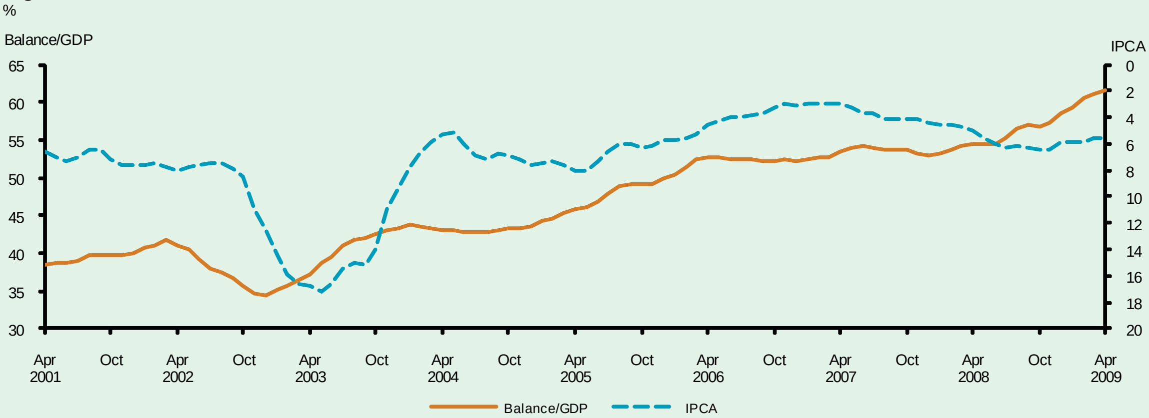
Recent Developments of Key Financial Investments

The main of financial investment available in the domestic market – savings accounts, investment funds and time deposits – have been posting altogether a significant expansion of inflows in recent years, movement associated, especially, with the increasing macroeconomic stability. The evolution of these investments, expressed as a proportion of GDP, is in Figure 1, which shows both the decline recorded in the second half of 2002, in response to the instability related to political transition, and the cooling observed from July 2007 associated with the impact of the subprime crisis in the U.S.

Figure 1 – Financial investments – Balance/GDP



The evolution of the balances and net borrowings of the three financial investments (Figures 2 and 3) clearly expresses the impact of financial instability, as well as institutional factors that determine significant moves by investors. The most significant event in this regard was the establishment of reserve requirements on interbank deposits from leasing companies in January 2008, through Circular no. 3,375, which aimed to match the fundraising by such companies, through the issuance of debentures to time deposits, in respect to the levying of gatherings. This measure prompted the gathering of CDBs (Bank Deposit Certificates), from March 2008, which accumulated the expansion of 97.4% during the two years period ended in May 2009, totaling R$300.9 billion.

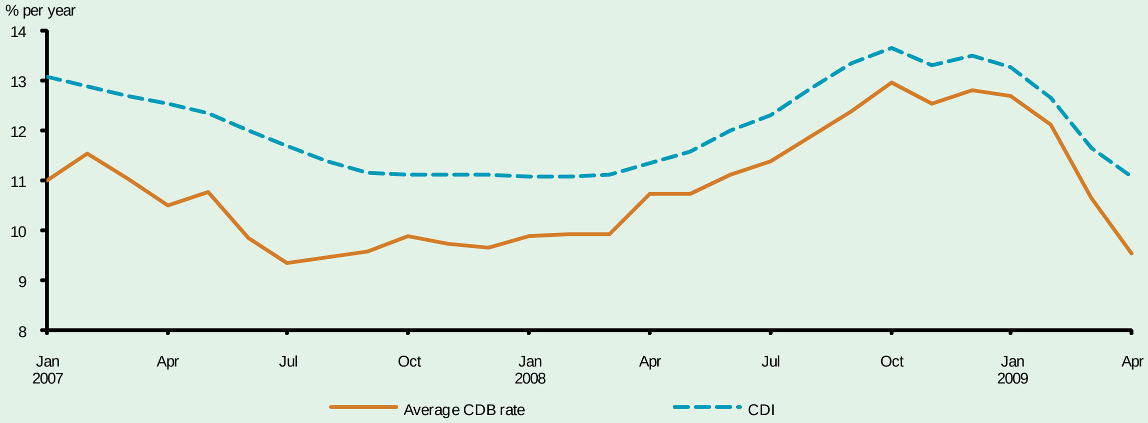
Figure 2 – Financial investments – Balances
R$ billion

Figure 3 – Financial investments – 12-month accumulated net flows
R$ billion

The funding inflow requirements by the banking system in an environment of greater resource scarcity, and until September 2008, strong credit growth, required an increased CDB's earnings rate, which were very close to the rate of CDBs between March 2008 and February 2009. However, the successful measures taken by the Central Bank as of September 2008, aiming at providing liquidity to markets, facilitated the decline of the average funding cost to 9.5% per year in April, a level lower than the one recorded in the end of 2007 (Figure 4).

