

INSIDE BRAZILIAN DEBT NUMBERS

1st Quarter 2020

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INTRODUCTION

Quite often, an individual income may fall short to cover all its spending needs, such as buying a house, paying a tuition, getting a new car, and so on. Sometimes it is not enough even to balance monthly expenditures. What do you do in this case?

You might have to get a loan or, in other words, to contract a debt.

The government operates in a similar way. To invest in infrastructure, for example, the government might want to distribute its costs over time. Moreover, whenever the tax collection falls behind the spending, the government might borrow to pay for health care, payroll, pensions.

Thus, it is important to understand government finance-related information so that citizenship can be actively and critically exercised. Government finances end up impacting everyone's lives: the quality of public services offered, the costs of financing, credit card fees, and so on.

This document aims to explain the numbers behind the public debt, related to the balance between revenues and expenditures contemplated in the public budget.

The idea is to present this information in simple language. We seek to explain the technical terms in a side section called "Important Concepts." In addition, where possible, we suggest additional sources of information in the "To Learn More" sections.

Comments are welcome:

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FEDERAL BUDGET OVERVIEW

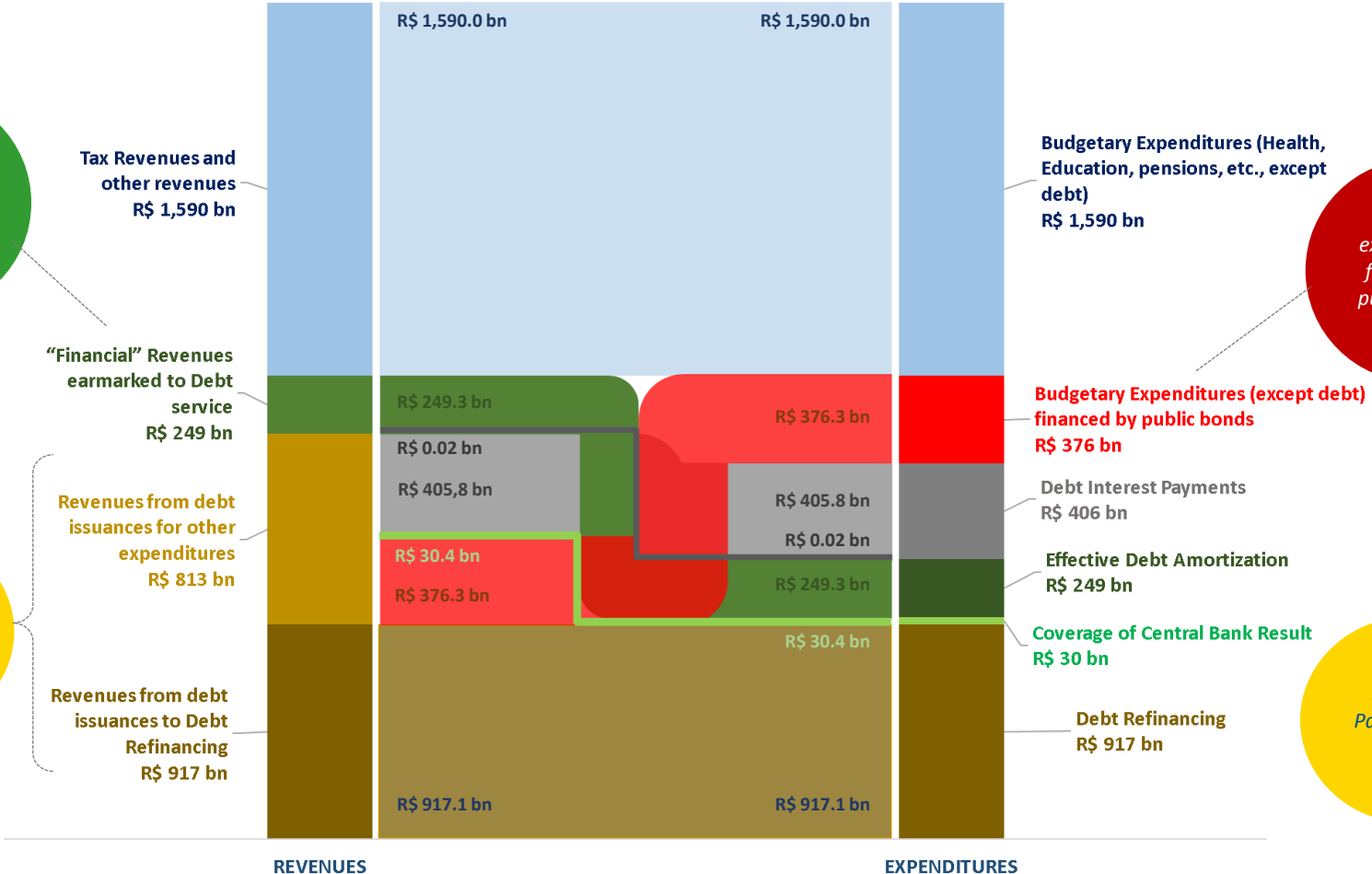
2020 Updated – Total R\$ 3,569 bn

These are revenues from non-debt issuance, earmarked for debt service. See pg 7

See "Revenues from Debt issuances" on pg 8

These are expenditures financed by public bonds. See pg 14

See Debt Payments on pg 10



PUBLIC DEBT VS FEDERAL BUDGET...

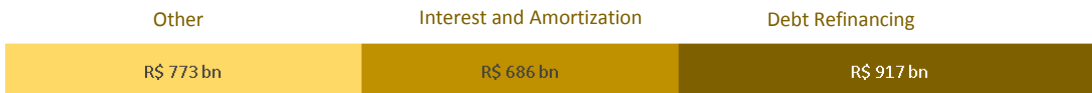
The Budget Law estimates revenues and fixes expenditures of the entire Federal Government. By fixing the expenditures, the Law segregates them into the Fiscal and Social Security Budgets, assigning the **Debt Refinancing** to the former.

Note that the Fiscal Budget includes debt service: **Debt interest and Principal (refinanced)**.

