



Monthly Report
June

Decrease in financial risk and in interest rates promotes portfolio reallocation

AFTER THE SIGNIFICANT IMPACT OF THE INTERNATIONAL CRISIS OCCURRED IN THE LAST QUARTER OF 2008, THE INITIATIVES TAKEN IN EARLY 2009 BY THE RECENT U.S. ADMINISTRATION FOCUSING ON MITIGATING THE PROBABILITY OF COLLAPSE IN THE WORLD FINANCIAL MARKET HAD POSITIVE INFLUENCE ON INVESTORS' APPETITE FOR RISK. IN BRAZIL, THE MEASURES ADOPTED BY THE GOVERNMENT IN 2008 TO REDUCE THE EFFECTS OF THE CRISIS ON THE COUNTRY, TOGETHER WITH THE REDUCTION, AS FROM JANUARY, OF THE TARGET FOR THE SELIC RATE OF 4.5 PERCENTAGE POINTS (FROM 13.75% TO 9.25% P.A.) WERE ALSO SUCCESSFUL, CONTRIBUTING TO THE 0.8% GDP DECLINE IN THE FIRST QUARTER, BELOW EXPECTATIONS IN THE MARKET AND OF THAT SEEN IN VARIOUS COUNTRIES. MOREOVER, BRAZIL REGISTERED SURPLUS IN NET FOREIGN PORTFOLIO INVESTMENTS, ESPECIALLY IN THE VARIABLE INCOME SEGMENT, WHICH FAVORED THE IBOVESPA 37.06% ACCUMULATED INCREASE IN THE FIRST HALF.



The decrease in base interest rate, which for the first time ever reached the level of one digit in Brazil, not only heavily decreased the curve of the term structure observed in the most acute phase of the crisis (end of October 2008), but also changed its inclination. If at that time of extreme uncertainty there were expectations of high interest rates in all vertices, at the end of June the curve reflected a projection of continuing decline for the next six months – what seemed to be influenced by the low inflationary pressure and by 16.49% decrease in the dollar price accumulated in 2009 – and of increase for more than a year terms. Thus, the relative improvement in the international scenario and the relaxation of monetary policy in Brazil, plus tax matters, played a decisive role in asset allocation in the first half of 2009.

Fixed income funding positive again

The reduction of uncertainty and interest rate in the first half favored the resumption of funding by fixed income funds, which accumulated net redemptions of R\$52.7 billion in the second half of 2008. The funds with DI (Interfinancial Deposits) references, which do not benefit from interest rate decrease, continued to record net redemptions, but at lower intensity compared to that at the end of 2008. Although they accumulate negative net funding until June, due to the expressive redemptions occurred in January, multimarket funds recorded positive monthly balances between February and May.

The greater propensity to risk by investors and improvement in the performance of this type of funds – IHFA (Andima Hedge Funds Index) recorded an 11.51% increase in the year up to June 26, exceeding the accumulated increase over the past 12 months, which was 11.13% – could explain the resumption of investments in these assets.

Despite having lost intensity when compared to the previous two semesters, CD funding continued to have the greatest balance between investment alternatives.

The stock recorded in Cetip grew from R\$537.9 billion on June 30, 2008 to R\$821.8 billion on the 30th this month, which represents approximately two-thirds of all private securities and fixed income assets in the Brazilian market, which is R\$1.221 trillion.

As the participation of such securities in the investment funds portfolio remained fairly stable, we can say that much of the growth occurred outside this segment. This performance can be due to the fact that the CDs offer daily liquidity and attractive profitability – especially in the case of subordinate bonds, which



have no coverage from FGC – Credit Guarantee Fund – besides of suffering Income Tax (IR) only in maturity, and not every six months, as it occurs with investment funds. Even in regard to that type of investment, the creation of DPGE should be highlighted - Term Deposits with Special Guarantee provided by the FGC up to the maximum amount of R\$20 million. Regulated in April, this asset recorded R\$8.8 billion funding in just three months.

With the decrease in interest rates, Savings Accounts, whose profitability have a 0.5% fixed portion per month and which has tax exemption, also started to attract more resources, which caused a debate on the need to review the financial system institutional framework, constituted in the past over an inflation system and high interest rates, as well as by mandatory fund allocation (please refer to May ANDIMA Monthly Report).

