



Monthly Report
December

Asset allocation in the domestic market reflects crisis impact

THE US CREDIT CRISIS WORSENING, ESPECIALLY AS OF SEPTEMBER 2008, WITH THE BANKRUPTCY OF LEHMAN BROTHERS, CHANGED THE ENTIRE SCENARIO OF THE DOMESTIC FINANCIAL MARKET. THE WORLD CRISIS AND THE SIGNIFICANT DECREASE IN INTERNATIONAL LIQUIDITY CAUSED, IN THE YEAR DATA CLOSING, THE SECOND HALF TO SHOW CHARACTERISTICS VERY DIFFERENT FROM THOSE OF THE FIRST HALF, BOTH DUE TO THE BEHAVIOR OF FINANCIAL INDICATORS AND THE LEVELS OF INTAKE AND REDEMPTION OF INVESTMENT FUNDS AND THE ISSUE OF PUBLIC AND CORPORATE SECURITIES. THE COUNTRY SUFFERED WITH THE RESTRICTION OF ACCESS TO FOREIGN FUNDS AND, INTERNALLY, WITH THE LIQUIDITY CONCENTRATION AND THE DIFFICULTY TO PASS TROUGH FUNDS AMONG FINANCIAL INSTITUTIONS, AS WELL AS AMONG THE LATTER AND THE COMPANIES. IN THIS ISSUE, SINOPSE ANDIMA ANALYZES THE CRISIS IMPACTS TO THE CAPITAL MARKETS IN BRAZIL AND PRESENTS AN INTERVIEW WITH THE HEAD ECONOMIST OF FEBRABAN – BRAZILIAN FEDERATION OF BANKS, RUBENS SARDENBERG, ON THE THEME.



Crisis influence to the fixed income market

During the first six-month period of 2008, the dollar depreciated 10.1% against the BRL, and since the beginning of July, it appreciated 46.8%, equivalent to R\$2.3370 on the last day of December. A similar variation was observed in the share market: in the first half of the year, Ibovespa appreciated 1.8%, versus a 42.2% depreciation in the second half. The worsening in the pressure on foreign exchange and asset depreciation were reflex of the intense outflow of foreign funds, especially at the beginning of the second half, and the strong reduction of foreign currency inflow into the country. According to data disclosed by the Brazilian Securities and Exchange Commission – CVM, the outflow of foreign funds of portfolio investments, which had already been presenting high levels since July, got stronger in August, having generated a record negative net balance of US\$8 billion in October.

Concerning foreign investments in the fixed-income market, the latest data disclosed by the Brazilian Central Bank comprising the period from January to October 2008 also showed a change in the level of fund inflow compared to the same period of the previous year.

The shortage of funds in the international market while it caused the outflow of foreign currency of domestic financial markets, caused the interruption in foreign intake by Brazilian companies. The levels of international intake by companies and financial institutions gradually decreased during 2008. Data from the Central Bank corresponding to the period from January to October indicate a 52% decrease in the total intake volume in medium and long-term securities by companies in all economy sectors compared to the same period in the previous year. In the comparison between October 2008 and 2007, the decrease was 69%, having the highest retraction, 91%, occurred in the financial service sector, which traditionally accounts for a high level of intake in bonds in the international market. In the period between January and October, the decrease in the volume raised in the segment was 48% compared to the previous year.

In this context, the alternative of intake of financial institutions became concentrated in CDB – Bank Deposit Certificates, even if in view of the uncertainty environment, such a possibility has been restricted to the large-sized institutions, which presented as an alternative of solid investment. This movement, which had already been observed in the first half of 2008, became stronger in the second half, with the increased need for funding by financial institutions and the investors' preference for more liquid assets. Intake mainly concentrated in the floating segment, mostly characterized by DI-rate remunerated deposits. Also related to financial institutions intake, it is worth pointing out the expressive growth in the subordinate CDB class recorded at Cetip, inventories of which increased from



R\$36 billion in December 2007 to R\$48 billion in the end of 2008. Among the reasons for the expansion, it is possible to highlight, among investors, the pursuit for investments with higher effective rates – subordinate CDB is not subject to FGC – Fundo Garantidor de Créditos and the mandatory collection on time deposits – and, among financial institutions, the need to extend the term of its liability operations in order to adjust to the distention observed in its assets. In addition, it is worth pointing out that the subordinate CDB may integrate Level II of PR (Reference Equity) of financial institutions, since among other characteristics set forth in Resolution 3.444/07 of CMN, it has effective maturity term of at least five years, not being possible the payment of amortizations before this period elapses nor redemption by the creditor's initiative.