FEDERAL BUDGET - 2020: R\$ 3,569 bn

(Law nº 13,978, Jan 17th 2020, art. 3rd, I, II e III – updated)

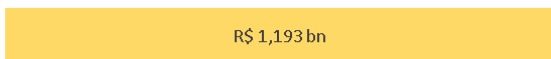
Fiscal Budget (total: R\$ 2,376 bn)



DEBT SERVICE (EXPENDITURES)

R\$ 1,603 bn

Social Security Budget



IMPORTANT CONCEPTS

DEBT REFINANCING

It's the share of the debt paid with money originated from new debt launched in the market or contracted with financial institutions.

DEBT INTEREST AND AMORTIZATION

Debt interest is just like any other interest charged on a loan. They represent the compensation the lender is entitled to receive.

Amortization represent principal payments (in Brazil, the original value given from a loan/bond added to inflation). The only difference from the "refinancing" concept is that obligation is met with money coming from a source other than new debt. Thus, the budget separates this special case from refinancing as it represents an actual debt reduction.

... AND THE DEBT BUDGET

Debt expenditures are fixed in R\$ 1.6 trillion, roughly 45% of Federal Budget. Nonetheless, the budget already estimates that 84% of those obligations (old debt) will be met with new debt, usually securities auctioned to the market. The remaining will be financed with a share of the so-called **non-issuance resources**.

DEBT RELATED REVENUES IN THE BUDGET (2020)



IMPORTANT CONCEPTS

PUBLIC SECURITIES ISSUANCES

The government may finance itself in many ways, most commonly selling bonds. They are defined as a promise to return a loan in a future date at a given condition.

Most debt payments are made with proceeds from new bond issues. That is, in general, a debt that is maturing with funds coming from the constitution of a new debt is repaid.

Although total debt is not reduced, this type of operation offers the opportunity to improve the debt "profile" (maturities, interest rates, indexes, etc.) by spreading the risks and costs of debt over time. A portion of the debt is repaid with other resources - the so-called "non-issuance resources", as presented on page 7 - configuring an "amortization", in other words a de facto debt reduction.

