Capital Account Management in Brazil

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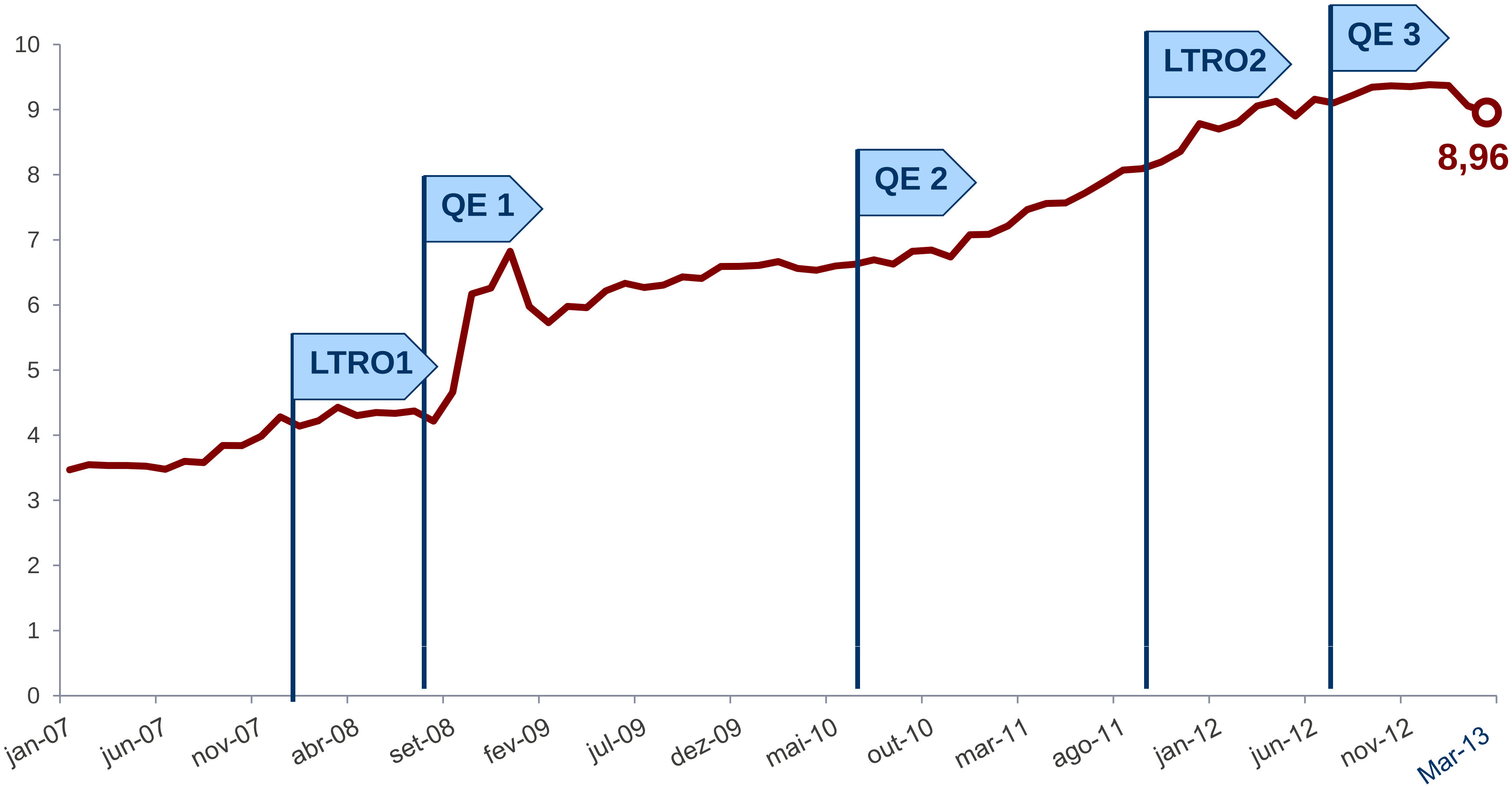
Expansion of International Liquidity (US$ trillions)

(USA, Europe, United Kingdom and Japan) - 2007-2013



Source: Bloomberg

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Unconventional Monetary Policy

