Credit, monetary and fiscal policies

3

Table 3.1 – Credit operations

R$ billion

Itemization	2009				% growth	
	Jan	Feb	Mar	Apr	3 months	12 months
Total	1 229.4	1 229.1	1 242.7	1 249.0	1.6	22.7
Nonearmarked	871.5	866.8	875.8	878.8	0.8	21.2
Earmarked	357.9	362.3	366.9	370.1	3.4	26.4
% participation:						
Total/ GDP	41.5	41.9	42.6	42.8		
Nonearmarked/GDP	29.4	29.5	30.0	30.1		
Earmarked/GDP	12.1	12.3	12.6	12.7		

Figure 3.1 – Credit by capital control of financial institutions
% of balance

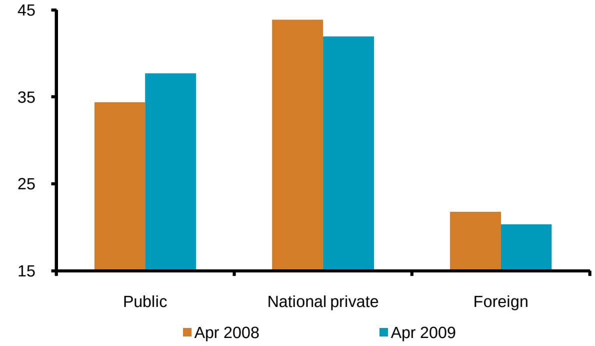
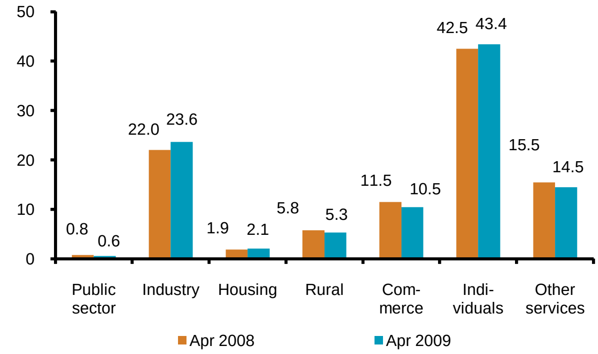


Figure 3.2 – Credit by borrower's economic activity – National private institutions
%



3.1 Credit

In the 3-month period ended in April, the credit growth was still conditioned by the pace of economic activity. Accordingly, the demand for credit by corporations reflected the scenario of uncertainties associated with the recession observed particularly in mature economies, as well as the recent retreat in the level of capacity utilization in the country. It also reflected the seasonality of the period, expressed in the accommodation of hirings by the trade segment. On the other hand, household demand registered a gradual recovery, driven by the trajectory of the payroll-deducted loans and purchase of vehicles modalities. Earmarked credit operations, notwhithstanding the slowdown observed in comparison to the previous 3-month periods, driven by home financing, showed a more enhanced dynamics in comparison to those contracted in the segment of nonearmarked resources.

In this environment, the financial system loans, including earmaked and nonearmarked resources, totaled R$1,249 billion in April, increasing 1.6% from January and 22.7% in twelve months. The credit/GDP ratio reached 42.8%, rising 1.3 percentage points in the period and 7 percentage points compared to April 2008.

With regard to the distribution of credit according to the capital control of financial institutions, the share of public sector banks moved upward, accounting for 37.7% of the total in April, compared to 36.5% in January and 34.4% in the same period of 2008. The participation of national private institutions reached 41.9% and that of foreign banks, 20.4%, compared to 42.7% and 20.8%, in January, and 43.9% and 21.7% in April of the previous year.

The balance of loans granted to the private sector, considering earmarked and nonearmarked resources, totaled R$1,221 billion in April, increasing 1.6% from January and 22.2% over the same period in 2008. Loans granted to the industry, driven by the buoyant segments of energy,

Figure 3.3 – Credit by borrower's economic activity – Public institutions

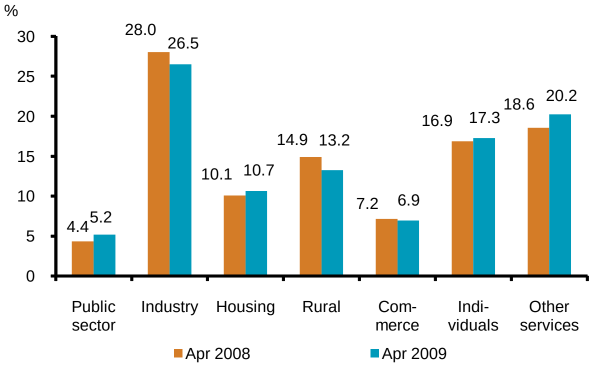


Figure 3.4 – Credit by borrower's economic activity – Foreign institutions

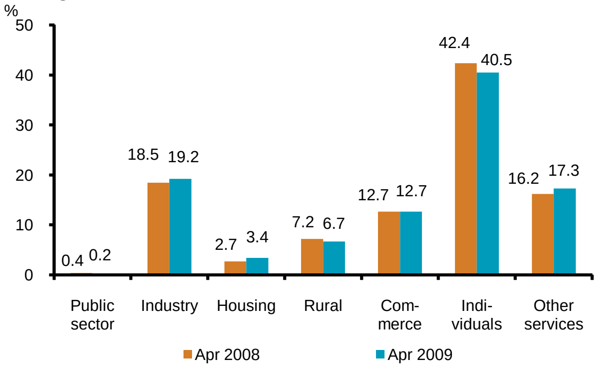


Figure 3.5 – Provisions of total financial system credit

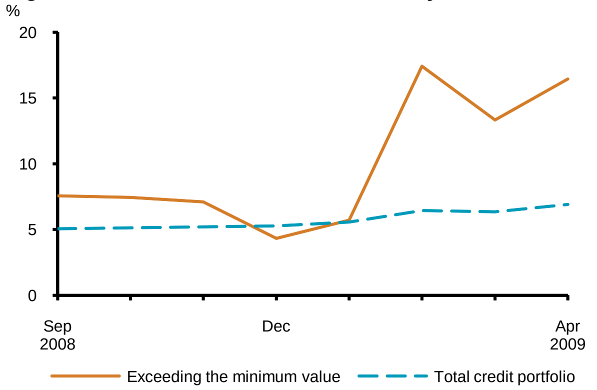


Table 3.2 – Earmarked credit operations

R$ billion

	2009				% growth	
	Jan	Feb	Mar	Apr	3 months	12 months
Total	357.9	362.3	366.9	370.1	3.4	26.4
BNDES	209.9	212.6	215.4	216.5	3.1	27.3
Direct	108.1	110.7	112.7	112.5	4.1	37.0
Onlendings	101.9	102.0	102.7	104.0	2.1	18.3
Rural	78.2	78.1	78.2	78.6	0.5	14.9
Banks and agencies	73.2	73.1	73.2	73.4	0.3	13.8
Credit unions	5.0	5.0	4.9	5.2	4.8	34.4
Housing	60.9	62.6	64.1	65.7	8.0	40.2
Others	8.9	9.0	9.2	9.3	5.2	23.5

chemicals and agribusiness, increased 1.1% in the period, reaching R$297.4 billion. Conversely, the operations related to the sector of trade and services decreased by 2.3% and 2.1%, amounting to R$119.8 billion and R$215.1 billion, respectively.

Financing to the public sector totaled R$28.3 billion in April, an increase of 2.4% in the 3-month period and 45.2% in twelve months. The federal government's bank debt decreased by 0.6% in comparison to January, to R$9.5 billion, while the portfolios referring to states and municipalities, reflecting the contracts of the sectors of housing, transportation and energy, with resources from the Employment Guarantee Fund (FGTS), grew 3.9%, to R$18.8 billion.

The amount of provisions set aside by the financial system totaled R$85.7 billion in April, representing 6.9% of the total portfolio, compared to 5.5% in January and 5.4% in the same period in 2008. The default rate of the financial system loans, related to delays of more than ninety days, closed at 4%, registering variations of 0.7 percentage points in the 3-month period and 0.9 percentage points in twelve months.

Credit operations with earmarked resources

The balance of loans in the segment of earmarked resources totaled R$370.1 billion in April. Expansions in the 3-month period, 3.4%, and in twelve months, 26.4%, reflected increases of 8% and 40.2% in the housing segment. The balance of operations of the Brazilian Bank for Economic and Social Development (BNDES) totaled R$216.5 billion, a growth of 3.1% in the 3-month period and 27.3% in twelve months.

Rural credit operations, except those performed by the BNDES, totaled R$78.6 billion in April, rising 0.5% in the 3-month period and 14.9% in twelve months. The participation of funds related to agricultural investments, funding and marketing operations reached, in the order, 48.6%, 42.1%, and 9.3% of the total, remaining at the same level observed in January.

Housing loans amounted to R$65.7 billion in April, rising 8% in comparison to February and 40.2% in twelve months. Disbursements carried ou with funds from savings accounts reached R$5.8 billion in the quarter ended in March, increasing 32.3% over the same period in 2008. This expansion was associated with a 43.7% increase observed in the financing granted in the framework of

Figure 3.6 – Credit to housing with resources from saving deposits – From Dec/2008 to Feb/2009

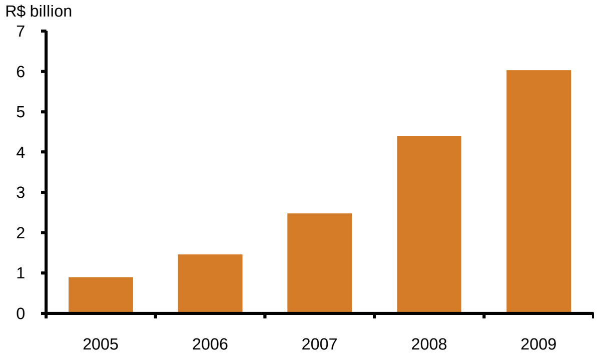


Table 3.3 – BNDES disbursements[1/]

R$ million

Itemization	2008	2009	% growth
Total	25 827	25 634	-0.7
Industry	12 312	10 860	-11.8
Food products	3 399	1 298	-61.8
Vehicle, towing truch and wagon	2 044	707	-65.4
Petroleum and alcohol refining	755	1 647	118.1
Cellulose and paper	399	2 640	561.7
Commerce/services	11 751	13 042	11.0
Overland transportation	4 753	4 639	-2.4
Electricity and gas	2 271	4 029	77.4
Construction	820	1 703	107.7

Source: BNDES
1/ Refers to April.

Table 3.4 – Nonearmarked credit operations

R$ billion

Itemization	2009				% growth	
	Jan	Feb	Mar	Apr	3 months	12 months
Total	871.5	866.8	875.8	878.8	0.8	21.2
Corporations	472.3	463.0	465.2	462.2	-2.1	22.1
Reference credit[1/]	384.6	385.4	388.1	386.3	0.4	23.5
Domestic funding	296.7	297.8	301.7	304.2	2.5	28.8
External funding	87.9	87.6	86.3	82.0	-6.7	7.2
Leasing[2/]	55.7	50.2	50.5	49.9	-10.4	17.8
Rural[2/]	3.8	3.9	3.9	3.8	1.2	84.8
Others[2/]	28.2	23.5	22.8	22.2	-21.1	3.5
Individuals	399.2	403.8	410.6	416.6	4.4	20.2
Reference credit[1/]	274.5	276.9	281.5	285.7	4.1	10.7
Credit unions	17.1	17.1	17.8	18.0	5.2	30.7
Leasing	57.3	63.0	63.6	64.1	11.9	64.8
Others	50.3	46.8	47.7	48.8	-3.0	35.7

1/ Interest rate reference credit, defined according to Circular n. 2,957 dated 12.30.1999.
2/ Operations backed by domestic resources.

Financial Housing System (SFH), which accounted for 87.4% of the credit granted to the segment in the period, contrasting with a decrease of 14.5% in transactions indexed to market interest rates. Operations involving FGTS totaled R$1.6 billion, rising 20.7% in the period.