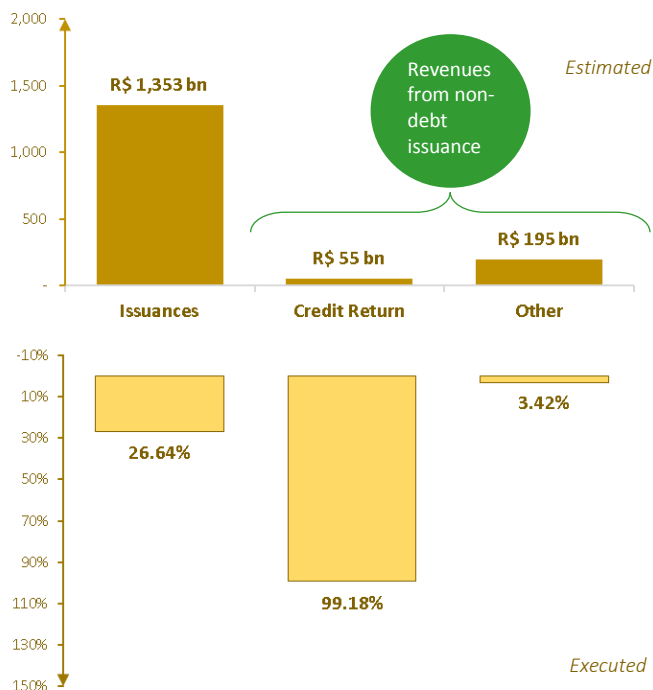
PUBLIC DEBT REVENUES

Budget revenue to meet public debt payments may or may not come from securities issues. Non-issuance revenues may be derived from the return on loans granted by the Union, arising from Bacen's positive income or other non-issuance revenues.

In addition, the budgeted revenues and their effective realization are presented.

It is also important to clarify that part of these revenues can be applied to expenses other than debt service (note on page 4 that R \$ 376 billion of the 2020 expected emissions will be allocated to budget expenses).

**BUDGETARY REVENUES EARMARKED TO DEBT SERVICE
2020
(R\$ bn)**



IMPORTANT CONCEPTS

OTHER FINANCIAL REVENUE (NON-ISSUE REVENUE)

In general, these are revenues that do not come from the collection of taxes, but from the Union's financial assets and rights. These are revenues such as income from financial investments, receivables from loans granted by the Union to states and municipalities, dividends from state-owned companies, as a result. positive from the Central Bank etc. Applying these revenues to debt relief reduces the need to borrow to repay debt that is falling due in the year, effectively reducing total government debt.

CENTRAL BANK RESULT

The Fiscal Responsibility Law states that the Central Bank must calculate its result after taking into account the income and expenses of all its operations. Positive results are then transferred to the National Treasury as revenues (which must be used for debt repayment), and negative results are covered by the National Treasury as expenses.

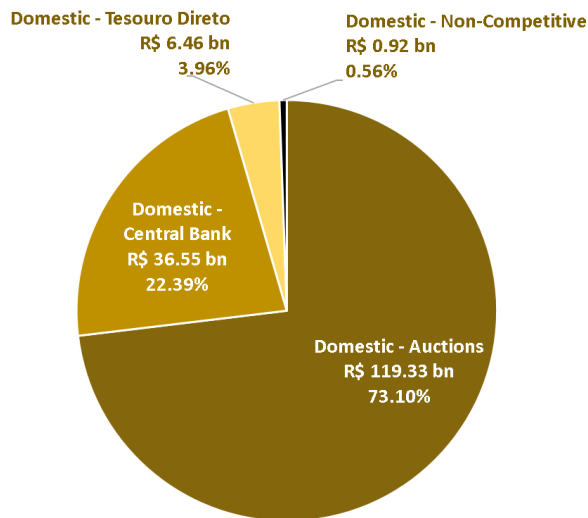
RETURN OF LOANS GRANTED BY THE UNION

It includes early repayments of Union loans to states, municipalities and state-owned enterprises.

DEBT REVENUES— ISSUANCES

Treasury bond issuances can be classified according to the site in which they are made.

DOMESTIC ISSUANCES involve securities whose payment is made in Real (BRL). They are set in the Brazilian scenario, regardless of the investor's nationality. Domestic securities may come from competitive issuances in auctions, issuances from the internet based retail sales program (Tesouro Direto), non-competitive issuances and issuances to compose the Central Bank's portfolio.



EXTERNAL ISSUANCES, in turn, include sovereign bonds that are issued on the international market, in Real or in foreign currencies, regardless of the nationality of the investor.

The figures on the side represent all issuances made in 2020 (R \$ 163.26 billion), including those intended for payment of other expenses not related to the public debt (shown on page 14).

Up to the end of the 1st quarter of 2020, there was no external issuances of securities in the foreign market.