According to data disclosed by the investment fund industry, only in the quarter from September to November 2008, the fund outflow reached approximately R\$44 billion, highlight to multimarket and fixed income funds, which lost R\$22.7 billion and R\$18.7 billion, respectively.

In the same period, CDB presented net capitulation of R\$45 billion, and savings of R\$3.7 billion, showing investors' migration to more conservative markets.

Such a behavior is another evidence of Brazilian investors' cultural preference for operations referred at

short-term interest rates. The volatility which involved assets with higher exposure to interest rates and shares catalyzed this redirection, although in some cases the options for long-term strategies may be more advantageous to investors in the following months.

One example to be highlighted was the asset performance with pre-established installments over the year. Only during the last two months of the period, IRF-M and IMA-B, theoretical portfolios of the set of securities of the Treasury debt prefixed and linked to IPCA (Amplified Consumer Price Index), present 7.46% and 9.64% returns, respectively, with the reversal of expectations for the track of actual interest and inflation rates.

The aversion to risk also made the hedge fund industry to be one of the most affected ones in the period. IHFA – ANDIMA's Hedge Fund Index, reference comprised of a set of funds of multimarket class, recorded expressive decrease in net equity of funds which comprise its theoretical portfolio, which decreased from almost R\$ 50 billion in the end of 2007 to nearly R\$ 23 billion in December 2008.

Such a move is the result of a low performance during almost the entire year and the expressive volatility in the period. However, interest curve revaluation and the decrease in losses with shares over the past two months of the year positively affected the industry profitability. In this period alone, up to December 30, IHFA appreciated 3.27%.



Despite the recent closing in curves, market volatility strongly affected the strategy of public security issuance. The period was characterized by the difficulty in the placement of securities in traditional auctions in the amount previously set forth by the Brazilian National Treasury. In the year, in November alone the pre-established goal was achieved, however it is worth pointing out it had been only R\$10 billion, significantly lower than the R\$33.8 billion average of the other months in 2008. As a result, since the end of October there was an increase in the level of the Central Bank's activities to take one-day funds, while operations among financial institutions (DI) have been decreasing – even stronger in December. Data observed show that, despite the high liquidity in the system, the funds are concentrated or directed only to very short-term investments. Such behavior influences asset distribution in investment fund portfolios. Data disclosed by the Central Bank show that the percentage of public securities in the fund portfolio decreased from 51% to 48% in September.

In the second half of the year, the securities market showed strong slowdown, especially as to the issuance of shares and long-term fixed-income securities, such as the debentures. This move had already been observed from the beginning of the year, upon the start of compulsories on the deposits of leasing companies in financial institutions, discouraging issuances in this segment. Some issuances of leasing companies were cancelled without having been even distributed to the market after registration with CVM – Brazilian Securities and Exchange Commission. In the year, debenture issuances had a 50% decrease when compared to the volume observed in the previous year, and many of the operations carried out over the past months of 2008 were characterized by single-tranche assets, indivisible, able to be exempted of registration by CVM.

As an alternative, the number of registration of commercial papers had a strong increase, with a volume 167% higher than in 2007. In view of the worsening of the scenario, banking credit shortage and higher rates to take funds, the companies started to fall back on short-term securities, in an average of 180 to 360 days, for their debt roll down, expecting to obtain better conditions at the end of this period. The securitization instruments, such as CRI – Real Estate Receivable Certificates and FIDC – Credit Rights Investment Funds, also posted an increase. Although they correspond to financial volumes significantly lower than the note and debenture issuances, CRI stood out, with a 223% increase in 2008 compared to 2007.

The highest risk resulting from the decrease in foreign and domestic intake levels and credit concentration relates to the retraction in investments estimated by the companies for next year, which seems to be an agreement among analysts. However, a recent study disclosed by BNDES1 on industrial and infrastructure Brazilian companies' financing standard highlights the intense participation of



funds from self-financing with retained earnings (51%) and BNDES financings (26%) in 2007, compared to those obtained with intakes in the domestic markets, with shares and debentures (13%), and foreign market (9%). Although such a standard repeats in 2008 and 2009, the growth level set forth for next year will hardly be achieved. CVM data referring to the last days of 2008 show an amount of R\$6.2 billion in primary offers of securities under analysis for registration, of which R\$1.2 billion in debentures and R\$21 billion in FIDC. In spite of this, intake amounts observed in the previous years will not be reedited in 2009, nor will offers be resumed until credit conditions observed before the crisis worsening are reestablished.

Thus, the amplitude of financial crisis impact on actual economy – that is, on job and income levels – in Brazil, in 2009, is still a reason for great uncertainty, which reduces the capacity of agents' perception as to the possibilities of recovery of the financial market itself.