BNDES disbursements totaled R$25.6 billion in the first four months of the year, dropping 0.7% over the same period in 2008. This movement reflected the more accentuated impact of the 11.8% decrease in the financing granted to industry, reflecting the slowed demand in the food and vehicles, trailers and bodies sectors as compared to the 11% increase in the financing granted to the segment of trade and services, led by large operations with the electricity and gas segments, and 4.5% with micro, small and medium-sized enterprises.

Consultations formalized with the BNDES, which is an indicator of potential demand for medium and long-term investments, totaled R$77.1 billion in the first four months of the year. The increase of 33.7% over the same period of 2008 largely reflected the increase of 106.8% observed in the consultations from industry, which totaled R$46.3 billion. It should be highlighted the requests from the coke, petroleum and fuel, as well as other transportation equipment sectors. Requests from the segment of trade and services, evincing the drop in the segments of construction and electricity and gas, fell by 14% in the period, totaling R$28.7 billion.

Credit operations with nonearmarked resources

The balance of loans with nonearmarked resources, representing 70.4% of the financial system's credit operations, reached R$878.8 billion in April, rising 0.8% in the 3-month period and 21.2% in twelve months. In the same basis of comparison, the corporate credit operations recorded variations of -2.1% and 22.1%, totaling R$462.2 billion. Of this total, 83.6% occurred in the framework of the referential credit, with emphasis on the performance of operations contracted with domestic resources, which reflected the higher demand by large enterprises for working capital as an alternative to raising funds in foreign markets. Loans backed by foreign funds totaled R$82 billion, decreasing by 6.7%, in line with the foreign exchange appreciation occurred in the period, and 7.2% in twelve months.

Loans to individuals totaled R$416.6 billion in April. Expansions observed in the 3-month period, 4.4%, and in twelve months, 20.2%, reflected, in particular, the

Figure 3.7 – Interest rates on nonearmarked credit

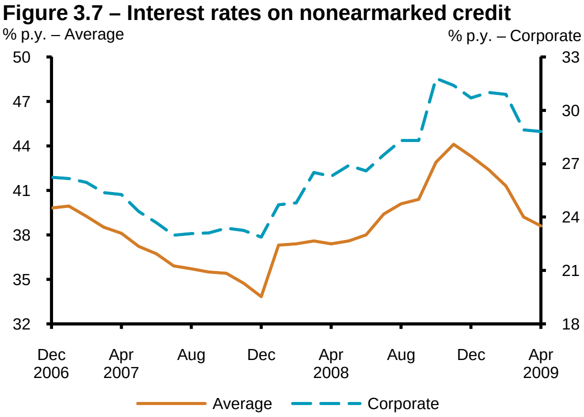


Figure 3.8 – Interest rates on fixed rate credit – Individuals

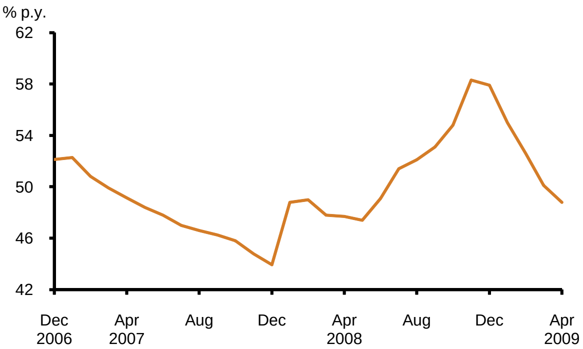


Figure 3.9 – Average spread on nonearmarked credit

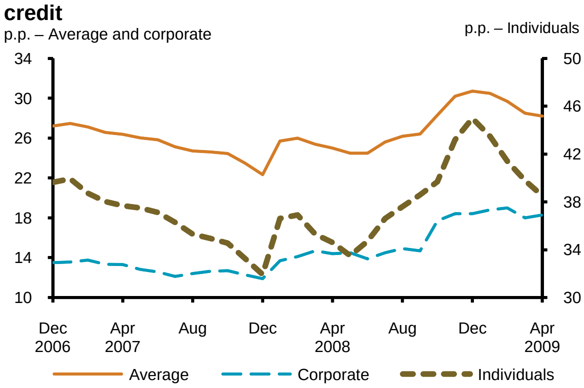
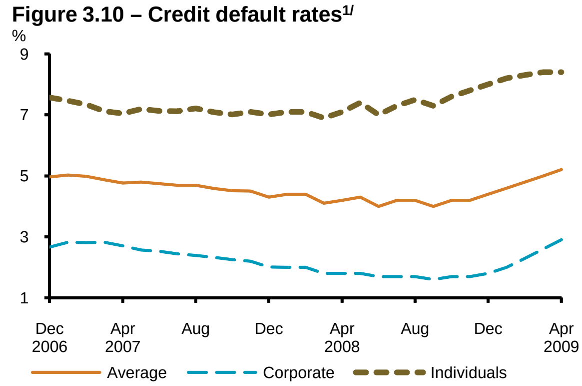


Figure 3.10 – Credit default rates[1/]



1/ Percentage of the portfolio with non earmarked resources in arrears for more than ninety days.

performance of leasing operations – a consequence of the recovery in the sales of the automotive sector – which totaled R$64.1 billion, an expansion of 11.9% and 64.8% in the same comparison periods.

Operations concentrated in the referential credit segment totaled R$285.7 billion, of which 48.6% related to personal credit, registering respective increases of 7.3% and 23.1%, on the same basis of comparison. Payroll-deducted loans, which accounted for 55.1% of the portfolio of personal loans in the month, increased by 7.5% in the 3-month period ended in April and 21.9% in twelve months. This performance was favored by lower interest rates, which moved downward from 30.8% per year in January to 28.9% per year in April, as well as by the re-establishment of theo 30% threshold for income commitment of retired persons under the INSS.

The average interest rate charged in credit operations reached 38.6% per year in April, dropping 3.8 percentage points in the 3-month period, reflecting reductions in the segment of individuals, emphasing the accentuated decreases observed in personal loans and overdraft accounts, 6.2 p.p. to 48.8% per year, and in corporate loans, 2.2 pp to 28.8% per year. The banking spread closed at 28.2 percentage points in April, registering a reduction of 2.3 p.p. in the 3-month period and a growth of 3.2 percentage points in twelve months. The performance in the period resulted in lower spreads for both the segment of individuals, 5 p.p., and corporations, 0.5 p.p., reaching, in the order, 38.5 p.p. 18.3 p.p.

The credit default rate, maintaining the upward trend began in September 2008, reached 5.2% in April, rising 0.6 percentage points in the 3-month period and 1 percentage point in twelve months. The observed delays in operations related to individuals and corporations represented, in the order, 8.4% and 2.9% of the referential credit of the respective segments, registering variations of 0.2 p.p. and 0.9 p.p, in the 3-month period, and 1.3 p.p. and 1.1 p.p., in twelve months (see box "The Evolution of Default, Indebtedness and Commitment of Household Income").

3.2 Monetary aggregates

The restricted money supply (M1), considering the concept of average daily balances, totaled R$197.7 billion in May, a decrease of 0.6% in the 3-month period and expansion of 5.4% in twelve months. The annual variation resulted from growth of 13.3% in currency outside banks and 0.2% in demand deposits. According to seasonally adjusted data,

Figure 3.11 – Average term for credit operations – Calendar day

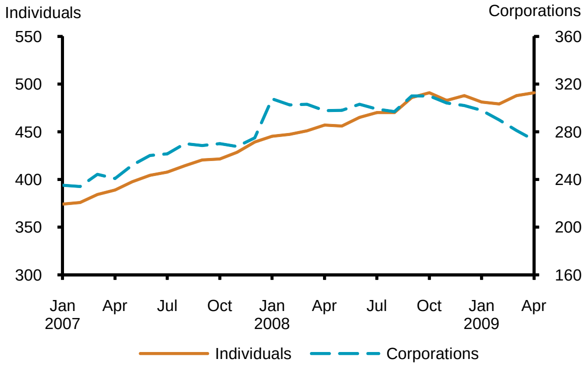


Figure 3.12 – Monetary base and M1 – Average daily balances

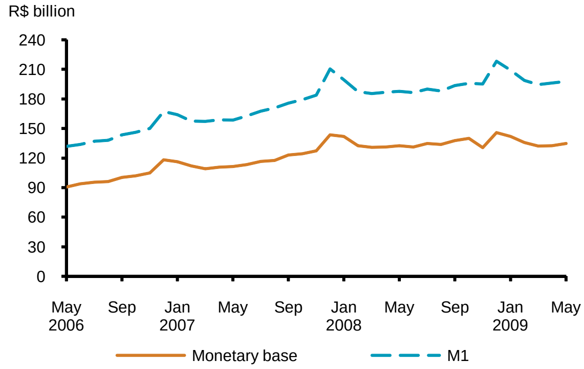
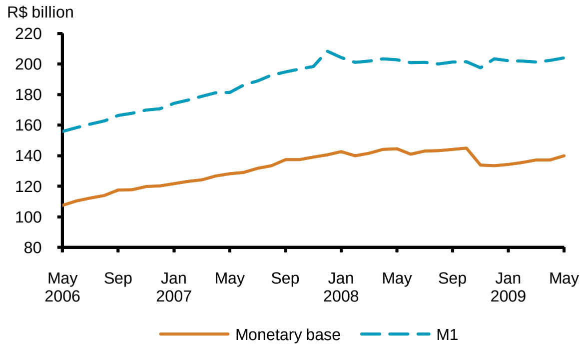
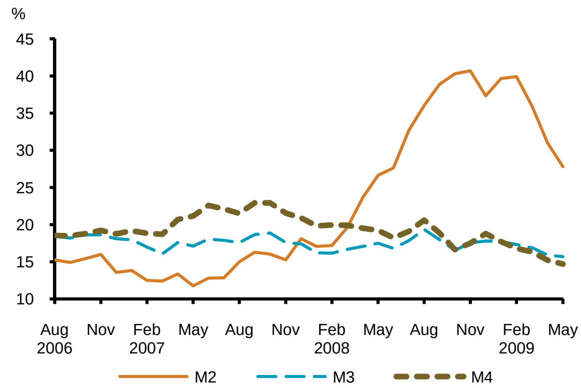


Figure 3.13 – Monetary base and M1 at May 2009 prices seasonally adjusted1/



1/ Deflated by: IPCA.

Figure 3.14 – Broad money supply – 12-month growth



deflated by the IPCA, the M1 grew 1.1% in comparison to February and 0.7% in twelve months.

The average daily balance of the monetary base totaled R$134.8 billion in May, for a 0.8% drop in comparison to February and a 1.6% growth in twelve months. The annual result reflected the impact of the more robust growth of 12.4% recorded in the average balances of currency issued, as compared to the 22.1% falloff in banking reserves, still reflecting the reduction in the rate of reserve requirements on deposits.

With regard to the end-of-period balances, the monetary base totaled R$133.3 billion in May. The retreat of R$2.9 billion in relation to February reflected the contractionary impact of Treasury operations, R$23 billion, and adjustments in operations with derivatives, R$1.9 billion, partly offset by net redemptions of R$10.3 billion in Treasury securities and by net Central Bank purchases of R$11.1 billion of foreign currency in the interbank foreign exchange market.

The CMN, through Resolution no. 3,692, dated March 26, 2009, established the Special Guaranteed Time Deposits (DPGE), a modality for funding time deposits guaranteed up to R$20 million by the Credit Guarantee Fund (FGC), carried out for periods of at least six months and a maximum of sixty months. This Resolution allowed the collection of total deposits worth R$6.8 billion by the end of May. In addition, Resolution no. 3,729, dated May 28, 2009, with the objective of strengthening the predictability of time deposits inflows and outflows, forbidden the partial or complete anticipated redemption of these deposits.