IMPORTANT CONCEPTS

AUCTIONS

The issuance of domestic securities, in general, is carried out through open and competitive auctions in which the government sells securities to several institutions. As a rule, investors buy the right to receive, at a future date, an amount greater than the amount paid for the security at issue. Institutions regularly registered in the Special System for Settlement and Custody (SELIC), corresponding to approximately 500 potential participants, can participate directly in the auctions by submitting proposals.

ISSUANCES TO THE CENTRAL BANK

The National Treasury issues securities to the Central Bank's portfolio to carry out transactions related to its monetary policy. In addition, as previously mentioned, under the terms of the Fiscal Responsibility Law and Law 13,820/2019, in case of a negative result in Central Banks' equity balance may be covered by the National Treasury. In such cases, securities are issued that will compose the Central Banks's portfolio, in order to offset the negative result.

TESOURO DIRETO

These are issuances carried out within the scope of Tesouro Direto, a National Treasury program developed in partnership with B3 (the former BMF & F Bovespa) for the sale of federal public securities to individuals, through the internet.

EXTERNAL ISSUANCES

External issuances relate to securities issued on the international market. Creditors of "external debt" are not necessarily foreign, just as creditors of "internal debt" are not necessarily only Brazilian.

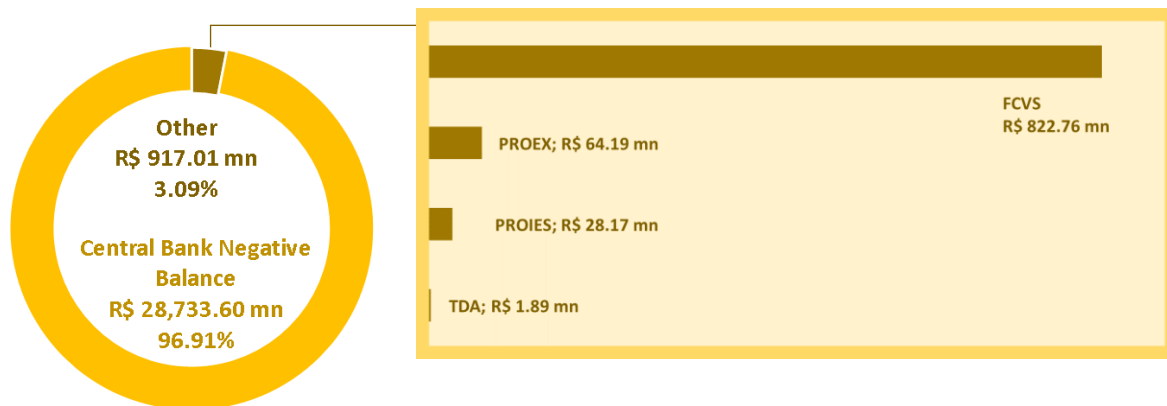
NON-COMPETITIVE ISSUANCES

These issuances will be covered on the next page!

DEBT REVENUES – NON-COMPETITIVE ISSUANCES

Besides traditional auction and the internet based retail sales program (Tesouro Direto), the Treasury issues securities directly on behalf of some holders, according to specific legal authorization. Usually they are designed to fulfill the needs for a program conducted by the government as well as the issuances to compensate Central Bank negative balance, if so.

NON-COMPETITIVE ISSUANCES – 20201Q



IMPORTANT CONCEPTS

FCVS

The purpose of the issues to the Salary Variation Compensation Fund (FCVS) is to cover the debts of the referred Fund assumed by the Union with creditors of the extinct Housing Financial System (SFH).

PROEX

Program to stimulate exports (PROEX) and to provide a subsidy in the financing interest rate. The Treasury issues bonds (NTN-I) to make sure financial institutions can offer subsidized loans to exporters.

PROIES

Program designed to restructure educational institutions financing conditions that originally hold undue taxes with the government. The Treasury issues bonds (CFT-B) so that these institutions pay back the government in exchange for scholarships offered to students.

TDA - AGRARIAN REFORM

Conducted by National Agrarian Reform Institute (INCRA), who pleads the Treasury to issue bonds (TDA) to compensate landowners must the process be fulfilled.