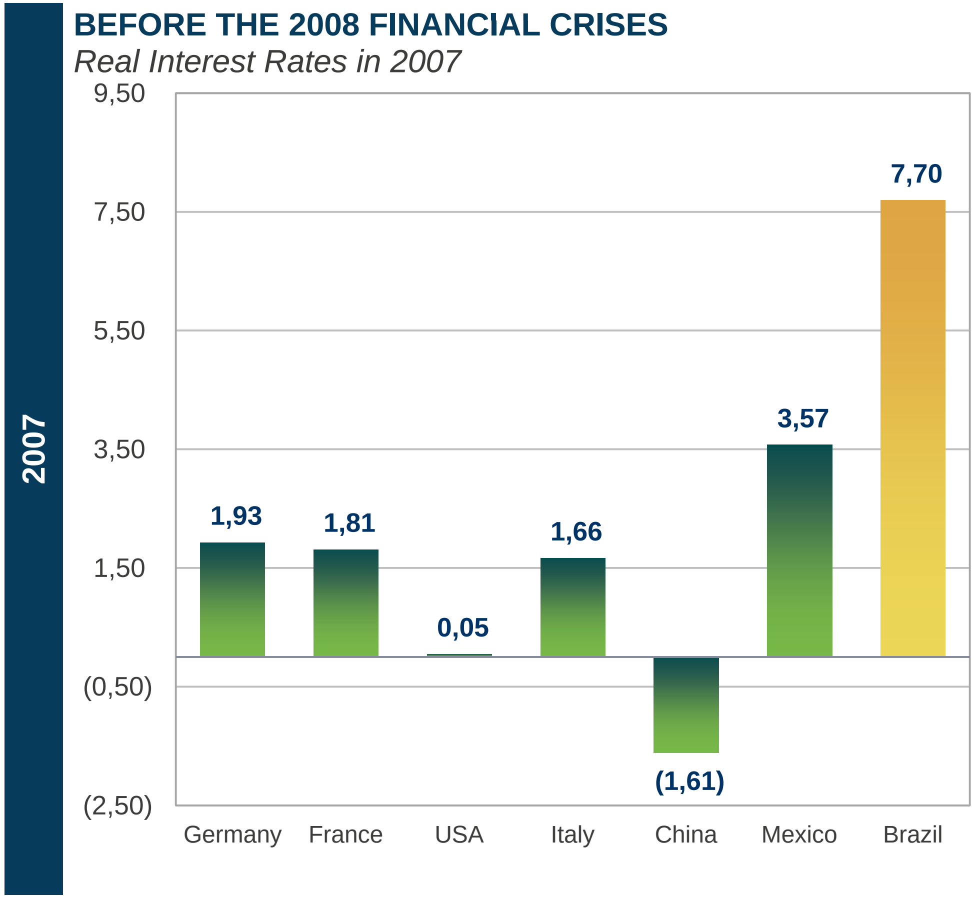
- Zero lower bound monetary policy in advanced economies associated with intense liquidity injection in their domestic financial system.

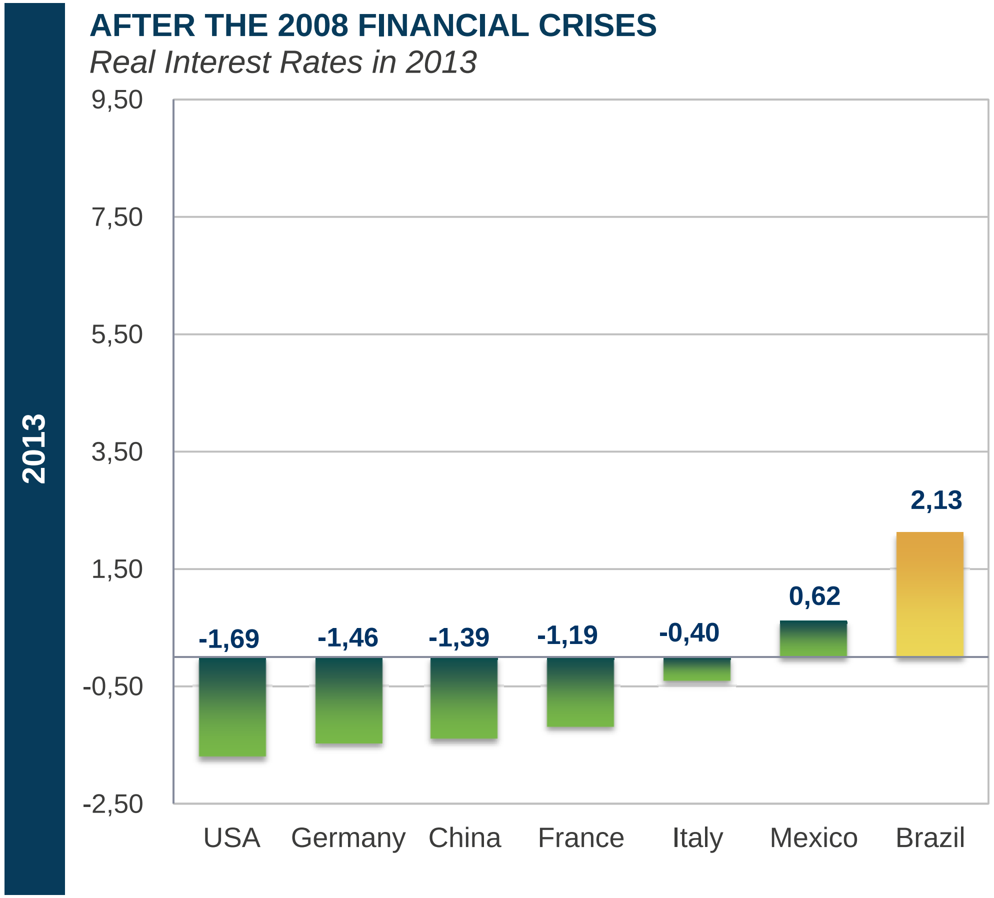
- Fiscal situation in most advanced economies is rather a problem than part of the solution.