M2, which adds to M1 the investment and savings deposits, as well as the bonds issued by financial institutions, totaled R$1.1 trillion in May, rising 1.3% in the 3-month period and 27.8% in twelve months. Among its components, it should be highlighted the growth in the stock of private bonds, 1.5%, and in the balance of savings deposits, 1.6%, which reached, in the order, R$596.9 billion and R$279,2 billion.

M3, the concept that adds to the M2 the shares of fixed income funds and public securities that back the net position of funding in repurchase agreements between the public and the financial sector, reached R$2 trillion in May, posting increases of 3,6% in comparison to February and 15.7% in twelve months. The M4 concept, which includes the M3 and the government securities held by the nonfinancial public totaled R$2.3 trillion, resulting in respective expansions of 3.3% and 14.7%, on the same basis of comparison (see box "Recent Developments of Key Financial Investments").

Evolution of Default, Indebtedness and Commitment of the Household Income

Figure 1 – Credit operations with individuals – Interest rates and average terms

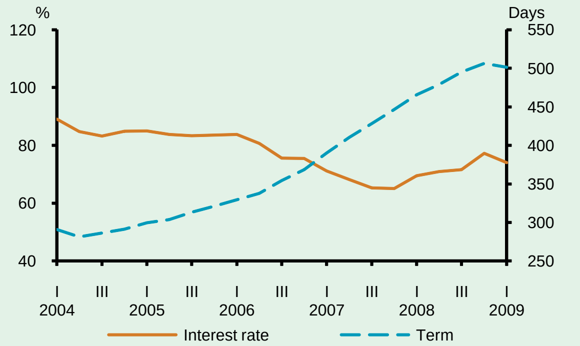


Figure 2 – Credit operations with individuals – Default and grantings

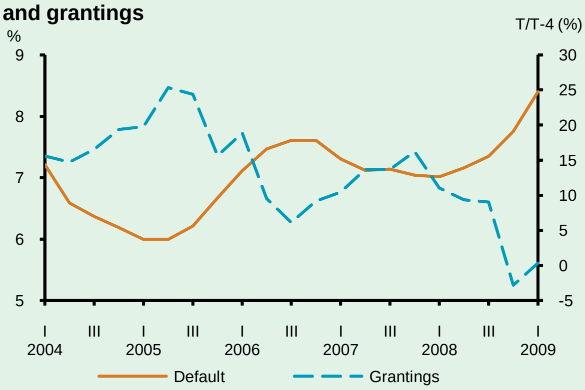


Table 1 – Default

April 2009

Modality	%	Change t-1	Change t-3	Change t-12
Individuals	8.4	0.0	0.2	1.3
Special overdraft checks	10.0	0.3	-0.2	1.7
Personal credit	5.7	-0.1	0.0	0.6
Automotive vehicles	5.2	0.2	0.6	1.7
Purchase of goods	14.6	0.4	0.8	1.7

In recent years, the expansion observed in the segment of credit to individuals was led by the dynamism of lower risk modalities, with emphasis on payroll deducted loans and operations targeted to the purchase of vehicles. This trajectory which, as shown in Figure 1, occurred in an environment of reduced interest rates and increase of medium terms, was interrupted as of the intensification of the crisis in financial markets, when in a scenario of deteriorating credit conditions, the external funding became more scarce and expensive and, domestically, liquidity constraints have hindered temporarily the financing of small and medium sized companies in the interbank market.

Additionally, highlighting the aggravation of the balance of risks, financial institutions have promoted an immediate reduction of new hires, with shorter deadlines and rising interest rates, as recorded in Figure 2. In this context, from mid-2008, a rise in default under the credit reference for individuals, which reached 8.4% in April 2009, compared to 7% in December 2007, a move due to general increase in arrears in all credit modalities, especially in personal credit, auto loans and credit card (Table 1).

This set of recent changes in the macroeconomic scenario makes it relevant to revisit the box published in the Inflation Report September 2008 issue, which addressed the trajectory of household indebtedness and the commitment of their income in the period prior to the restriction in the channels of credit.

The compilation of credit statistics was unchanged when compared to the previous survey, also using the quarterly averages of end-of-month balances in the modalities interest rate reference credit, to leasing operations and those carried out by credit cooperatives. As regards the interest rates and the terms of the modalities not belonging to reference credit, proxies were estimated adjusted to tax specificities: to leasing, parameters of the mode of acquisition of vehicles were adopted; for cooperatives, were adopted those ones related to the type of personal credit. Channeled housing credit was not included because of the lack of regular statistics on interest rates and maturities for these operations.

Household income, which is called Extended Overall Wage (MSA), was estimated from the aggregation of the overall wages, calculated in the Monthly Employment Survey (PME),[1] with transfers from the official social security. Similar to the previous study for the final calculation of the MSA, the average of the last four quarters was used to mitigate seasonal effects on income. A methodological change in the compilation of income resulted in achieving higher levels estimated for the indebtedness and commitment of income, since the MSA corresponds to an amount about 20% lower than the one of the indicators used in the previous study.

The household indebtedness was estimated as the ratio of debt stock in a given period and the average income of the previous four quarters. For the construction of an indicator of income commitment, the value of disbursements to the principal, corresponding to the ratio of the balance and the average maturity of the portfolio during that period, was calculated for each modality. In terms of revolving credit, overdraft check and credit card, it was considered only the income commitment for the payment of interest. In addition to the main payments with the estimated debt service, it also includes interest payments, given by multiplying, for each modality, the average monthly interest rate by the respective balance. Finally, the income commitment was obtained by dividing the debt service for the MSA of the respective period. It is important to note that the statistics available to the average maturity of the portfolio does not match the period running until the expiration of the last installment, but the average time of benefits weighted

1/ Since the PME encompasses the metropolitan areas of Belo Horizonte, Porto Alegre, Recife, Rio de Janeiro, Salvador and São Paulo, the indicator referring to the overall national wages was obtained by multiplying the ratio of Brazil GDP to the GDP of each of the six metropolitan areas by the PME's overall wages.

by their respective values. In this concept, the average term of a loan with 24 equal monthly installments will be 12.5 months. In terms of income commitment, the use of the term to come would reflect more faithfully the period in which the borrower is overtaxed by the credit operation. Therefore, it was used in this study the period to come, obtained by the approximation from the medium term.

Figure 3 – Indebtedness and income commitment

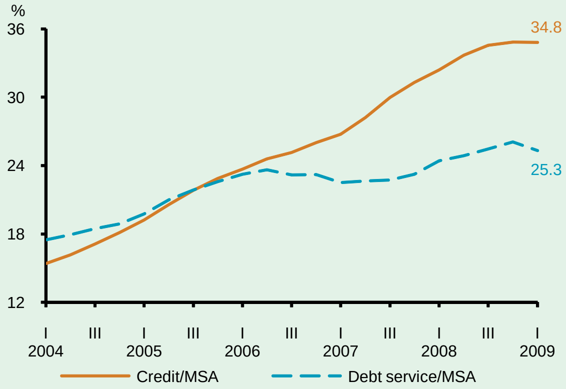
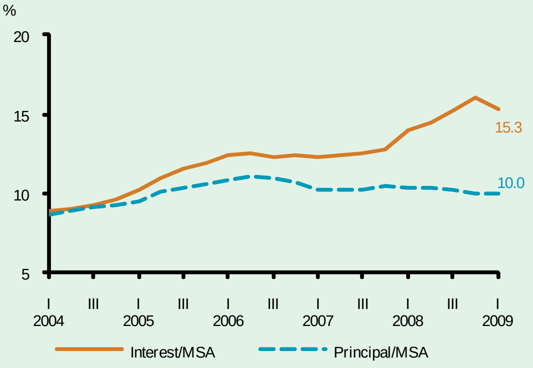


Figure 3 shows the significant increase of the level of indebtedness over the past few years, a movement associated with the very development of the credit market, which was incipient before the consolidation of macroeconomic stability. In March, the level of household indebtedness reached 34.8% of the annual earned income in the last twelve months, recording increases of 2.4 p.p. over the same period of the previous year and of 8.1 p.p. over the past two years. From the third quarter of 2008, the indebtedness starts to present a deceleration trend, a behavior consistent with the slowing of hires.

Figure 4 – Income commitment with interests and principal



The income commitment level with the debt service, reached 25.3% in March, dropping 0.8 p.p. in the quarter, recording increases of 0.9 p.p. in twelve months and of 2.8 p.p. in two years, as expressed in Figure 4. This indicator evolves in a less remarkable manner, reflecting the combined effects of changes in balances, terms and interest rates. In this sense, the income commitment decreased from the second quarter of 2006 and the first quarter of 2007, when the increase in time and the reduction in interest rates offset the expansion of credit. From mid 2007, the indicator began to record growth, mainly explained by the rapid expansion of sales. Throughout 2008, this growth rate became more pronounced, driven particularly by high interest rates. In 2009, there was further decline, primarily explained by lower rates.

The analysis of the income commitment from its components shows that the amount paid regarding the principal remains relatively stable over the past two years, which indicates that balances respond more slowly to overcooling in grants and lengthening of terms. Different behavior is shown by the commitment resulting from interest payments, which showed expansion, interrupted only in early 2009, when it was observed a decline of 0.8 p.p., reflecting the impact of monetary policy on bank interest in this period.

As in the study published in September 2008, it is important to note that the estimated construction of the indicators requires the adoption of various hypotheses and assumptions, besides the subjection to significant limitations. Therefore, the focus of the analysis should be on the behavior of these indicators over time, in its variations and trends rather than on their absolute levels. Even with these reservations, it should be noted that, as shown by Figures 2 and 3, the latest indicators of income commitment show stability and fall, indicating a cooling off of the growth trend of the household leverage.

Figure 3.15 – Net financing position of the federal public securities – Daily average

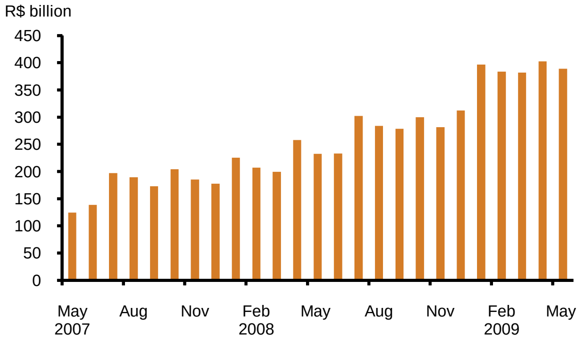


Figure 3.16 – Central Bank repo operations – Maturity – Aveage daily balances

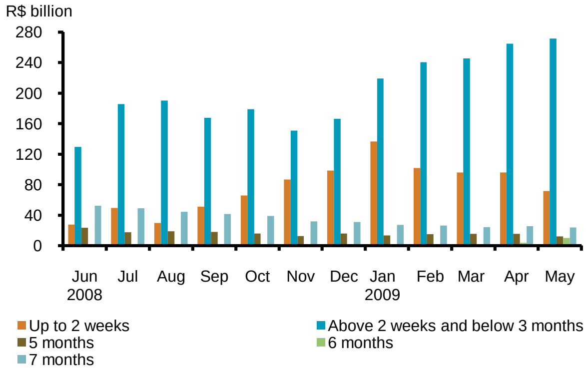
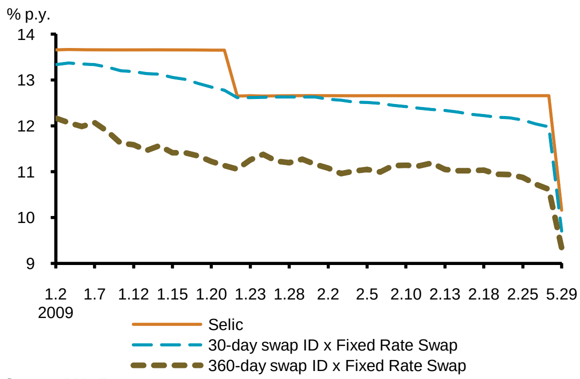
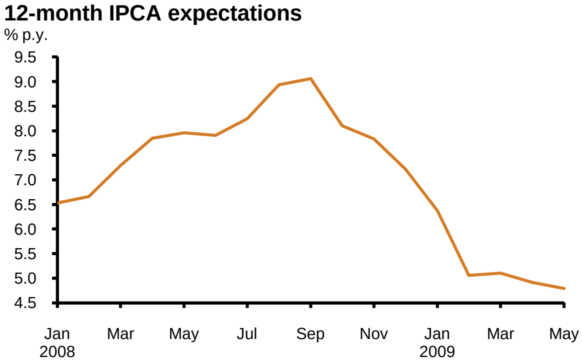


Figure 3.17 – Interest rate



Source: BM&F

Figure 3.18 – Ex-ante real interest rate – Deflated by 12-month IPCA expectations



Federal public securities and Central Bank open market operations

The monetary impact of Treasury primary operations with federal securities grew R$17.3 billion in the 3-month period ended in May, with placements totaling R$82.2 billion and redemptions, R$99.5 billion. Swap operations, concentrated in National Treasury Notes – Series B (NTN-B), reached R$9.1 billion, while anticipated redemptions totaled R$4.8 billion.