The government's proposal to tax deposits over R\$50,000 as of 2010, announced in May, not only makes this type of investment more complex, avoiding investments which are partly directed for real estate financing, but also delays a final solution to the matter, involving the removal of the floor it represents to the interest rates.

The increased uncertainty caused by the international crisis was also reflected in the composition of federal debt securities. The comparison of the position from May 2009 with the same month last year points to an increase in installments linked to the Selic Rate and price indices, rather than a reduction of the prefixed installment. However, the assessment of the IMA components show that the profitability accumulated in the year and in 12 months of the IRF-M, which measures the performance of prefixed public securities in the market, was higher than that recorded by the IMA-S, which measures the profitability of the floating debt installment, rewarding investors who bet on interest rate decrease. The best investment alternative in this segment, however, were the securities linked to the IPCA (Extended Consumer Price Index), whose profitability, measured by IMA-B, was 12.59% in the semester.

Regarding the securities market, the effects from the crisis were significant. In the stock market, after the boom of primary offerings occurred in 2007 and 2008, the first primary issue in 2009 occurred only on the 24th of this month. However, although secondary, the initial public offering (IPO) of Cia. Brasileira de Meios de Pagamento (VisaNet) should be recorded, cause it reached the largest volume ever recorded in the Brazilian market (R\$8.4 billion) and in the world, in this case considering only the current year.



In the fixed income corporate securities market, the increase in the uncertainty and lack of credit resulting from the crisis at the end of 2008 led companies to increase the volume of commercial papers issues (short-term securities with maturities from 180 to 360 days), mainly aiming at reducing liabilities and debts, awaiting better funding conditions.

The debenture market experienced significant reduction in the issue volume since the second half of 2008, not only because of the crisis, but mainly by the imposition of compulsory collection on DI-Leasing operations, which discourage companies in the sector - that dominated the segment with significant volumes since 2005 - making new fundings. To have an idea, in the first half of 2008, the amount issued was approximately R\$33 billion, compared with just R\$7 billion in the same period of 2009. However, since the latter does not include any issue of leasing companies, and that of the amount for 2008, not lower than R\$31 billion was generated in this segment, one can consider that in practice the volume of issues of companies in the non-financial sector grew three and a half times in that period for comparison.

There was also improvement in the distribution of funding by industry and activity in the first half of 2009, with the predominance of issues by companies in the telecommunications industry (37% of total). As in the case of commercial papers, those destined to reducing liabilities and extending the debt profile also prevailed. It is also worth pointing out the increasing use of the issue with limited efforts regulated in January by CVM Rule 476. Although it does not have the same reach as a traditional issue regarding potential investors, the method has accounted for 29% of issues in the period, which added up to 12% of those exempted from registration with the CVM reached 41% of total. Regarding remuneration, the DI rate continued to stand out in 2009.

Despite the worsening of the international crisis and the liquidity concentration, data for May show that the credit operations in the financial system continued to grow in 2009, although at a slower pace, reaching 43% of GDP, or R\$ 1.259 trillion, versus 41.3% and 34.2% in December 2008 and 2007, respectively. The figures also point to the growth of such operations over the past 12 months, both in the segment of free resources (18.8%) and in targeted credit (24.8%). However, in spite of the contribution of demand for payroll deductible loans and mortgage, the statistical effect (foreign exchange, interest and inflation) on these results should be considered.



Higher capital markets share in domestic savings

Apparently, the continued reduction of the base interest rate and the expected recovery in the level of activity in the second semester should stimulate the growing participation of the Brazilian capital market in savings and financing of the country's development (see interview on page 5). In this regard, it is worth observing that stock of private securities now approaches the public debt volume, which was R\$1.312 trillion at the end of May. However, in order to concretize this scenario, some factors should be taken into consideration. At the international level, the monitoring of macroeconomic risks such as the global dollar depreciation, asset inflation (commodities) and the opening of long rates in developed countries. In the domestic scope, in addition to maintaining tax balance, it is necessary to review the institutional and tax framework of the financial market, so as to create conditions for the continued development of capital markets.