- Central Bankers are trying to boost growth under such challenging circumstances.

- However, this has led to the "currency war", as it is a non-cooperative or competitive not zero-sum game.

Ex-ante Real Interest Rate (% p.a), Before and Then





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Brazil is implementing a set of policies that sustains economic growth

- Flexible monetary policy
- Countercyclical fiscal policy
- Floating exchange rate regime with more competitive Brazilian Real under "currency war"
- Promoting investment, mainly in infrastructure sector, fostering productivity
- Reduction of financial costs of investments
- Reduction of tax costs with widen tax exemptions due to fiscal space
- Promoting long-term capital market
- **And, also managing capital inflows as part of the economic policy toolkit**

The policy toolkit to manage capital account

- Higher IOF rates on short-term capital inflows, including external loans up to 1 year.

- IOF rates derivate margin deposit.

- IOF rates on excessive long position on BRL.

- Banks have to park at the Central Bank 60% of short dollar positions that exceed the limit of US$ 3 billion. The deposits should be in cash and receive no interest rate.

IOF rates on Portfolio Investments and External Loans

	3/12/2008	10/19/2009	10/04/2010	10/18/2010	07/26/2011	12/01/2011	02/29/2012	03/09/2012	Today
Portfolio									
Fixed Income	1.50%	2.00%	4.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%
Long-Term Corporate Bonds	1.50%	2.00%	4.00%	6.00%	6.00%	0.00%	0.00%	0.00%	0.00%
Equity	0.00%	2.00%	2.00%	2.00%	2.00%	0.00%	0.00%	0.00%	0.00%
Derivative Margin Deposit	0.38%	0.38%	0.38%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%
External Loan up to									
90 Days	5.38%	5.38%	5.38%	5.38%	6.00%	6.00%	6.00%	6.00%	6.00%
270 Days	0.38%	0.00%	0.00%	0.00%	6.00%	6.00%	6.00%	6.00%	6.00%
1 Year	0.38%	0.00%	0.00%	0.00%	6.00%	6.00%	6.00%	6.00%	6.00%
2 Years	0.38%	0.00%	0.00%	0.00%	6.00%	6.00%	6.00%	6.00%	6.00%
3 Years	0.38%	0.00%	0.00%	0.00%	0.00%	0.00%	6.00%	6.00%	0.00%
5 Years	0.38%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	6.00%	0.00%
Excessive Long Positions On BRL	0.00%	0.00%	0.00%	0.00%	1.00%	1.00%	1.00%	1.00%	1.00%