The Central Bank net financing position in the open market, based on the average daily balances, totaled R$389.3 billion in May, increasing 1.4% in comparison to February. The average short-term operations decreased from R$101.8 billion in February to R$71.8 billion in May, while those relating to transactions with maturities of five and seven months declined from R$15.1 billion and R$26.3 billion, respectively, to R$12.1 billion and R$23.8 billion. Conversely, medium-term operations from two weeks to three months increased from R$240.7 billion to R$271.6 billion in the period. In addition, operations with 6-month terms at the start of the period reached R$10.1 billion in May. These movements largely reflect a renewed confidence by financial agents, after the deterioration of the expectations inherent to the international financial crisis.

Real interest rates and market expectations

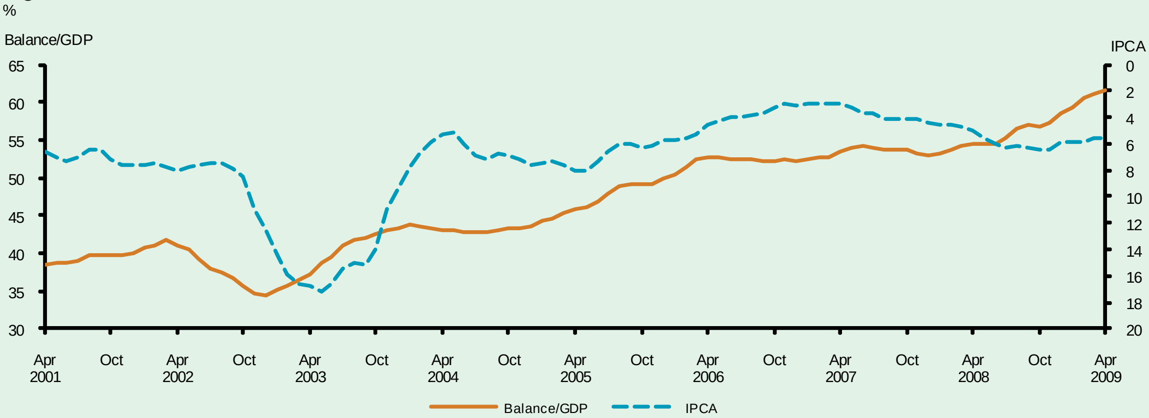
The curve of future interest rates for contracts of swap DI x fixed-rate, maintaining the trend observed since the last quarter of 2008, shrank in all vertices in the 3-month period ended in May (compared to February), with emphasis on the reductions observed in the rates for contracts with maturity of less than 360 days. This movement, consistent with expectations of persintent reduction in the benchmark interest rate, was also evident in the decline of 128 basis points observed in the period to 9.3% per year – the lowest level of the series – related to the rate for contracts of 360 days, the most traded on the BM&F.

The real Selic rate ex-ante for the next twelve months, calculated by the Central Bank Market Report surveyed on May 29, reached 4.8% per year – the lowest value of the series, compared to 5.1% per year at the end of February. This movement reflected the larger impact of a reduction of 9.88% per year to 9.09% per year on expectations for the 12-month Selic rate, compared to the decrease of 4.57% per year to 4.14% per year on the IPCA expectations.

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

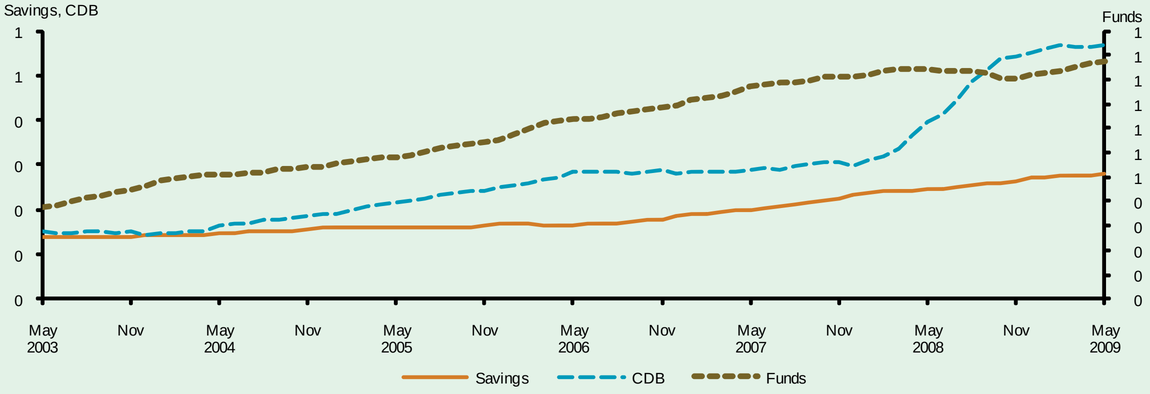
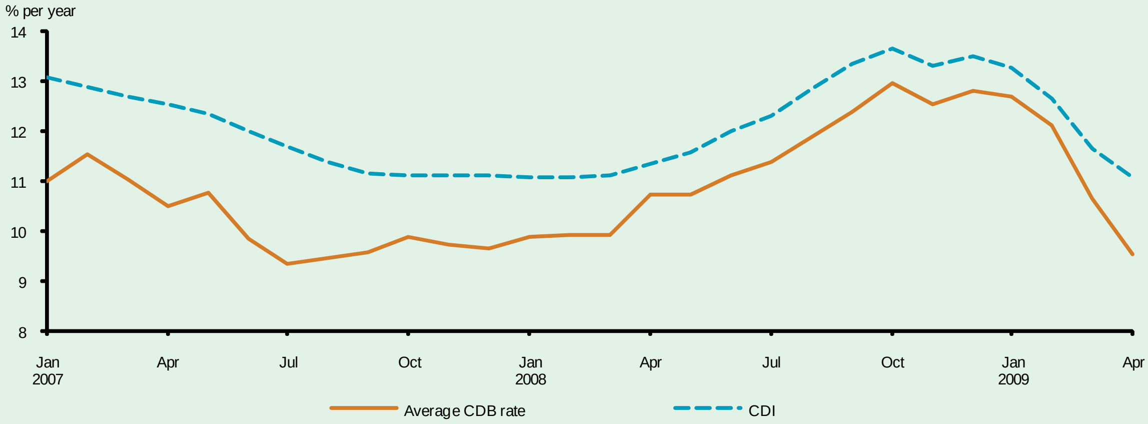


Figure 3 – Financial investments – 12-month accumulated net flows
R$ billion

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).

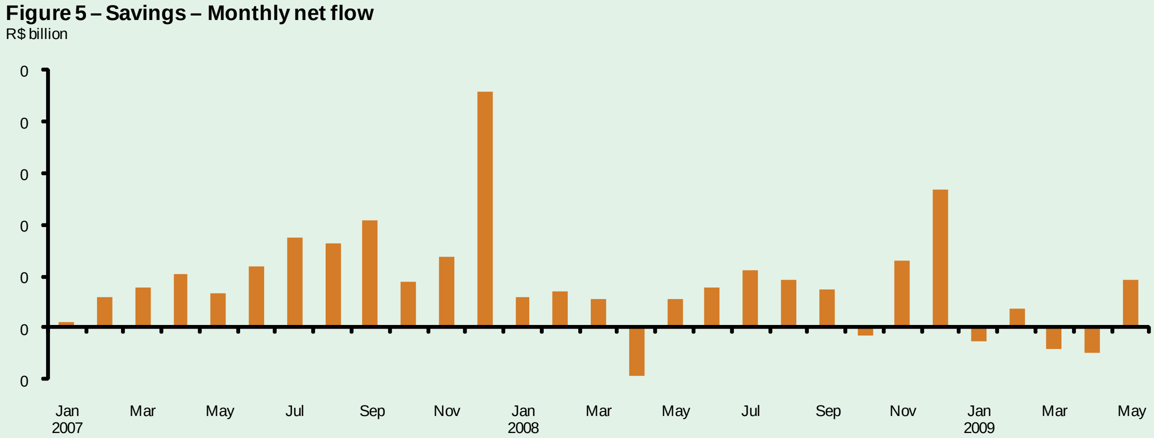
Deposits in savings accounts grew 39.3% between May 2007 and May 2009, a period during which the net inflows totaled R$45.1 billion (Figures 2 and 3). In 2009, net outflows recorded in January, March and April were offset by net inflows of R$1.9 billion in

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

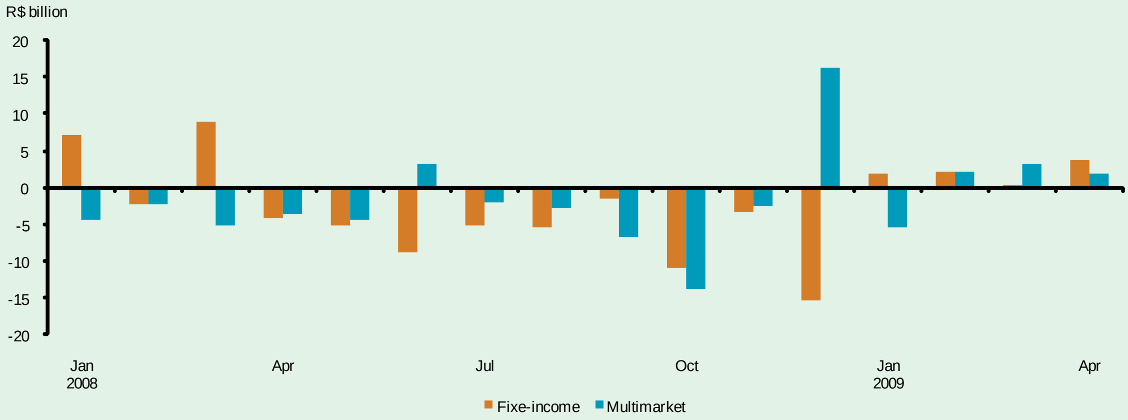


Figure 7 – Investment funds – Monthly net flows

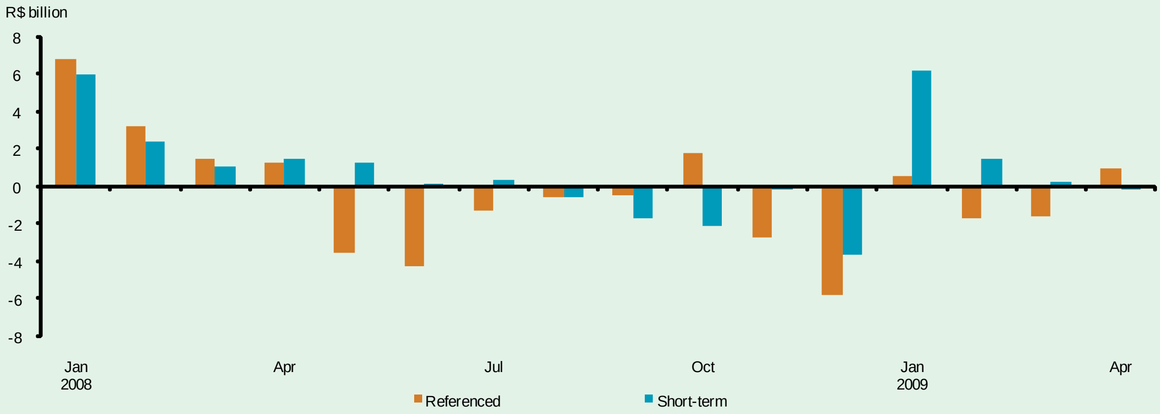


Figure 6, which has a time span that covers both the moment of euphoria as a result of granting the degree of investment to Brazil and the worsening of the international financial crisis, shows net redemptions in fixed-income funds and multimarket funds in almost all the months in 2008. In cumulative 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

