



Monthly Report
May

Monetary flexibility points out a 1-digit nominal interest rate

THE FOREIGN SCENARIO FLUCTUATION – ESPECIALLY IN THE LAST YEAR – IMPOSED RESTRICTIONS TO THE INTERNAL ECONOMY; NOTWITHSTANDING DOMESTIC INDICATORS SHOW THE COUNTRY'S GREAT CAPACITY TO OPPOSE AND REACT TO IMPACTS RESULTING FROM FOREIGN SCENARIOS. ALTHOUGH BRAZIL HAS NOT REMAINED SAFE FROM THIS PROCESS, THE ECONOMIC POLICY HAS NOT FAILED, DIFFERENTLY FROM WHAT WAS OBSERVED IN PREVIOUS CRISIS. IN SPITE OF A STRONG SLOW-DOWN IN THE ACTIVITY LEVEL AND A PERSPECTIVE OF SLOW RECOVERY, INFLATION IS UNDER CONTROL, FINANCIAL INDICATORS HAVE ALREADY SHOWN A REST, OVERCOMING PERIODS OF HIGH VOLATILITY, AND BANKING SECTOR CONFIRMS ITS STABILITY AND LOW SYSTEMIC RISK. BY THE LOOKS OF THINGS, THIS WORLD WIDE CRISIS GIVES BRAZIL A HISTORIC OPPORTUNITY TO KEEP UP WITH THE ECONOMIC STABILITY BY MEETING THE INFLATION TARGET AND SUPPORTING THE FLOATING EXCHANGE RATE REGIME, ACCOMPANIED BY THE DECREASE IN INTEREST RATES TO THE LEVELS OF FOREIGN INTEREST RATES. FINALLY, THE COUNTRY IS APPROACHING A 1-DIGIT NOMINAL INTEREST RATE.

ONLY THIS YEAR, COPOM – MONETARY POLICY COMMITTEE REDUCED THE SELIC RATE GOAL BY 3.5 PERCENTAGE POINTS – FROM 13.75 TO 10.25% –, AND IT IS EXPECTED THAT THE PROCESS OF MONETARY FLEXIBILITY CONTINUES IN 2009. TO THIS EFFECT, ACCORDING TO THE COMMITTEE, AND DRAWN UP IN THE MINUTES OF ITS LAST MEETING, IT IS "IMPERIOUS THAT THE ASPECTS RESULTING FROM A LONG PERIOD OF HIGH INFLATION, ABIDING IN THE INSTITUTIONAL STRUCTURE OF NATIONAL FINANCIAL SYSTEM, SHOULD BE UPDATED".



Breaking the paradigm requires adjustments to the financial system structure

The Finance Minister, Guido Mantega, and Brazilian Central Bank's CEO, Henrique Meirelles, announced, on last 13th, a proposal of saving accounts taxation, which shall be followed by the decrease in the Income Tax levied on other fixed income investments. Such measures aim at preventing imbalances among the different investment options, including a possible migration of major investors into saving accounts. It is worth to remember that, pursuant to the law, deposits in saving accounts are remunerated at a monthly 0.5% compensatory interest plus Referential Rate.

Summing up, the government proposal of saving accounts taxation forecasts:

- to incur income tax, as of 2010, on yield – considering only the portion related to the monthly 0.5% fixed compensation – of deposits higher than R\$50.000,00;
- a progressive taxation subject to decreases in Selic Rate (applying the reducer of calculation basis);
- a definite taxation in the annual statement of income tax return, based on the sum of the taxpayer's total monthly taxable income; and
- a withholding tax, considering the monthly income tax-free range.

So far, the proposal was not formalized by the Federal Government, and shall be forwarded to the National Congress as a legislative bill or a provisional measure. Regarding the procedure and approval of the legal text, it is likely that there may be political opposition – as already expressed by politicians from opposition parties at the House of Representatives and the Senate –, and even some changes in its content.

Regarding a still possible decrease in taxation imposed to other fixed income investments in 2009, it is worth to notice that, even if it is temporary, this rate may be equalized to the variable income rate. The last record in this sense occurred between 2002 and 2004, which incurred a 20% rate. As of 2005, the current system came to be effective, establishing the difference from variable income (15%) and fixed income; the latter is applied to decreasing rates pursuant to the funds lock-up period, varying from 22.5% to 15%.

From a more conceptual point of view, it is worth making some comments. Considering this is about the most popular investment alternative, it is reasonable to suppose that simplicity is one of its great attractions. Therefore, the adoption of a more complex taxation rule should affect the demand of this kind of investment.



Additionally, it is worth remembering that the total tax-free individual saving accounts has been maintained since June 1990. However, for more distant times in the past, taxes were levied on deposits reaching certain amounts, as defined in the legislation.