Source: Ministry of Finance

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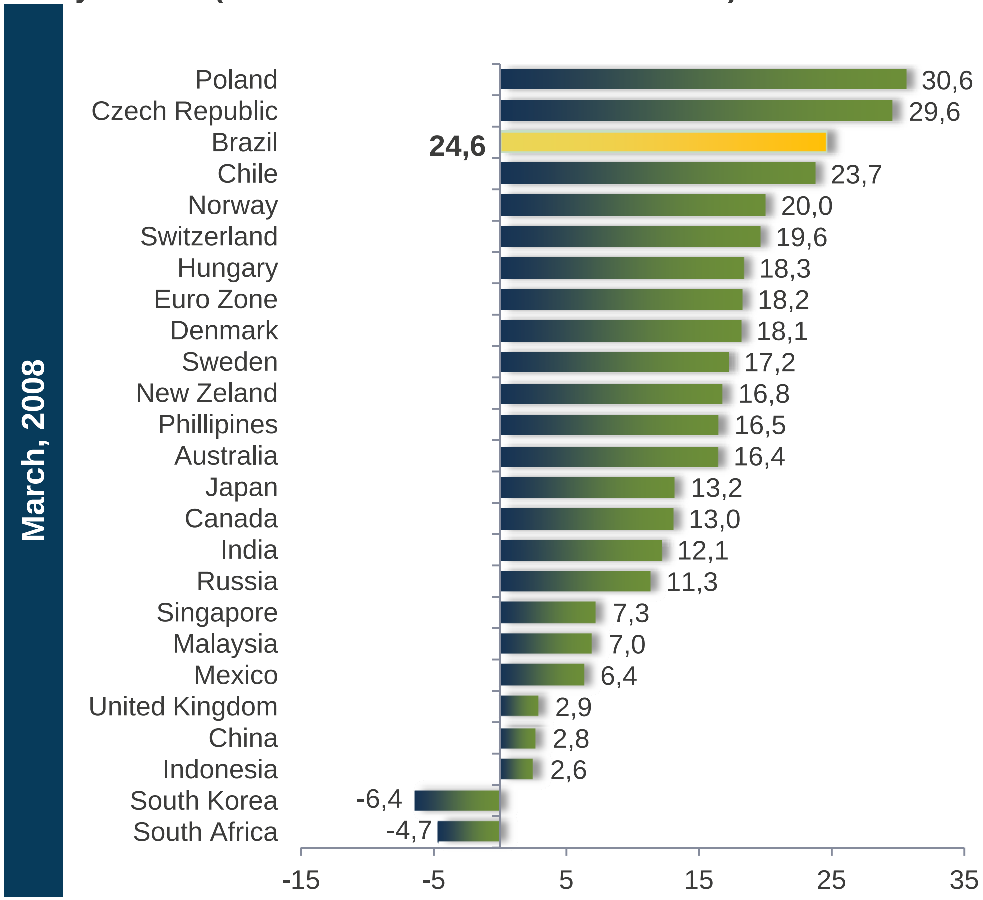
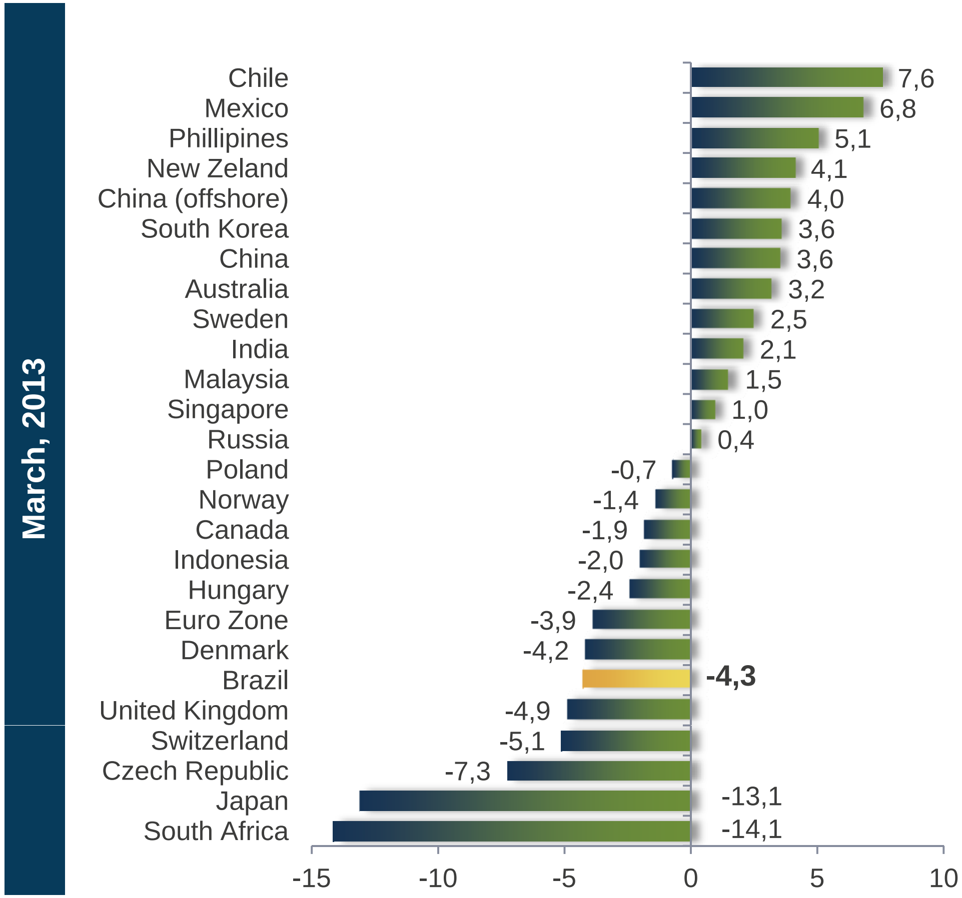
Carry Trade Transactions: changing capital account composition

Carry Return* (% accumulated on a 12-month basis)





* The carry return is equal to the return on investment in fixed income securities minus the cost of foreign currency loans.