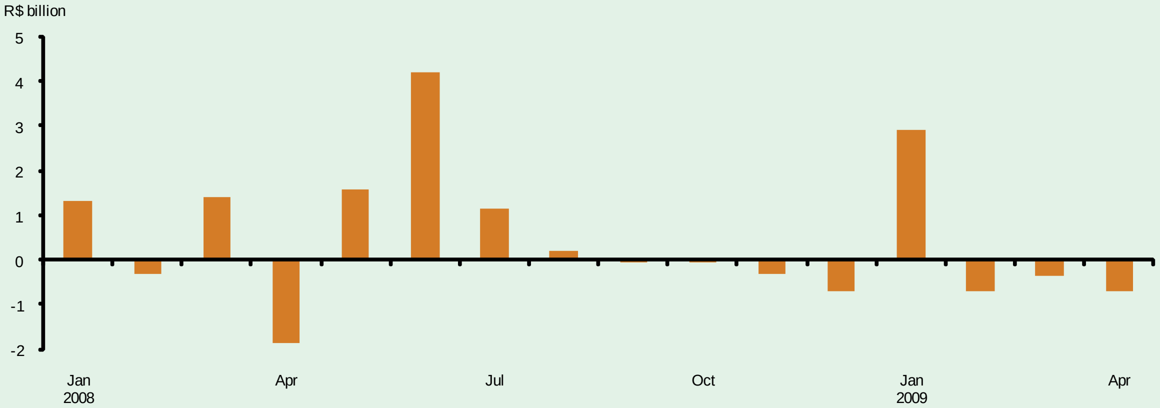
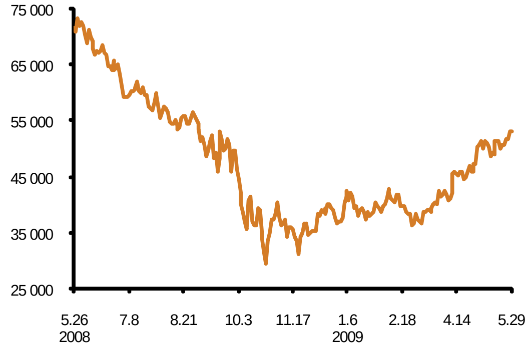


Figure 3.19 – Ibovespa
Points



Source: Bovespa

Figure 3.20 – Stock exchanges
July 2008 = 100

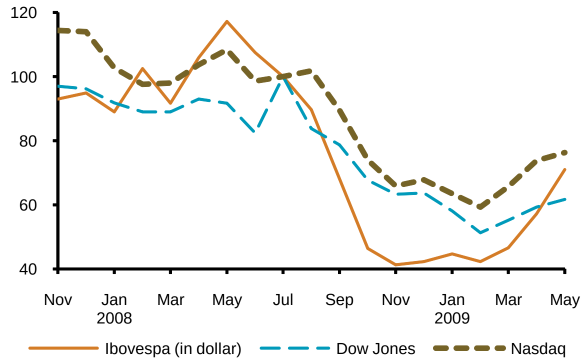
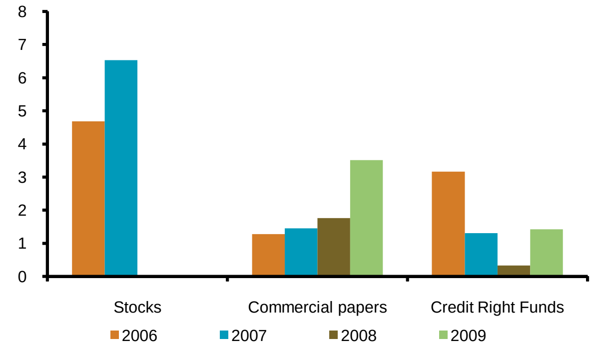


Figure 3.21 – Debenture primary issues in the capital market
R$ billion – Accumulated through May

Source: CVM

Figure 3.22 – Primary issues in the capital market
R$ billion – Accumulated through May



Source: CVM

Capital markets

The São Paulo Stock Exchange Index (Ibovespa), showing signs of recovery in the domestic activity and the return of foreign capital inflows, accumulated successive increases in the 3-month period ended in May, when the average daily volume traded on the Bovespa rose 23 2% in comparison to February. The Ibovespa reached 53,197 points at the end of May, for a a 39.3% growth in the 3-month period. In this period, the market value of listed shares increased by 28.1%, closing at R$1.81 trillion.

The Ibovespa, measured in dollars, grew 67.9% in the 3-month period ended in May, aided by the persistent dollar appreciation observed in the period. In the United States, the Dow Jones and Nasdaq, influenced by more positive expectations in relation to the effects of the international financial crisis, rose respectively 20.4% and 28.8% in the same comparison period.

Business financing through issues of shares, debentures, promissory notes and placement of receivables-backed rights totaled R$9.1 billion in the first five months of 2009 compared to R$49.2 billion in the same period in 2008. This movement reflected, in particular, sharp reductions in issues of registered debentures, from R$32.6 billion to R$4.2 billion, and promissory notes, from R$8.8 billion to R$3.5 billion.

3.3 Fiscal policy

In March, in an attempt to ensure more favorable conditions for the recovery of domestic economic activity, the federal government expanded the temporary tax relief measures implemented in December 2008. In this sense, temporary reductions in IPI rates on several construction products were introduced and the original deadline set for the reductions related to the acquisition of new cars and trucks was extended by three months.

Moreover, in order to mitigate the impacte of the lower collection of federal taxes on funds transferred to regional governments, the Federal Government released, in the month of May, a measure that guarantees in 2009 the maintenance of the nominal value of resources transferred to municipalities in 2008 under the Municipalities Participation Fund.

Also in the month of May, the Ministry of Planning announced updated forecasts of Central Government nonfinancial revenues and expenditures for 2009. Net Treasury income was revaluated to R$439.4 billion, representing a decrease of R$9.4 billion compared to estimates released in March. Conversely, the projections for Treasury obligatory expenditures and to Social Security benefits were increased, respectively, by R$3.1 billion and R$2.1 billion. These revisions, coupled with a reduction of R$23.7 billion for the primary surplus target provided an increase of R$9.1 billion in the Federal Government discretionary expenditures. It should be highlighted that the government had announced in March, as a preventive measure, a R$21.6 billion reduction of expenditures.

It should be mentioned that the reduction from 3.8% of GDP to 2.5% of GDP introduced in the primary surplus target for the public sector incorporates the exclusion of the Petrobras Group from the fiscal statistics (see Box: "The Trajectory of the PSND/GDP Ratio").

Public sector borrowing requirements

The public sector primary surplus, excluding the Petrobras Group, totaled R$30.8 billion in the first four months of 2009, accounting for 3.32% of GDP. The reduction of R$32.1 billion in comparison to the same period of the previous year, when it accounted for 7.01% of GDP, reflected widespread retractions in all public sector components, with emphasis on the decrease of R$26.3 billion recorded by the Central Government. The surplus accumulated in twelve months up to April reached 2.54% of GDP, 0.04 percentage points above the target set for the year.

Table 3.5 – Public sector borrowing requirements – Primary result

Segment	2007		2008		Apr 2009	
	R$ billion	% GDP	R$ billion	% GDP	R$ billion	% GDP
Central Government	-59.4	-2.3	-71.3	-2.5	-22.4	-2.4
Sub-national governments	-29.9	-1.2	-30.6	-1.1	-9.6	-1.0
State companies	-0.4	-0.0	-4.5	-0.2	1.2	0.1
Total	-89.7	-3.5	-106.4	-3.7	-30.8	-3.3

The decline registered in the Central Government surplus reflected both a decrease of R$23.7 billion, 2.78% of GDP, observed in the Federal Government result due to a combination of reduced revenues and increased expenditures, and a growth of R$2.6 billion, 0.24% of GDP, reported in the Social Security deficit, due to the larger impact of increased expenditures with the payment of benefits as against the expansion of revenues.

National Treasury revenues decreased 5.2% in the first four months of the year over the same period in 2008, a performance related to the effects of the global economic crisis on the level of economic activity and fiscal waives associated with temporary tax incentives implemented by the government.

Figure 3.23 – National Treasury gross revenue
Jan-Apr

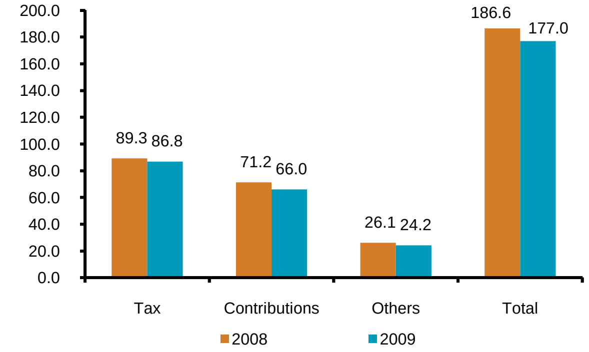
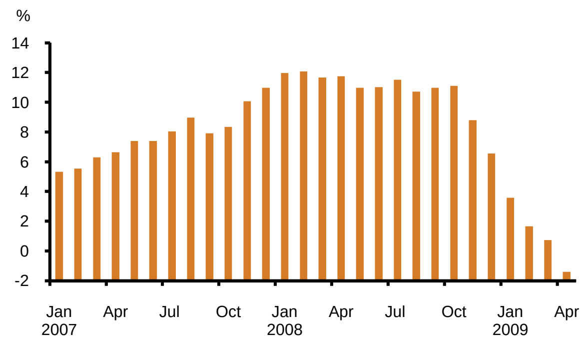


Figure 3.24 – 12-month real growth rate of Treasury revenues[1/]



1/ Updated by IPCA.

Table 3.6 – National Treasury Expenditures
Jan-Apr

Itemization	2008		2009	
	R$ million	% GDP	R$ million	% GDP
Total	82 991	9.3	102 115	11.0
Personnel and payroll charges	40 184	4.5	49 921	5.4
Capital and current expenditures	42 559	4.7	51 840	5.6
Workers Support Fund	4 852	0.5	6 790	0.7
Subsidies and economic	1 648	0.5	587	0.7
subventions	1 648	0.2	587	0.1
Loas/RMV	4 994	0.6	6 051	0.7
Investment	5 374	0.6	6 761	0.7
Other capital expenditures	25 690	2.9	31 650	3.4
National Treasury transfers				
to the Central Bank	248	0.0	354	0.0

Source: Minifaz/STN

In this scenario, the collection of Income Tax (IRPJ) decreased by 5.6% in the period, while the resources associated with the Contribution to Social Security Financing (Cofins) and PIS/Pasep recorded respective declines of 9.9% and 5.3%.

IPI revenues decreased by 23.5% in the first four months of the year. The nominal reduction of R$2.9 billion was due to the changes introduced in the rates levied on the automotive industry, in the calculation period of taxes levied on the beverage sector, which was increased from ten days to 30 days, and the impact of the industrial production slowdown observed in period.

Similarly, revenues related to concessions, as a result of bidding for exploration of blocks of oil and natural gas held in March 2008, without correspondence in 2009, and the financial compensation as a result of the reduction in international oil prices, declined by R$4.5 billion over the first four months of 2008.

