make the greatest contribution to immunizing the balance to long-term shocks, the total would be greater than the amount indexed to interest rates. The most representative liability accounts are National Treasury bonds (LFT, NTN-B, NTN-F and LTN), repo operations, the monetary base and the Other Deposits account at the Central Bank which basically concentrates the reserve requirements maintained by financial institutions.

Graph 11. Central Government Asset and Liability Profile - December 2007


Source: National Treasury

With regard to Central Government asset and liability mismatches, the targeted composition projects an increase in fixed-rate liabilities in 2008, together with reductions in net floating rate and exchange rate liabilities, coupled with falloffs in net price-indexed assets.

Graph 12. Central Government Asset and Liability Mismatches as a Ratio of GDP


* The 2008 projected composition is estimated as the midpoint value of the target ranges of the PAF 2008.

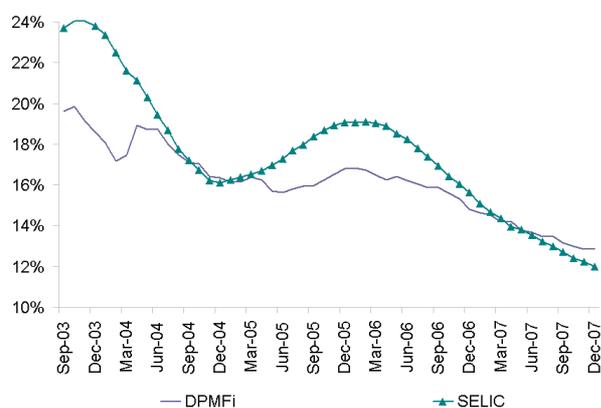
Source: National Treasury

IV. FINAL CONSIDERATIONS

In the previous section, we analyzed some of the main risks that impact the elaboration of the National Treasury borrowing strategy. However, risk is just one of the aspects that must be considered in choosing the best strategy. Another important aspect is the impact of the adopted strategy on DPF financing costs. Over the short-term and whenever the scenario does not include the possibility of unexpected shocks, the choice of strategies that results in a higher level of fixed-rate debt together with longer maturity terms tends to result in higher costs than in the case of strategies that maintain the debt concentrated in the short-term or in securities that are more sensitive to macroeconomical changes. For this reason, the National Treasury must remain attentive to DPF costs so as to certify that these costs are compatible with the protection (risk-insurance) obtained.

Since the average cost of the fixed-rate debt already included in the stock does not change over the short-term, it is natural that greater participation of fixed-rate securities will generate greater inertia in the average costs of the debt in moments of interest shocks. This inertia will be greater to the extent that the participation and average maturities of the fixed-rate share in the stock increase, since its cost will tend to come closer to the SELIC rate as this amount is refinanced. Thus, the increase in the participation of fixed-rate securities in the debt means that, in periods of declining interest rates, the average cost of DPMFi shows a lesser rate of reduction than in the case of floating-rate debt. On the other hand, during cycles of rising rates, the speed of the increase in average DPMFi costs will be less than the Selic rate increase. As a matter of fact, the behavior of average DPMFi costs in recent years is quite useful to illustrate the dynamics of this process, as is shown in the following graph.

Graph 13. Average Cost of DPMFi vs the Selic Rate, 12 Month Cumulative Result



Source: National Treasury

It is evident that the definition of a public debt financing strategy involves choices regarding the balancing of expected costs and risks that can result from specific debt structures. In this sense, the debt manager must define the profile desired for the long-term public debt, based on the most efficient cost/risk relation, in such a way that borrowing will generate the least possible burden without, however, aggravating uncertainties in the results.

Following the example of what occurred in the previous year, the 2008 PAF adopts a structure based on the analysis of the trade-offs between costs and risks that impact the public debt. This has been done through the optimal long-term benchmark model²³ for DPF developed by the National Treasury. The advances represented by this model are essential to refining the process of medium and long-term planning and definition of short-term strategies.

Considering DPF objectives and guidelines, as well as the orientation suggested by the model mentioned above, one can affirm that the targets presented in this PAF are consistent with gradual movement in the direction of a debt composition capable of ensuring steady and continued downward movement in financing costs in the coming years, a factor of highest importance to fiscal results. At the same time, the minimization of these costs is sought without increasing current DPF exposure to the effects of unexpected macroeconomic shocks and short-term financial market volatility.

²³ The benchmark is an optimal long-term debt structure that guides short and medium-term financing strategies and constitutes an important DPF risk management and strategic planning tool.