Source: Bloomberg

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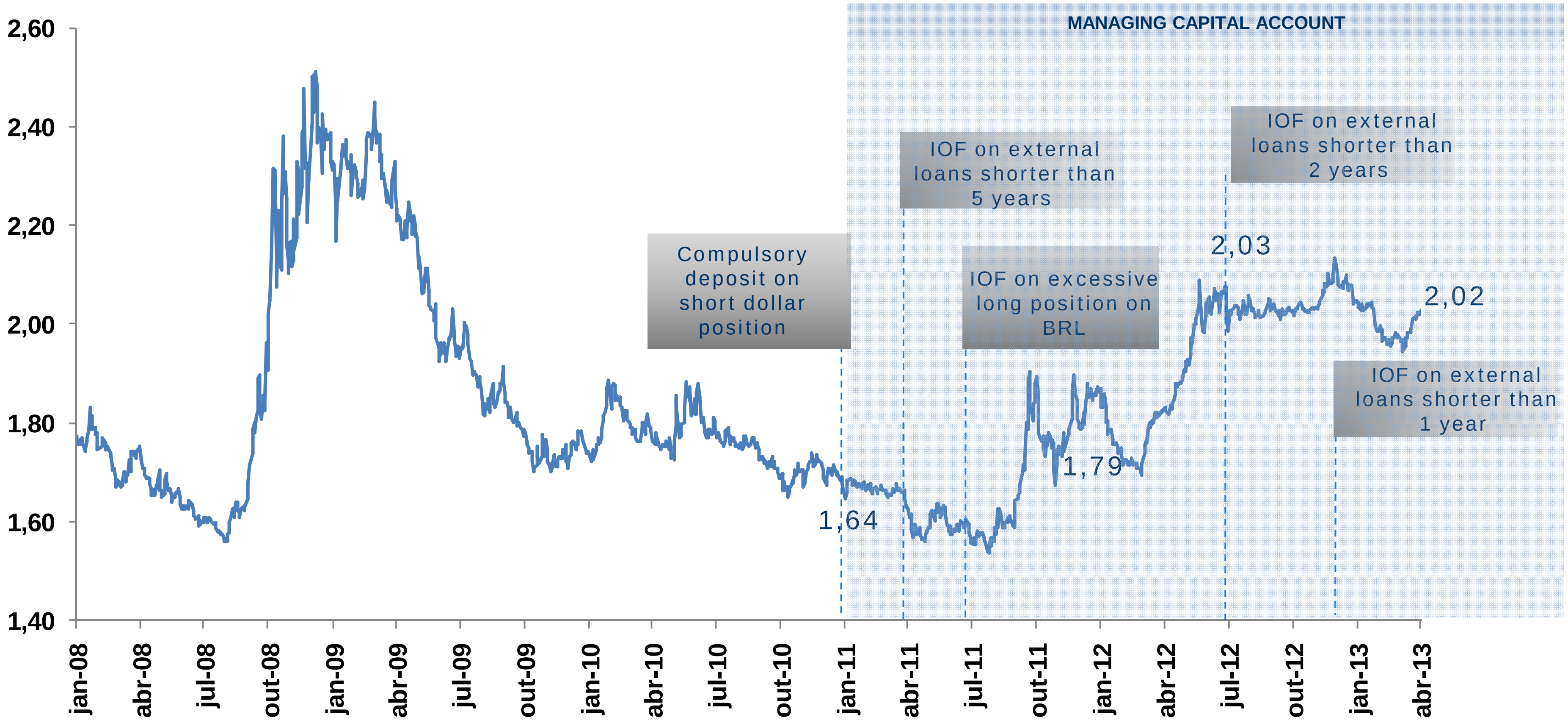
Brazil: macroprudential measures put forward since 2011 stamped appreciation