The collection of the Contribution of Intervention in the Economic Domain (CIDE-Fuels) dropped R$2.2 billion in the four-month period, reflecting a reduction in the rate charged per cubic meter of gas and diesel, as of taxable events of May 2008, as well as of compensation occurred between January and March of the current year.

Conversely, collections associated with the Income Withholding Tax (IRRF), highlighting the growth of labor income and remittances abroad, and the Social Contribution on Net Profits (CSLL), reflecting an increase in the tax rate on financial institutions, registered respective increases of 8.6% and 9.7% in the four-month period, totalling R$3.9 billion.

The real growth rate of federal revenues accumulated in twelve months has moved downward, expressed in the reversal of the 6.5% growth registered in December 2008 over the same period of 2008, to a decline of 1.4% in April.

National Treasury expenditures totaled R$102.1 billion in the first four months of 2009, increasing 23%, equivalent to 1.75% of GDP, over the same period of the previous year. Personnel expenses and payroll taxes rose 24.2% in the period, a performance associated with the impact of the restructuring of careers in the Executive and Judiciary branches, as well as large disbursements of payments referring to judicial demands.

Expenditures related to the Worker Support Fund (FAT) rose 39.9% in the four-month period, due to increases in

Figure 3.25 – Central Government expenditures
Jan-Apr

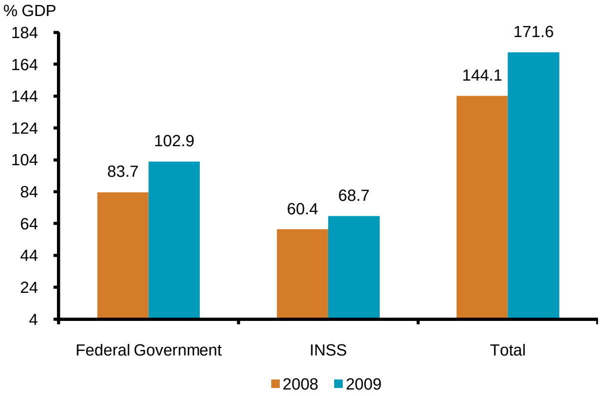


Figure 3.26 – Federal Government: investment expenditures paid
Jan-Apr

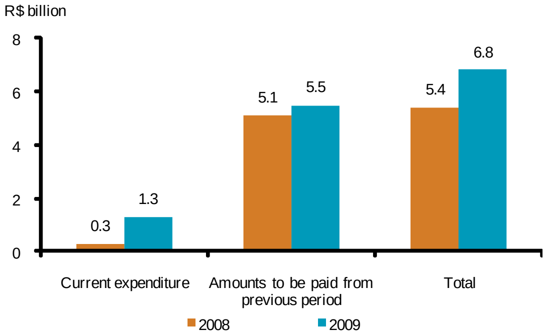


Figure 3.27 – Basic Investment Plan (PPI) expenditures
Jan-Apr

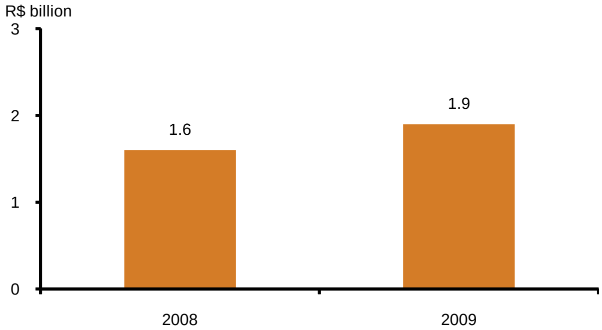


Table 3.7 – Social security primary result
January-April

R$ billion

Itemization	2008	2008	Var. %
Gross inflow	53.9	60.4	12.1
Cash refunds	-0.1	-0.2	100.0
Transfers to third parties	-5.9	-6.7	13.6
Net inflow	47.9	53.5	11.7
Social Security benefits	60.4	68.7	13.6
Primary result	-12.5	-15.2	20.9
Net inflow/GDP	5.3%	5.8%	
Social Security benefits/GDP	6.7%	7.4%	
Primary result/GDP	-1.4%	-1.6%	

expenditures associated with salary bonuses, in line with an increase in the minimum wage and unemployment insurance, a result of the shrinkage recorded in the formal labor market. The increase in minimum wage contributed with an additional 21.2% growth in expenditures on welfare benefits related to the Organic Law of Social Assistance (Loas) and Lifetime Monthly Income (RMV).

Investment expenditures, highlighting the government's effort to raise the GFCF in the country, grew 25.8% in the first four months of the year, totaling R$6.8 billion. The expenditures included in the Pilot Project Investments, subject to a deduction of the primary surplus, increased 18.4%, to R$1.9 billion. O the total expenditures on investments, 80.5% refers to amounts to be paid from previous years.

In relation to expenditures, the reduction of 64.4% in heading allowances and subsidies reflected the net return on operations conducted by the National Development Fund.

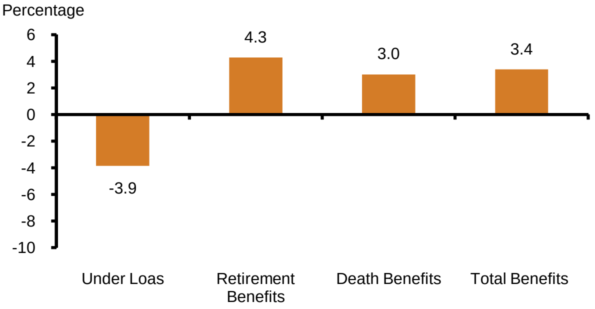
The primary Social Security deficit increased by 0.24 percentage points of GDP in the first four months of 2009, consequent upon an increase of 11.7% in net inflows, due to the increase in contributions on payroll, and a growth of 13.6% in expenditures, resulting from the impact of the minimum wage increase, coupled with the 24.1% growth in the payment of judicial proceedings plus 3.4% in average monthly amount of benefits paid.

Transfers to regional governments totaled R$38.9 billion in the first four months of the year, compared to R$41.9 billion in the same period in 2008, a reduction due to lower revenues of those taxes that make up the constitutional funds, to the international price of oil (which impacts the transfers of royalties), and transfers of the CIDE-Fuels, as a result of the rate reduction and compensation of revenues.

Collections related to the Tax on the Circulation of Goods and Services (ICMS), the main regional tax collection, increased by 3.4% in the first four months of the year, compared to the same period in 2008. The revenues related to the Tax on Automotive Vehicles (IPVA) recorded a growth of 15.3%, on the same basis of comparison.

The primary surplus of states and municipalities totaled R$9.6 billion in the first four months of 2009, falling 0.35 percentage points of GDP over the same period of the previous year, emphasizing the unfavorable outcome observed in the municipal sphere.

Figure 3.28 – Growth in the number of benefits issued by Social Security (Jan-Apr 2009 average/Jan-Apr 2008 average)



Source: STN

Figure 3.29 – Transfers to states and municipalities
Jan-Apr

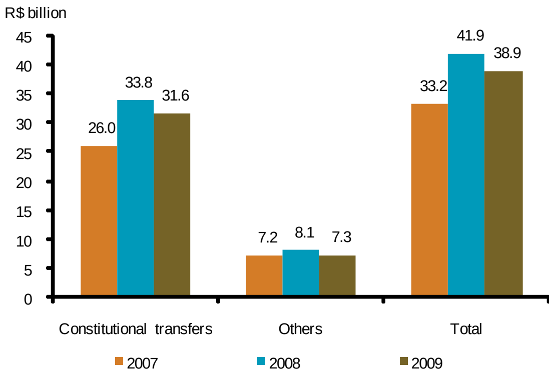


Figure 3.30 – ICMS and IPVA inflow
Jan-Apr

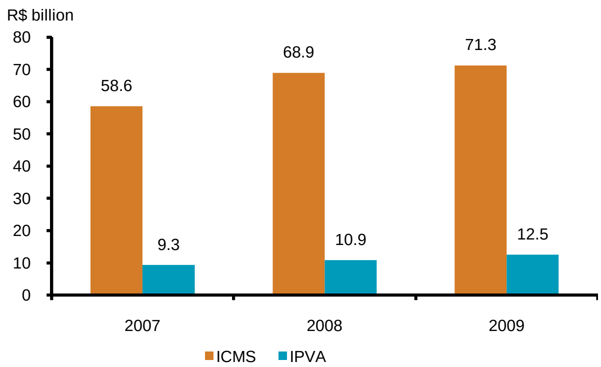
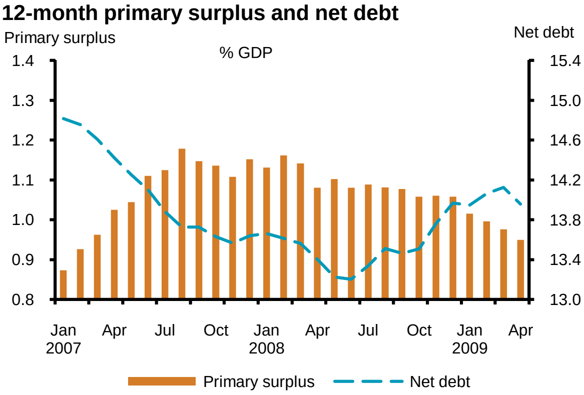


Figure 3.31 – Regional governments: cumulative 12-month primary surplus and net debt



State owned enterprises, excluding Petrobras, recorded a primary deficit equivalent to 0.13% of GDP in the first four months of the year, against a surplus of 0.20% of GDP in the same period in 2008.

The nominal interest appropriated totaled R$52.8 billion in the first four months of the year, compared to R$55.5 billion in the same period in 2008. This reduction, equivalent to 0.49 percentage points of GDP, reflected especially the reversal of the unfavorable result obtained with currency swap operations in the first four months of 2008, while the impact exerted by the monetary easing is expected to be more intense over the next months, considering that the interest accrued during the period still reflect the level of fees charged at the time that monetary policy suited to the environment of the gap between domestic supply and demand.

The public sector nominal deficit reached R$22.1 billion in the first four months of the year, against a surplus of R$7.4 billion in the same period of 2008, equivalent to 3.21% of GDP. The financing of the negative result accumulated in the year reflected, in particular, the expanded domestic debt, equivalent to R$68.7 billion. Conversely, reductions in bank debt and other net domestic financing sources, including the monetary base, were also observed.

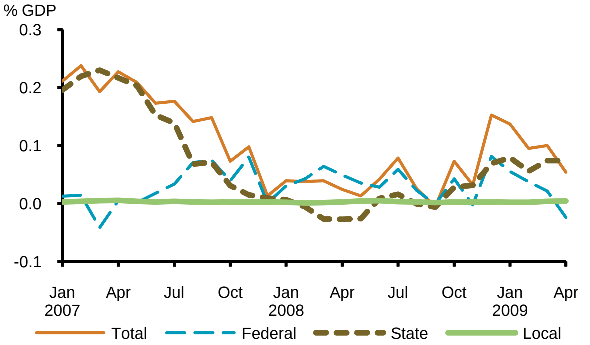
Federal securities debt

The federal securities debt, as measured by portfolio position, reached 43.1% of GDP in April, rising 1.8 percentage points of GDP in comparison to January, for a 0.8 percentage points of GDP reduction as compared to the same period of 2008. This performance reflected the expansion of net issues on the primary market, the financial effects of currency appreciation of 6% observed in the period, and the incorporation of nominal interest of R$33.7 billion.

The participation of securities tied to the Selic rate, indexed to price indices and fixed-rate securities in the total federal securities debt reached, in the order, 29.6%, 23.6%, and 22% in April, compared to 29.4%, 23.4 %, and 21.4% in January, while, conversely, exchange-indexed securities dropped 0.84% to 0.76%.