1 PUGA, Fernando Pimentel; NASCIMENTO, Marcelo Machado. Como as empresas financiam investimentos em meio à crise financeira internacional. Visão do desenvolvimento. [Rio de Janeiro], n. 58, December 2008. Electronic magazine issued by BNDES. Available at:

<<http://www.bndes.gov.br/conhecimento/publicacoes/catalogo/visao.asp>>.
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Interview – Rubens Sardenberg

Foreign financing decrease affects credit market

IN AN INTERVIEW TO SINOPSE ANDIMA, HEAD ECONOMIST OF FEBRABAN – BRAZILIAN FEDERATION OF BANKS, RUBENS SARDENBERG, ANALYZES THE EFFECTS OF THE DECREASE IN FOREIGN INTAKE ON THE BRAZILIAN MARKET AND THE IMPACTS OF THE LIQUIDITY CRISIS IN THE FIXED INCOME SEGMENT..

Data recently disclosed by BIS and by the Central Bank show that Brazil was one of the countries which mostly suffered with the crisis, concerning the decrease in number and volume of foreign intake. There was also a significant decrease in intake made by means of shares and debentures, and an increase of those made by means of short-term securities, such as promissory notes or securitization instruments, as shown in the growth of registrations of CRI and FIDC at CVM. How could these changes affect the trajectory of credit extension observed over the past years?

2009 will certainly be very different from 2008 in terms of credit market, especially up to the third quarter. The worsening of the international financial crisis practically closed the international credit market, dramatically reducing one of the most important sources of financing for banks and companies in Brazil. With this, there was an important displacement in dollar credit demand for BRL. The local financial system was unable to fully meet this additional demand. Although the numbers of September and October show an increase in credit operations, it was not enough to meet all the local demand, with negative highlight to some segments, especially small-sized and medium-sized companies.

Credit should increase less in 2009. On the offer side, due to the foreign funding shortage, including not only commercial operations strictu sensu, but also all financing options via capital markets. In addition, the financial institutions tend to be more selective and cautious in an environment of high uncertainty and volatility such as the one we live in. On the demand side, companies and families also tend to control their appetite for credit, consumption and investment, in view of a scenario of more uncertainties and lower economic growth. The result should be credit expansion around 15% in 2009, maintaining the growth path, but at a slower pace. This growth would be below the one verified in 2008, still it would be exceptional if compared to the average of projections for the worldwide economy behavior in 2009.



As from the North-American crisis worsening, a liquidity concentration was observed in the domestic market, which can be measured by the increasing volumes in fund-taking operations for one day carried out by the Central Bank. In your opinion, is it possible to wait for 2009 a better perception of risk in the country, so that these funds are reallocated and the asset market accelerates?

On the contrary of what we mainly saw in the financial markets of the USA and Europe, in Brazil we are undergoing a liquidity problem, not solvency. The crisis worsening in North-American credit market spread uncertainty through the worldwide economy, provoking a broad move of preference for liquidity. In Brazil, we had the so-called liquidity concentration, which especially impaired small and medium-sized institutions, which have a less stable intake basis, given the absence of time deposits in a significant volume and a higher concentration on the basis of time deposits.

Fortunately, this most difficult phase has already been overcome, and for two reasons. First, because of the measures adopted by the Central Bank, highlighting the releases of compulsory deposits to the purchase of credit portfolios, which ensure rebalance, at least partial, of the liquidity conditions of the banking market. Second, because if we are far from a final solution for the global crisis, at least the most serious stage of the financial and banking crisis in the USA seems to have been left behind. Nowadays, for instance, the bankruptcy of other significant financial institutions, such as Lehman Brothers, is no longer feared, to mention the most typical case so far. Thus, uncertainty from abroad decreased, which has also contributed to normalize the local market. However, we should be optimistic, but with no false illusions. The retake will be gradual and, as previously said, we will not resume, at least in 2009, the pre-crisis expansion rhythm.

Despite the crisis worsening in mid-2008, there was an increase in the credit/GDP ratio in September and October. Would this move be residual or a response to the measures already adopted by the government? Can it be sustained during 2009?

In a certain way, the results of credit operations in September, October and November positively surprised the economic agents. The expansion rhythm has been lower, but yet it is positive in terms of balances, which strongly contrasts with the international scenario. Two factors have been fundamental in this path: first, the financial health of our banking system, which was not obliged to large leverages in its operations – as it has been observed in the USA and in Europe, mainly – and it could maintain the credit offer at a high level; in second place, the Central Bank's measures, highlight to the release of compulsories and the auctions of foreign business line auctions. But these factors will not be enough,



nor could they be, to fully offset the important change in the direction of the international scenario verified over the past months. Worldwide economy in recession and world commerce and commodities price in significant decrease will charge their price in 2009. The economy and credit should grow less over the next year.