Another matter to be discussed regards the allocation of fundings into saving accounts. Currently, at least 65% of these funds must be invested in real estate financing operations, of which at least 80%, should be in housing financing operations in the scope of the HFS – Housing Financing System (SFH – Sistema Financeiro da Habitação). In this sense, the government choice for the deposits taxation, in opposition to the review of rules that ensure the income on saving accounts, may result, in a near future, in changes of financing costs based on these fundings. At most, there may be more favorable conditions for borrowers in financings based on “free” funds, in addition to the difficulty to comply with allocations by the institutions integrating BSLs - Brazilian Savings and Loans System (SBPE – Sistema Brasileiro de Poupança e Empréstimo). Such problems may be part of the authorities’ agenda so that to prevent impediments to the economic growth, considering its important share in the real estate industry.

Regarding the balance among the several investment options – referred to by the government as one of the main reasons to the proposed changes –, it must be observed that investors tend to pay attention to possible income resulting from arbitration and that, without a doubt, it is incumbent to the government to prevent the changes in financial savings with relevant impacts on the entire society. Accordingly, it includes the concern with management of federal public securities debt, mainly related to the government securities demand; and, on the other hand, with the efficiency of the National Financial System and investor protection.

Still on the same matter, it is important to mention that many adjustments were made to the TR index over the years, specially, in its reducer, in order to improve its calculation method, considering mainly the large range of operations in the scope of financial system related to this index. The most recent changes consisted of defining the parameter (“b”) for the TR calculation in cases that BFR - Basic Financial Rate (TBF – Taxa Básica Financeira) is lower than 11%, thus adapting it to the new interest rate level. In addition to integrate the calculation of monetary restatements to saving accounts, TR is used in many types of financial agreements and in the compensation of FGTS accounts.

By the looks of things, punctual adjustments promoted by the regulating bodies so far – specially referring to TR calculation – were enough to correct the



conjunctural instability. However, the new reality, with perspectives of changes in the interest rate level, requires a deeper review of the legal and normative structure which supports operations and funding and investment instruments of the National Financial System (Sistema Financeiro Nacional). The new target for Selic Rate defined by Copom, to be fixed on June 9 and 10, surely will be determining to define measures to be adopted by the government in this matter.

Together with this controversy, at the end of the month, a discussion started about the need of the government to adopt new measures aiming at keeping the continuous movement of Brazilian Real valuation under control – dollar closed this month quoted at R\$1.9730, accumulating a 9.42% devaluation. Taking into account the pressure made by the exchange rate flow, it has been speculated the return of IOF charge on entry of funds in the country to be allocated to fixed income investment. The other new change referred the disclosure of information about the volume of Central Bank interventions in the exchange market; as of the 27th, it will be on weekly basis. The discussion on the exchange rate policy may continue in June. In particular regarding the use of taxes to restrain the entry of foreign funds in the economy, it seems not to be a good option, due to the negative effects that can be generated in terms of rules instability and legal riskiness, affect the credibility of the country. In addition to the adjustments to the structure of the financial system regulation, which were above mentioned, maybe it is the time to promote a more general review in the tax rules incurred on financial operations, including operations carried out by non-resident investors.



Interview - Luiz Antônio Nogueira de França

Real estate credit should be seen as business

INTERVIEWED BY FONTE ANDIMA, THE CHAIRMAN OF ABECIP – BRAZILIAN ASSOCIATION OF REAL ESTATE CREDIT AND SAVINGS ENTITIES, LUIZ ANTÔNIO NOGUEIRA DE FRANÇA, EVALUATES THE PROPOSAL OF PROGRESSIVE TAXATION OF INCOME ON SAVING ACCOUNTS PRESENTED BY THE GOVERNMENT AND THE POSSIBILITY OF TEMPORARY ADJUSTMENTS TO THE INCOME TAX LEVIED ON OTHER FIXED INCOME INVESTMENTS: “THE PURPOSE IS TO PREVENT THAT GREAT INVESTORS CHANGE TO SAVING ACCOUNTS AND ENSURE THE ECONOMIC STABILITY, SO THAT TO MAINTAIN THE DECREASE IN THE BASIC INTEREST RATE”.

What do you expect in relation to the achievement of these measures, and what are other initiatives that should be taken?

Taxation for big deposits kept in saving accounts sought to fulfill two purposes. One of them is to cause the continuous decrease in Selic Rate, which is extremely important to the country. The other one is to keep the Saving Accounts as an instrument for people with a lower income, but with no migration of funds from the market into this investment, which could result in the withdrawal of funds from the economy that are being currently to finance the productive industry.

What should be done to make income on saving accounts compatible to the proper conditions for the real estate financing – mainly from the borrower’s point of view -, considering the current rules of mandatory allocation of funds for the housing industry?

Although the Housing Financing System has been created in the 60’s, the model continues almost with the same structure of directed credit after these four decades. This model prevailed in other countries in the 60’s, 70’s and 80’s, but is out-of-date. We need to update the model by creating conditions to stimulate the secondary market. Brazilian real estate credit must be seen as business, and not as an obligation. It is what happens in other countries, and it cannot be different in Brazil.