Source: Thomson Reuters

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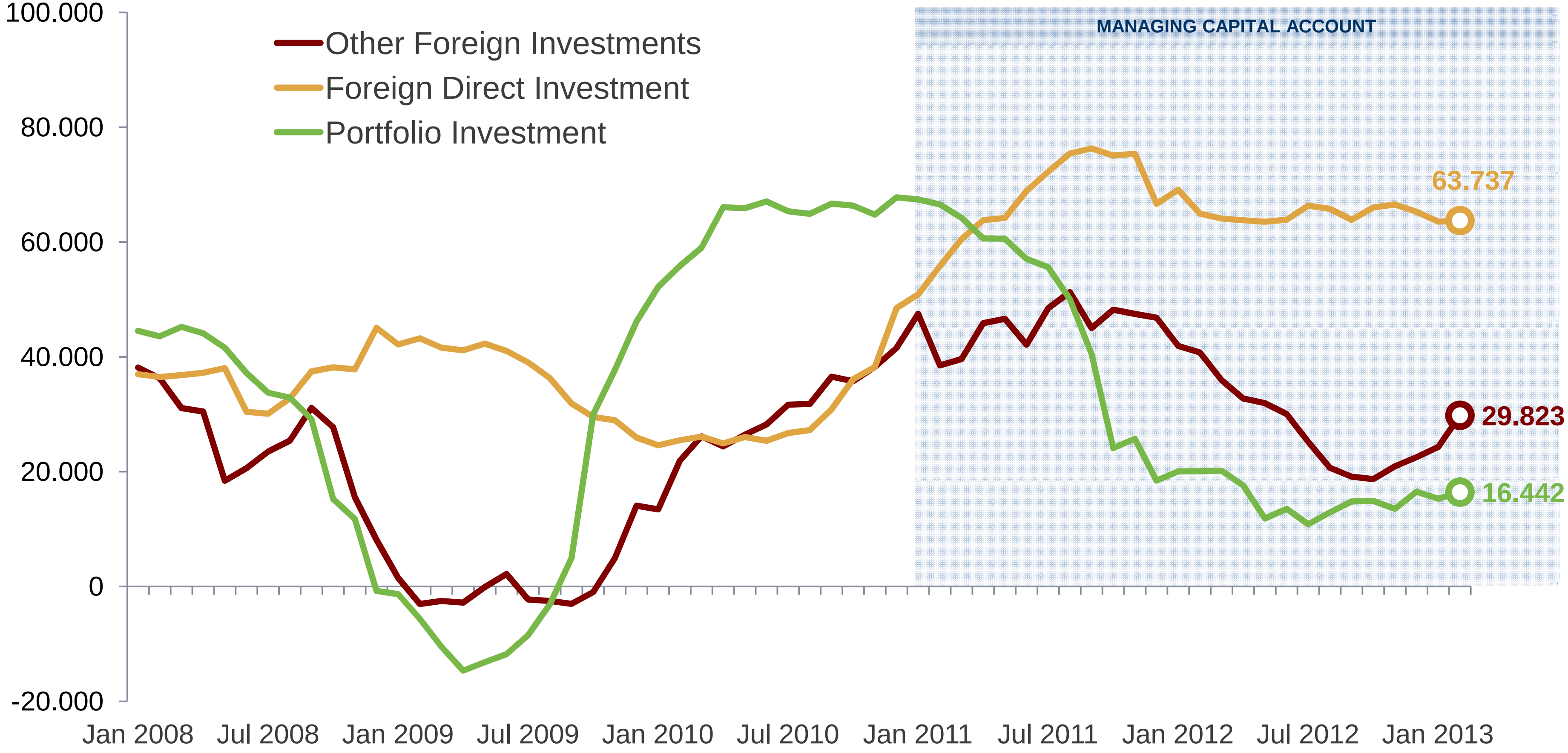
Financial Account

(On 12 Month Basis – USD Million)



Source: Central Bank of Brazil

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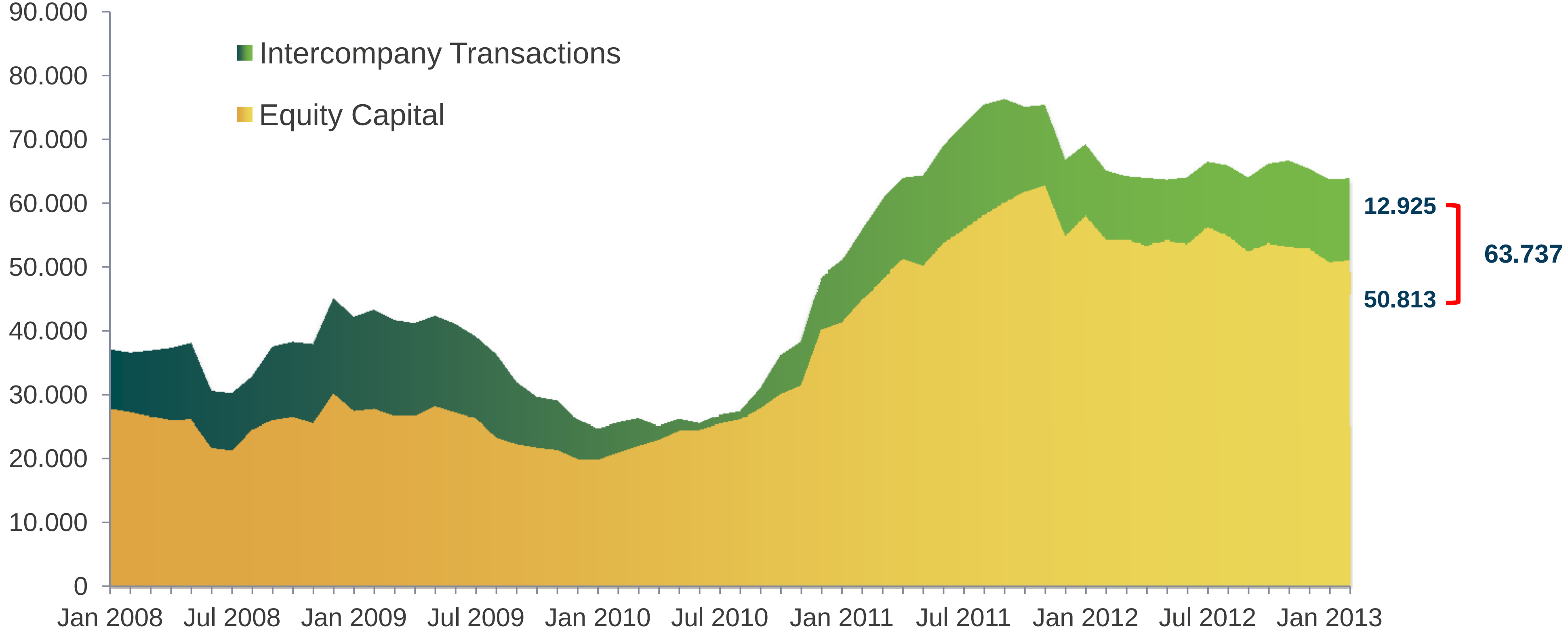
Foreign Direct Investment
(On 12 Month Basis – USD Million)