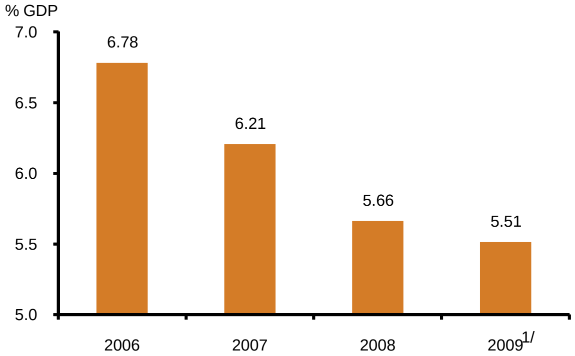
The 2009 Annual Financial Plan (PAF) defined the participation of the indexing factors in relation to total public debt in the following ranges: fixed-rate, from 24% to 31%, price indices, from 26% to 30%, over/Selic rate, from 32% to 38%, and exchange rate, from 7% to 11%. In

Figure 3.32 – Primary surplus of public enterprises
12-month cumulative data



(+) Surplus (-) Deficit

Figure 3.33 – Nominal interest

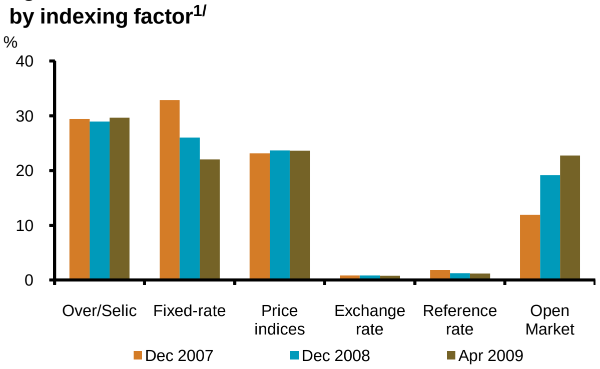


1/ Twelve-month accumulated up to april.

Table 3.8 – Public sector borrowing requirements

Itemization	2007		2008		Apr 2009	
	R$ billion	% GDP	R$ billion	% GDP	R$ billion	% GDP
Uses	71.5	2.8	57.2	2.0	22.1	2.4
Primary	-89.7	-3.5	-106.4	-3.7	-30.8	-3.3
Interest	161.2	6.2	163.7	5.7	52.8	5.7
Sources	71.5	2.8	57.2	2.0	22.1	2.4
Domestic financing	263.5	10.1	82.3	2.8	19.7	2.1
Securities financin	239.4	9.2	171.1	5.9	68.7	7.4
Bank financing	-4.4	-0.2	-92.9	-3.2	-48.1	-5.2
Others	28.5	1.1	4.1	0.1	-0.9	-0.1
External financing	-192.0	-7.4	-25.0	-0.9	2.4	0.3

Figure 3.34 – Federal securities debt structure by indexing factor[1/]



1/ It does not include swap.

April, these percentages reached, respectively, 22%, 23.6%, 29.6%, and 0.8%.

In accordance with the amortization schedule of debt securities on the market, except for financing transactions, 16.4% of the total debt in April matures in 2009; 22.8% in 2010; and 60.8%, in January 2011. This schedule represents a reduction of maturities in comparison to the same period in 2008, when 15% of the outstanding debt matured in the same year, 22.1% the following year, and 62.8% as of the second year.

The maturity schedule for securities maturing in 12 months closed at 27.4% in April, within the range between 25% and 29% established by the PAF for 2009. The average debt maturity reached 40.1 months, lower than the ceiling of 40.8 months set in the PAF 2009.

The result of currency swap operations, defined as the difference between the yield of the Interbank Deposit (DI) and exchange rate plus coupon was favorable to the Central Bank in the amount of R$1.4 billion in the 3-month period ended in April. The cumulative result since the beginning of these operations in 2002 is favorable to the Central Bank in the amount of R$7.1 billion.

Net and gross debt

The public sector net debt reached R$1,207.4 billion in April (41.4% of GDP) rising 2.5 percentage points of GDP in comparison to the end of 2008. The Central Government net debt increased by 2.5 percentage points of GDP in the period, while those relating to regional governments and state enterprises remained unchanged (see box "The Trajectory of the PSND/GDP Ratio").

The increase recorded in the PSND/GDP ratio reflected the impacts associated with the appropriation of nominal interest rates, 1.8 percentage points of GDP, the adjustment resulting from exchange rate appreciation, 0.7 percentage points of GDP, the change of parity of the basket of currencies that compose of the net foreign debt, 0.4 percentage points of GDP, and the drop in the GDP valued by the centered IGP-DI, 0.7 percentage points of GDP, partly offset by the contribution of 1.1 pp of GDP of the primary surplus accumulated in the year.

The participation of the net debt indexed to the Selic rate increased from 58.2%, in December 2008, to 63.3% in April,

The Trajectory of the PSND/GDP Ratio

The Bill amending the Budget Guidelines Law (LDO), 2009, sent to Congress in May, and the Decree no. 6,867, published in the same month, is about monetary and financial programming of the Federal Executive, introducing major changes in the country's fiscal accounts.

In this sense, the companies forming the Petrobras Group[1] are no longer to be considered in the context of fiscal statistics and the target for public sector primary surplus in 2009, evidencing that fact and also the impact of the international crisis on the level of activity and consequently on the level of was reduced from 3.8% of Gross Domestic Product (GDP) to 2.5% of GDP. It should be noted that this reduction considered the purpose of maintaining, over the medium term, the downward trend of the ratio Public Sector Net Debt (PSND)/GDP, an outlook strengthened both by the impact of the current process of monetary easing, and by the establishment of primary surplus target for 2010 at 3.3%.

The aim of this box is to examine the impact of such changes in a scenario of monetary easing and changing market expectations regarding the evolution of exchange rates and of price indices, on the dynamics of PSND/GDP IN 2009 and in the subsequent year. The projections made for the biennium consider as parameters[2] the medians of market expectations disclosed in the Central Bank Focus Bulletin.

1/ The exclusion of Petrobras of fiscal statistics is consistent with its specific characteristics, considering that, in the case of one of the ten largest oil companies in the world, it follows corporate governance rules similar to those experienced by private companies, having the autonomy to raise funds in domestic and foreign markets. By not being part of the fiscal indicators, the company ensures greater autonomy in managing its investment projects, which are fundamental to the development of the country.

2/ See Table1.

Table 1 – Parameters for the projection of the PSND/GDP ratio[1/]

	2008	2009	2010
GDP (% annual growth rate)	5.10	-0.57	3.50
IGP-DI (%)	9.11	1.53	4.50
IPCA (%)	5.90	4.40	4.30
Average Selic rate (%)	12.48	9.84	9.13
Exchange rate (R$/US$) – End-of-period	2.34	2.00	2.00
Primary surplus (% GDP)	3.68	2.50	3.30

1/ Parameters released by the Boletim Focus of 5.19.2009, except the primary surplus.

Figure 1 – Public sector net debt

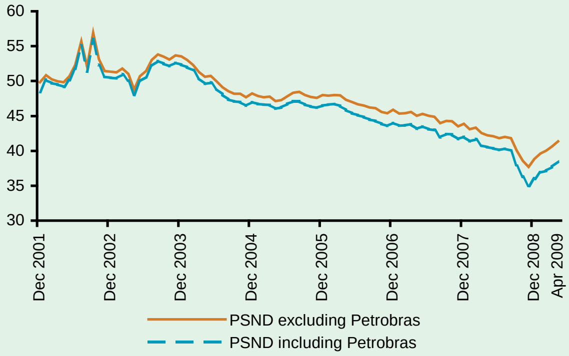
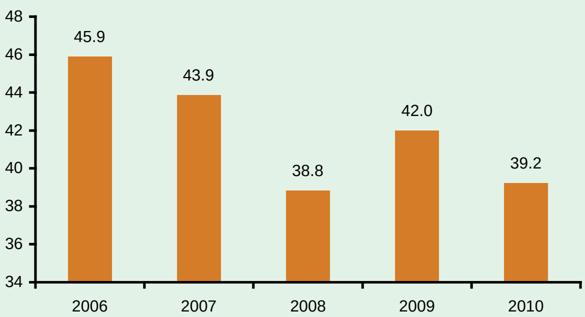
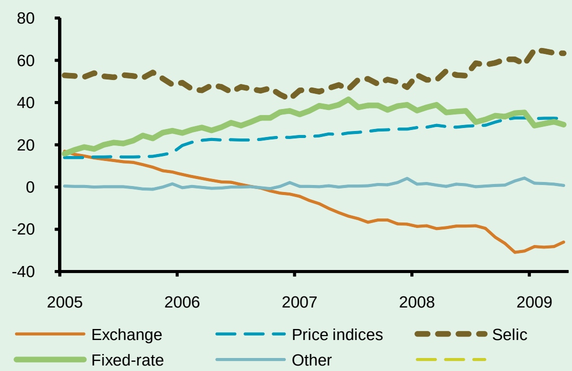


Figure 2 – PSND – Effective and projected data[1/]



1/ Effective data up to 2008 and projected data for 2009 and 2010.

Figure 3 – PSND – Participation by indexing factor



The trajectory of the ratio between PSND and the GDP, with and without the exclusion of Petrobras,[3] is expressed in Figure 1, which shows the downward movement recorded in the two concepts, between late 2003 and 2008, when the indicators began to reflect, in particular, the impact exerted by the international crisis on the evolution of the exchange rate and of the consolidated primary result of the public sector. It is worth mentioning that the level of such ratios is closely matching the period considered, and that their difference reflects the net creditor balance recorded by Petrobras in the period.

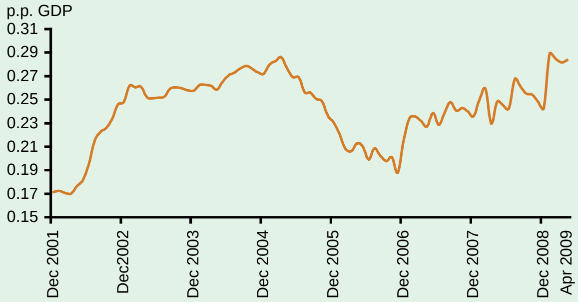
Considering the reprogramming of fiscal targets and the parameters defined in Table 1, the projection of the ratio PSND/GDP in the 2009-2010 period recorded an increase of 3.2 p.p. in the first year, expressed in percentage of 42% reached in December. It should be noted that, although it turns in an increase on an annual basis, the ratio is expected to be in December at a level similar to that observed in April 2009. The representativeness of the net indebtedness to GDP is expected to resume, in 2010, the downward trend recorded in recent years, reaching 39.2% in December, as recorded in Figure 2.

The projection of the ratio PSND/GDP translates, beyond the targets set for the primary result, its sensitivity to interest rates and exchange rates, and to the pace of GDP growth.

The effect of monetary easing on the evolution of the indicator PSND/GDP is primarily associated to the debt composition, recording directly relationship with the participation of securities indexed to the Selic rate in its total. It should be noted that by highlighting the confidence of investors in the country's macroeconomic fundamentals and the policy of the government aiming at separating the national debt from the foreign exchange movements, the share of PSND indexed to the Special System of Clearance and Custody (Selic) has been reporting an increase in recent years, from 41.7% in December 2006 to 63.3% in April 2009, as seen in Figure 3.

3/ The exclusion of Petrobras from fiscal statistics began to be performed from May 2009. The new primary surplus target for the year considers the new concept.

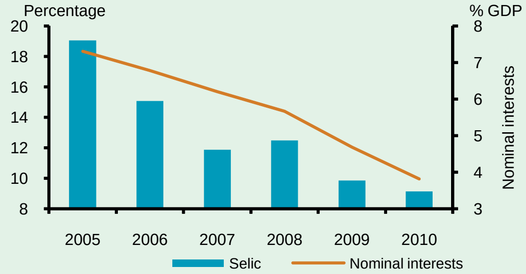
Figure 4 – Sensitiveness of the PSND/GDP ratio to the Selic rate[1/]



1/ 12-month PSND/GDP ratio change in response to a a positive 1 p.p. change in the Selic rate.