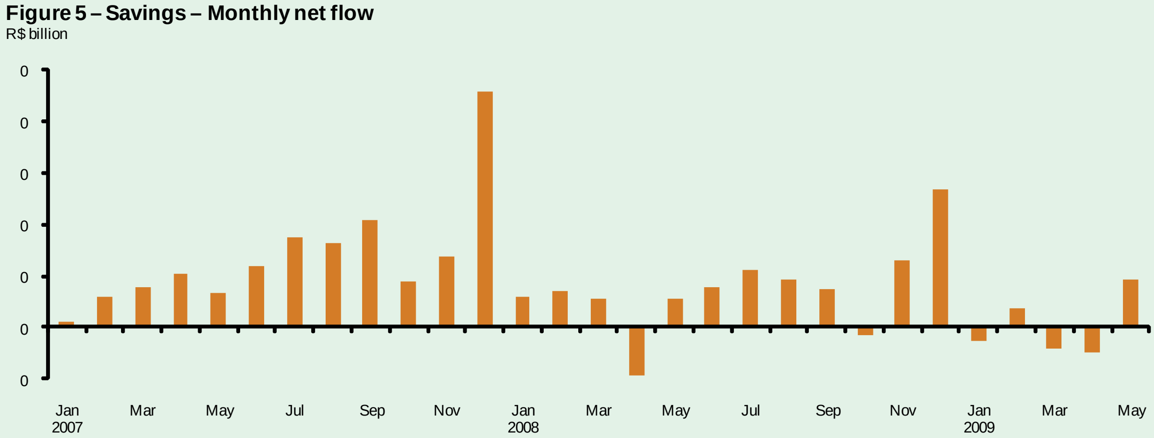
Deposits in savings accounts grew 39.3% between May 2007 and May 2009, a period during which the net inflows totaled R$45.1 billion (Figures 2 and 3). In 2009, net outflows recorded in January, March and April were offset by net inflows of R$1.9 billion in

Figure 4 – CDBs – Yield



May. This resulted in a net inflow of R$357 million in the first five months of the year. The series of monthly net flows confirms the stability of growth of savings deposits, which was interrupted only in April and October 2008 and, due to the effects of the slowdown in the economic activity level in early 2009 (Figure 5). Accordingly, the expected economic recovery should result in continued growth trend of deposits, which, moreover, tends to be stimulated by a favorable profitability from savings in the current outlook of monetary policy. Given the current unprecedented level of interest rates, major changes in borrowings of various instruments can occur and should be closely monitored by authorities.

Figure 5 – Savings – Monthly net flow



Investments in investment funds, including fixed income, short-term, foreign exchange, multimarket and referenced funds, evolved in the opposite direction, accumulating net outflows totaling R$75.2 billion between March 2008 and February 2009, which resulted in an expansion of only 12.2% in its consolidated net worth. The expansion of the balance, despite the negative net flow is explained by the incorporation of profitability to the amounts invested. The negative net inflow was due to the expansion of the uncertainties perceived in financial markets, which resulted in the search for applications with greater predictability regarding their remuneration. Throughout 2008, the biggest losses occurred in fixed-income funds and in hedge funds, a segment that tends to provide larger variations in its profitability as a result of greater diversity of assets that comprise their portfolios. From January 2009, however, the net flow of investment funds became positive, driven by recoveries of fixed-income funds, short-term and multimarket funds (Figures 6 and 7).