Source: Central Bank of Brazil

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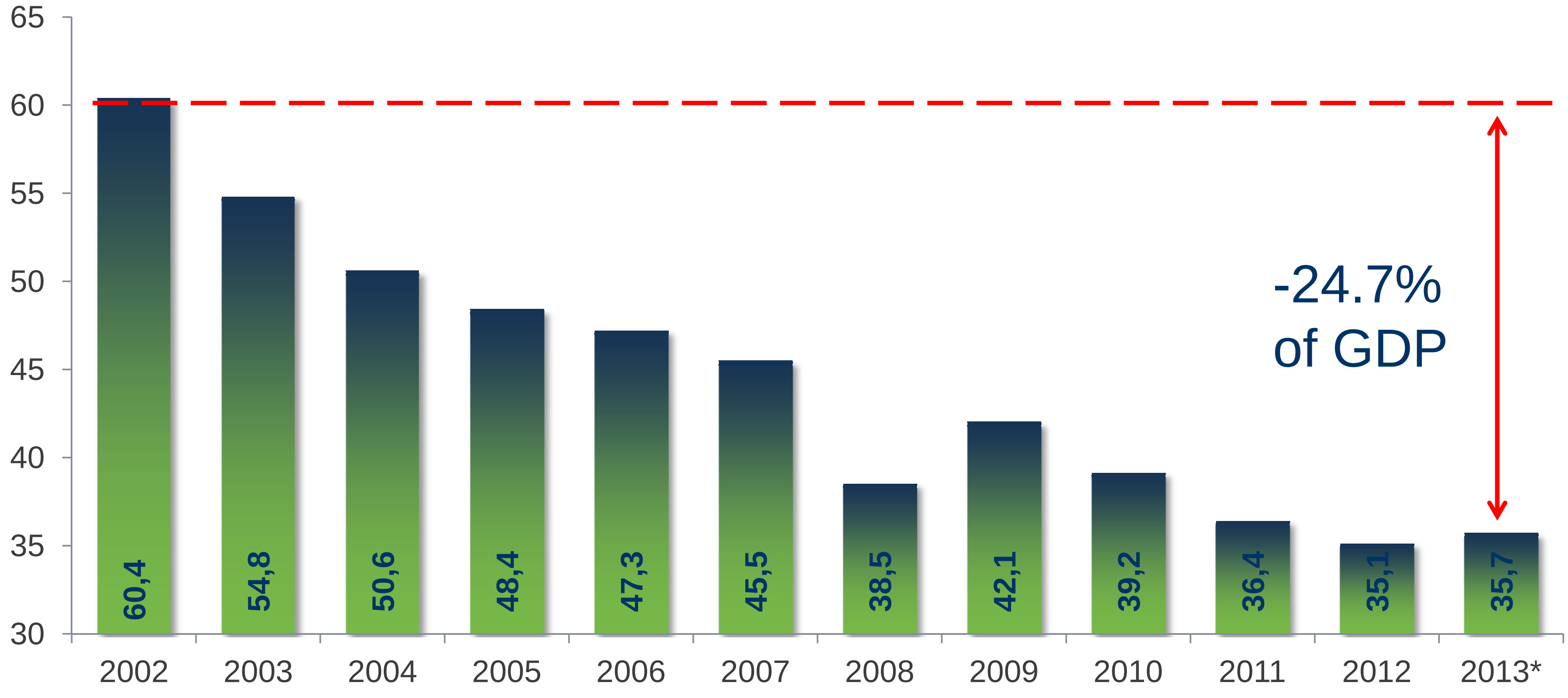
Why?