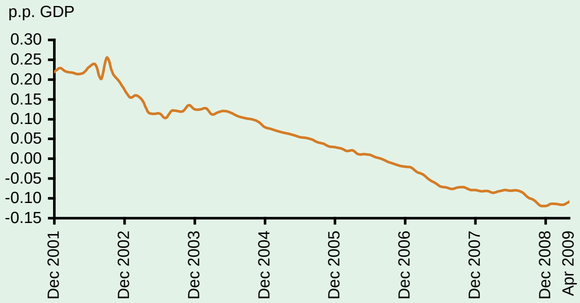
Figure 5 – Appropriated nominal interests and Selic rate[1/]

12-month accumulated



1/ Projected values for 2009 and 2010.

Figure 6 – Sensitiveness of the PSND/GDP ratio to the exchange rate[1/]



1/ 12-month PSND/GDP ratio change in response to a 1% devaluation of the exchange rate (R$/US$).

In this context, a change of 1 p.p. in the Selic rate, considering the possibility of maintaining it in the subsequent twelve months, now provides, in April 2009, a movement, in the same direction, of 0.28 p.p. in PSND/GDP. This means an impact of 0.06 p.p. higher than in the recorded in December 2006 (Figure 4).

One should note, however, that given the existence of significant portion of PSND tied to the price index, 32.3% in April 2009, the total impact of monetary policy on its dynamics is complex. This is because after periods of monetary contraction (expansion), inflation tends to fall (rise), reducing (increasing) the nominal interest incorporated to the debt.

In this scenario, appropriation of 12-month cumulative nominal interests, which also reflects the process of raising interest rates observed in the first three quarters of 2008, considered the market expectation for the Selic rate, will begin to register a declining trend during 2009 and 2010, reaching, in this order, 4.7% of GDP – the lowest percentage since 1997 – and 3.8% of GDP, compared to 5.7% of GDP in 2008, as shown in Figure 5.

The susceptibleness of PSND to the fluctuations in the exchange rate reflects, just as occurred in relation to interest rate, changes experienced by the composition of net indebtedness, which had, by mid-2006, a share linked to the exchange with net debtor balance. Thus, a 1% depreciation in the exchange rate (R$/US$), which, at the end of 2004 determined an increase of 0.08 percentage points in PSND/GDP ratio has come to mean a reduction of 0.11 p.p. in the mentioned indicator (Figure 6). The market scenario projects that the real is expected to record an appreciation of 14.4% in 2009, a movement responsible for variation of 1.4 p.p. in the ratio PSND/GDP and for providing stability in 2010, thus exerting no impact on the indicator. In 2008, depreciation amounted to 32%, accounting for a decrease of 2.6 p.p. of GDP in net indebtedness.

The change in GDP valued by the General Price Index (IGP-DI) Centered should exert a negative contribution to the evolution of PSND/GDP in 2009, 1 p.p., and in 2010, 3.2 p.p., compared to -3.5 p.p. in 2008. The projections reflect, indeed, the impact

Table 2 – Net debt growth[1/]
Conditioning factors

			% GDP
	2008	2009	2010
PSND – Balance	38.8	42.0	39.2
PSND – % change	-5.0	3.2	-2.8
Factors (accumulated flows in the year):	-1.6	4.2	0.4
PSBR	1.9	2.2	0.5
Primary	-3.6	-2.5	-3.2
Nominal interests	5.5	4.6	3.7
Exchange rate adjustment	-2.6	1.4	0.0
Domestic exchange securities debt[2/]	0.1	-0.1	0.0
Foreign debt – Methodological adjustment	-2.7	1.5	0.0
Other adjustments	-0.9	0.6	0.0
Foreign debt[3/]	-0.9	0.4	0.0
Acknowledgment of debts	0.0	0.2	0.0
Privatizations	-0.0	-0.0	0.0
Effect GDP growth – Debt	-3.5	-1.0	-3.2

1/ In 2009 and 2010, projected data.
2/ Domestic dollar-indexed securites debt.
3/ Parity of the basket of currencies that compose of the foreign net debt.

related to estimates for real growth of the product and of the IGP-DI.

In summary, the projection on the growth of the ratio PSND/GDP in 2009 incorporates the most pronounced effect of reducing the primary surplus target and of the impacts of currency appreciation estimated for the year and of the lower contribution associated with the valued GDP growth in comparison to that provided by the reduction in nominal interest appropriation. The falloff forecasted projected for the 2010 ratio, returning to a level lower than the one recorded prior to the crisis, reflects the atmosphere of recovery in the rate of growth of the product and increase of the primary surplus. The individual contributions of determinants of the evolution of PSND/GDP ratio in the two-year period are shown in Table 2.

It is worth mentioning, therefore, that the projection for the PSND/GDP ratio, essentially based on market parameters, by ensuring the continued reduction of public indebtedness over the medium-term, shows the benign nature of the fiscal measures adopted by the government in order to strengthen relevant sectors to the recovery of the level of internal activity, provided that they are temporary, as the authorities in charge have indicated.

Figure 3.35 – Profile of maturities of the securities debt

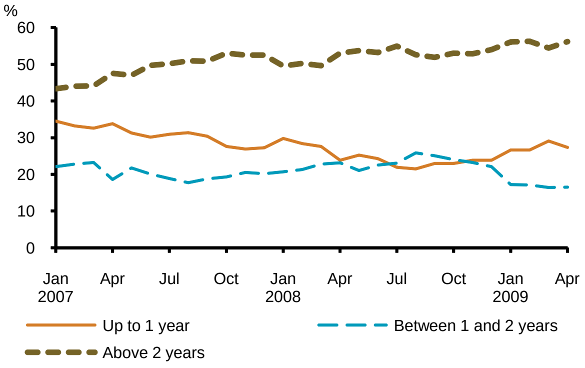


Figure 3.36 – Swap and open market position

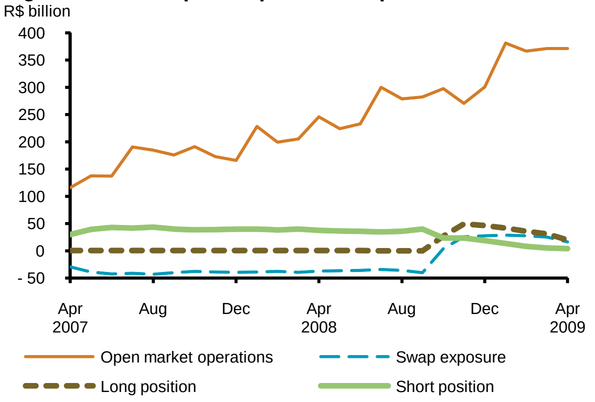


Table 3.10 – Net debt growth

Conditioning factors

Itemization	2007		2008		Apr 2009	
	R$ million	% GDP	R$ million	% GDP	R$ million	% GDP
Total net debt – Balance	1200 799	43.9	1153 631	38.8	1207 377	41.4
Flows	**Accumulated in the year**					
Net debt – Growth	88 098	-2.0	-47 168	-5.0	53 745	2.5
Conditioning factors	88 098	3.2	-47 168	-1.6	53 745	1.8
PSBR	71 492	2.6	57 240	1.9	22 078	0.8
Primary	-89 730	-3.3	-106 420	-3.6	-30 760	-1.1
Interest	161 222	5.9	163 660	5.5	52 838	1.8
Exchange adjustment	21 016	0.8	-77 373	-2.6	20 735	0.7
Domestic securities debt[1/]	-2 432	-0.1	3 180	0.1	- 915	0.0
External debt	23 449	0.9	-80 553	-2.7	21 650	0.7
Others[2/]	-2 516	-0.1	-26 404	-0.9	11 227	0.4
Skeletons	- 630	0.0	135	0.0	329	0.0
Privatizations	-1265	0.0	-767	0.0	-624	0.0
GDP growth effect		-5.2		-3.5		0.7

1/ Domestic dollar – Indexed securities.
2/ Parity of the basket of currencies in the net external debt.

while the participation of the fixed-rate net debt and credit position referenced to the dollar decreased, in the order, from 35.3% to 29.6%, and from 30.3% to 26%, in the same comparison period. Also, net issues worth R$66.1 billion of debt tied to the Selic rate and net redemptions of R$74.8 billion in fixed-rate debt were observed.

The General Government Gross Debt (GGGD), which includes the Federal Government, the Social Secutiry and the regional governments, reached R$1,797.1 billion in April, 61.6% of GDP. The growth of 3.0 pp of GDP recorded in December reflected, in particular, the impact of the incorporation of nominal interest and growth in valued GDP, partly offset by exchange rate adjustments due on debts.

3.4 Conclusion

In the 3-month period ended in April, the credit market continued to reflect the slowdown in in the pace of economic activity. Interest rates kept a downward trend, especially in credit operations with individuals, a segment in which defaults remained relatively stable. By contrast, in the corporate credit segment, the reduction in the cost of borrowing was less expressive and the default rate, though at a moderate level, is moving upward since the beginning of the year. The perspective of maintenance of a downward trend for interest rates, consistent with the evolution of default and basic interest rates, should help to restore the credit market, a prerequisite for a sustained economic recovery.

The recent performance of economic activity has been partly conditioned by the impact of temporary tax relief measures implemented in specific sectors for boosting the aggregate demand. In this framework, the evolution of fiscal accounts in the first four months of the year reflected both the effect of reduced activity and the aforementioned tax measures on the government revenues, as well as the impact of the policy of public investments adopted with the objective of promoting the recovery of the stock of capital and expand the aggregate demand.

It should be highlighted that the impact of these counter-cyclical policies on the downward trend of PSND/GDP, even against the backdrop of a decline in the primary surplus targets, should be neutralized by the process of easing monetary policy, favoring the maintenance of the declining trajectory over the medium term.

Figure 3.37 – NPSD – Percentage share of indexator

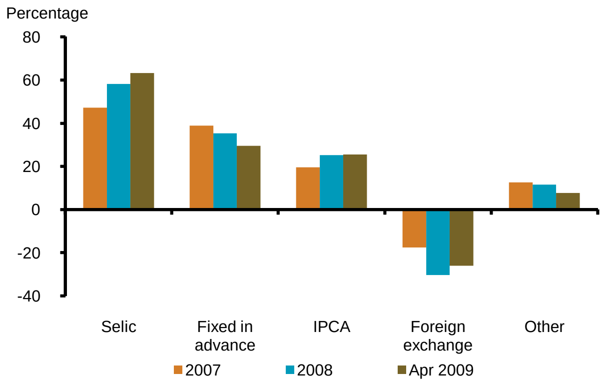


Table 3.10 – General government gross debt
Conditioning factors

Itemization	2007		2008		Apr 2009	
	R$ million	% GDP	R$ million	% GDP	R$ million	% GDP
GGGD – Balance	1 542 852	56.4	1 740 888	58.6	1 797 074	61.6
Flows	**Accumulated in the year**					
GGGD – Growth	206 207	1.2	198 036	2.2	56 186	3.0
Conditioning factors	206 207	7.5	198 036	6.7	56 186	1.9
GGGD borrowing requirements	222 097	8.1	158 976	5.4	64 282	2.2
GGGD net issue	42 958	1.6	-41 963	-1.4	- 280	0.0
Interest	179 139	6.5	200 938	6.8	64 562	2.2
Exchange adjustment	-27 462	-1.0	38 473	1.3	-10 855	-0.4
Indexed internal securities debt1/	-2 432	-0.1	3 180	0.1	- 915	0.0
External debt	-25 029	-0.9	35 293	1.2	-9 940	-0.3
Others2/	7 123	0.3	-2 662	-0.1	2 513	0.1
Skeletons	4 448	0.2	3 250	0.1	247	0.0
Privatizations	0	0.0	0	0.0	0	0.0
GDP growth effect		-6.3		-4.4		1.0

1/ Domestic dollar – Indexed securities.
2/ Parity of the basket of currencies in the external debt.