Figure 6 – Investment funds – Monthly net flows

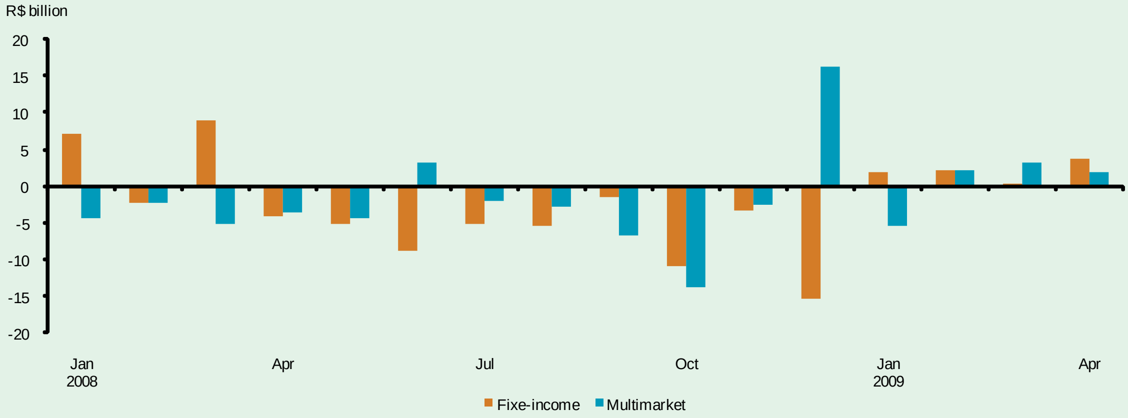


Figure 7 – Investment funds – Monthly net flows

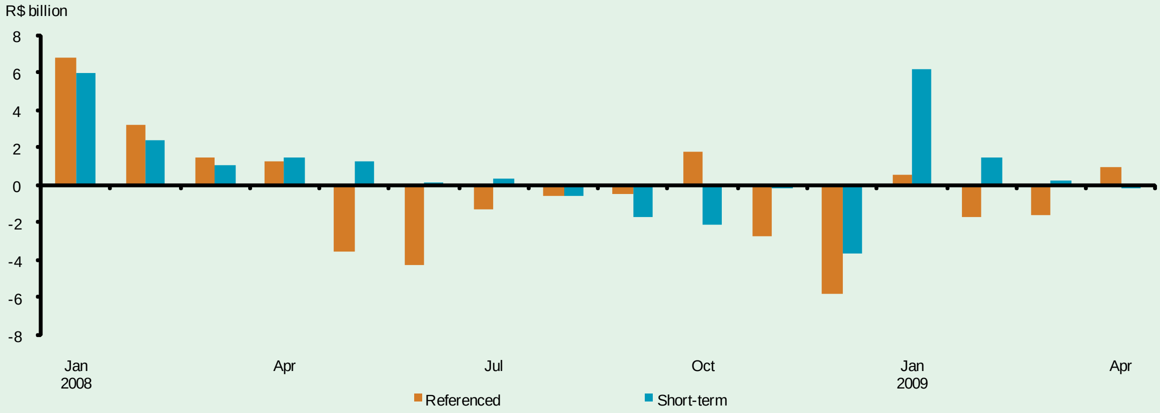


Figure 6, which has a time span that covers both the moment of euphoria as a result of granting the degree of investment to Brazil and the worsening of the international financial crisis, shows net redemptions in fixed-income funds and multimarket funds in almost all the months in 2008. In cumulative terms for the year, a combination of factors involving the relative attractiveness of other financial investments, especially of time deposits, besides fluctuations in preference for liquidity and uncertainties, have contributed to the occurrence of net redemptions of R$46 billion and R$28.7 billion, respectively, in these two asset classes. The other classes of funds did not display the same uniform behavior throughout the year. In early 2008, growing uncertainties increased the demand for quotas of referenced funds and short-term funds. This scenario was reversed in recent months, during the most critical period of the international crisis, due to the renewed expansion of instability in the financial markets (Figure 7).

Stock funds have accumulated a net inflow of R$26.6 billion between May 2007 and May 2009, reaching a balance of R$129.5 billion. This form of investment received large inflows of resources in the first half of 2008, being highlighted the monthly net inflow of R$4.7 billion in June, following the announcement of investment grade for Brazil (Figure 8). In the second half-year, despite the unfavorable performance of the stock market, there was the occurrence of massive withdrawals of these investments. This fact demonstrates the maturity of the Brazilian investors who avoid making investment decisions based solely on very short-term scenarios.

Figure 8 – Stock funds – Monthly net flows