- Less “liability dollarization” and low “fear of floating”
- Reduced debt to GDP ratio and country risks
- Better public debt denomination and maturity
- Low interest on debt to GDP ratio
- Good economic perspectives in the medium term

Net Public Sector Debt
(% of GDP)



* February, 2013

Source: Central Bank of Brazil

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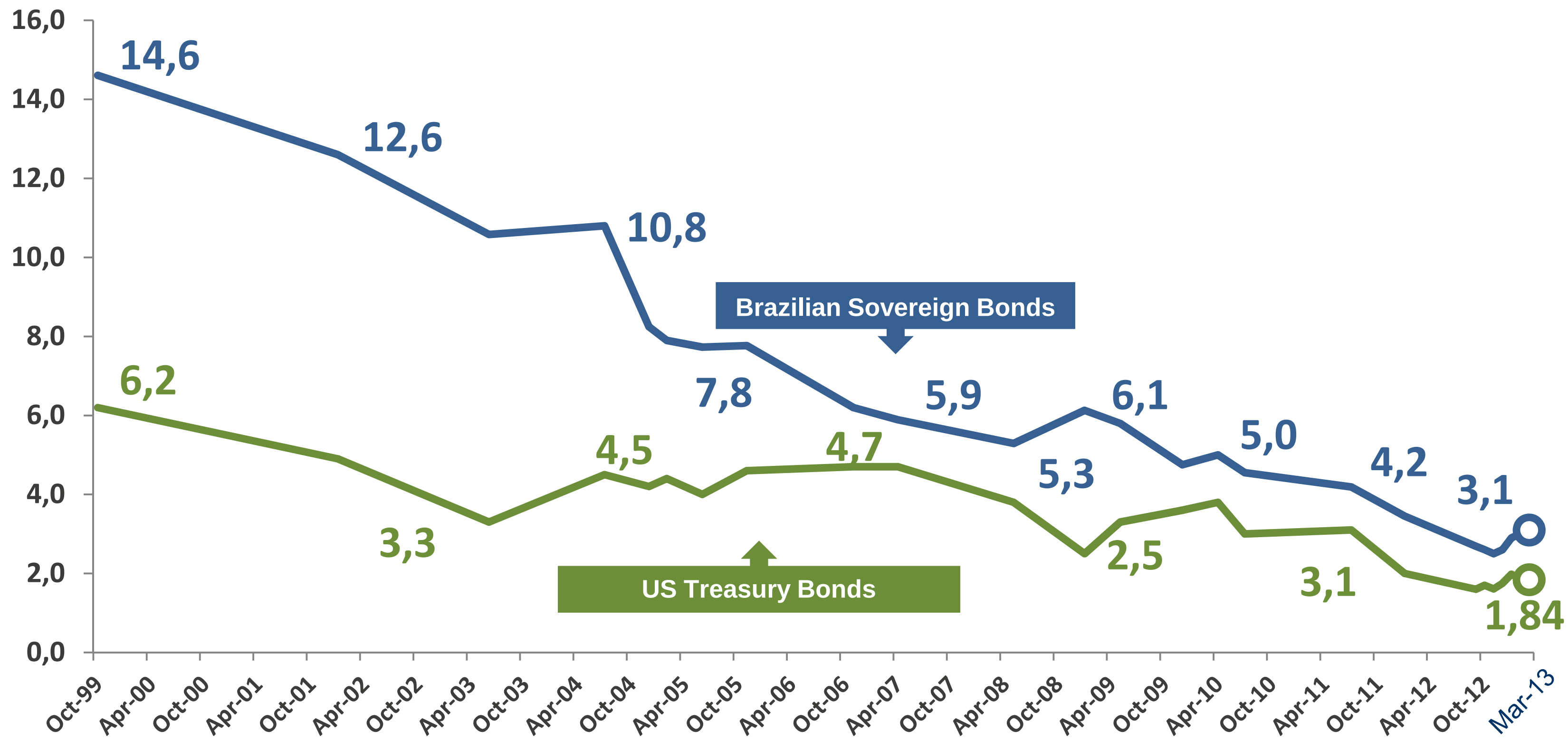
Increase of Investors Confidence for Sovereign Bonds

Commitment to fiscal responsibility throughout the years combined with economic growth have contributed to the reduction of credit risk* in Brazil.

YIELDS OF 10-YEAR BRAZILIAN AND US BONDS (% PER ANNUM)



* Measured by the differential of yields on issue date from 10-year Brazilian bonds denominated in USD and yields from US Treasury bonds, same maturity traded on the secondary market on the same date.

** From October 2012, Brazilian and US Treasury 10-year yield bonds (same maturity) traded on the secondary market on the same date.

Source: Brazilian Treasury Secretariat/Ministry of Finance and Bloomberg **Produced by:** Secretary of Economic Policy/Ministry of Finance

Summing up

- Excessive international liquidity provokes side effect in emerging market economies.
- Brazil has put forward a set of macroprudential macroeconomic policy including capital account management, along with conventional monetary policy.
- Capital account management is much more **a technical issue** rather than an ideological one.
- It has been obtained successful results under the circumstances.
- Growth prospects: investment is **the main economic policy** in a context of inflation under control, growth-friendly fiscal consolidation program, solid financial system, and strong income inequalities reduction.

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