Parallel to the discussions about the remuneration provided by Savings and the fund allocation for credit operations and housing, this new environment should also stimulate a reassessment of the CDI indexing culture. In the tax sphere, the correction of systematic periodic income tax paid by fixed-income securities will certainly stimulate primary and secondary markets for these securities, especially with the increase of individuals and non-financial legal entities' participation in the market. Furthermore, the harmonization and reduction of inequalities in taxation among different assets and investments could help reduce some of the imbalances existing today.



Interview – Carlos Rocca

Capital markets have growing significance in economy financing

CREATED IN 2008 WITHIN THE SCOPE OF THE AGREEMENT BETWEEN ANDIMA, IBMEC AND FIPECAFI TO ASSESS THE PERFORMANCE OF THE BRAZILIAN CAPITAL MARKET, CEMEC (CENTER FOR CAPITAL MARKETS STUDIES) IS DISCLOSING THE FIRST RESULTS OF THE PROJECT: “ALTHOUGH THE ANALYSIS IS AT THE BEGINNING, IT HAS BEEN FOUND THAT OVER 80% OF THE INCREASE IN FINANCIAL ASSET STOCKS COMPARED TO GDP BETWEEN 2000 AND 2008 SHOULD BE DUE TO THE INSTRUMENTS IN THIS MARKET”, SAYS CEMEC’S OFFICER CARLOS ROCCA..

What are Cemec’s goals and how should they be achieved?

Cemec aims to assess, disclose and promote debate on the performance and functionality of the Brazilian capital markets, in fulfilling its mission to move financial saving funds and finance the economy. Besides the implementation and disclosure of studies, including through the promotion of technical seminars, Cemec seeks to stimulate the implementation of works and theses of academic researchers, technical areas of public and private entities and professionals in the market. The goal is to contribute to the correct assessment of the economic and operational efficiency with which capital market play its role in order to identify eventual obstacles to its development and to propose actions to overcome them, consequently generating subsidies to update the Capital Markets Directive Plan.

How is the financial account model prepared and how can it contribute to assess savings allocation options?

The basic model of financial accounts is only a tool designed to generate a database that will be used in the studies to achieve these goals. This is a model based on fund flow matrix, which is not yet available for the Brazilian economy. What has been arranged so far is a very simple model that allows data collection from about a dozen sources of public and private information, so as to generate a consolidated view of the financial system – domestic capital markets, banks and international market. Its main limitation is to treat financial savings sources and their use separately. Cemec has already developed a more complete model that allows this integration, but its implementation requires additional resources that are being raised from other members of IBMEC. Anyway, this basic model is the



first step to learn, for example, the composition of the consolidated portfolio of financial assets, how the various types of investors – institutional, foreign and other non-financial investors – react to changes in the macroeconomic scenario or in the Selic rate. It can help, for example, understand how the financial crisis has affected the availability of funds for companies, or how to compare financing alternatives offered by the capital markets with the options of banking credit or even those available in the international market.

What results have been obtained?

It has been possible to consistently organize a database of nearly two hundred sets of monthly series since January 2000. The great potential to generate results capable of providing for the first time the development of a consolidated view has been proved, and at the same time, of providing a detailed view on the management of financial savings of the main non-financial domestic and foreign investors and their allocation to Brazilian companies' financing, as well as of the risk management processes. There is no need to stress the importance of this initiative. The need to generate better understanding of the financial system behavior and of how the risks inherent in its operation are recognized and managed is one of the main lessons of the recent international crisis, which has shown the importance of proper performance of the sector to support production, employment and economic growth.

Is it possible to identify proposals to be suggested to the Directive Plan?

Although preliminary results show a high potential to explain how the instruments and vehicles in the capital markets and the financial system in general work for savings funding and fund allocation in the economy, only now the analysis starts. In any case, the increasing importance of capital markets is clear: more than 80% of the increase in the stock of financial assets related to GDP between 2000 and 2008 should be due to instruments in this market, represented by shares, private debt securities and portfolios of institutional investors, such as pension and investment funds, open pension and insurance companies.