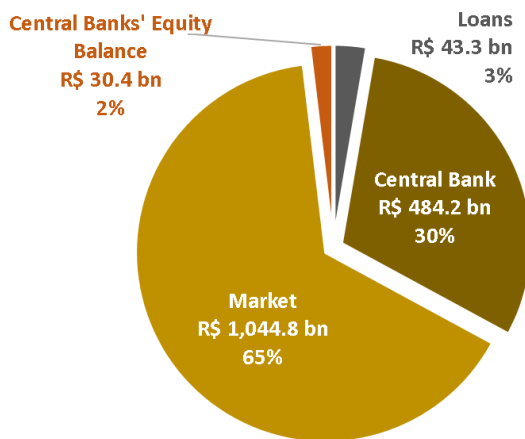
PUBLIC DEBT EXPENDITURES

Up to the 1st quarter of 2020, R\$ 421 billion were used in public debt expenditures.

The chart below presents the updated budget allocation (R\$ 1,602 billion) for debt expenses, sorted by type of debt, as well as its paid amount (26% of the total allocation) in the period.

PUBLIC DEBT EXPENDITURES – 2020

Updated Budget Allocation



Payment of Debt Expenditures



IMPORTANT CONCEPTS

MARKET

These are expenditures corresponding to the payment of principal and interest on securities, issued on domestic or foreign market.

CENTRAL BANK

These are expenses related to payments of principal and interest on securities issued to compose the Central Bank's portfolio.

CENTRAL BANK'S EQUITY BALANCE

These are securities issued to the Central Bank's portfolio, in order to cover any negative result in its equity balance. According to the Fiscal Responsibility Law, the negative result in Central Bank's equity balance constitutes a Treasury obligation to the Central Bank and will be recorded in a specific budget allocation.

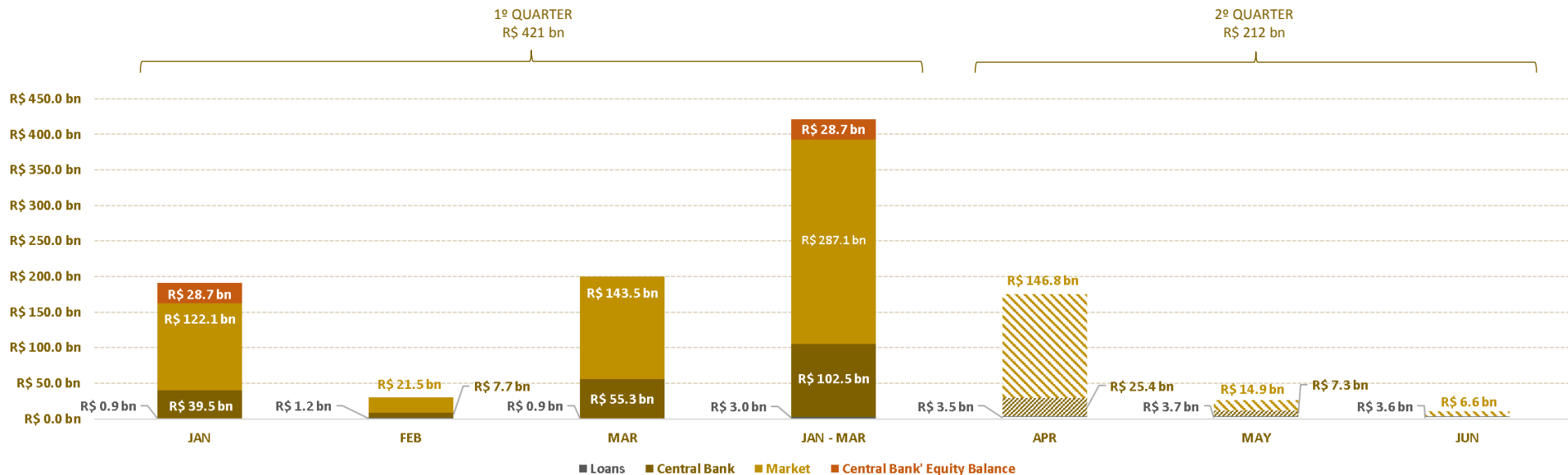
LOANS

Expenditures related to the payment of obligations originated from credit operations contracted by the Union with financial institutions, government agencies and international organizations.

PUBLIC DEBT EXPENDITURES MATURITIES – 2020

The chart below shows the execution and projection of expenditures related to the Union's Debt in 2020, showing the amounts that have already been paid up to the 1st quarter (R\$ 421 billion) and the amounts expected to be paid in the 2nd quarter (R\$ 212 billion). The installments are classified according to the amounts referring to the coverage of the negative result of the Central Bank's equity balance, payments related to loans and payments of securities in market or Central Bank portfolios.

PUBLIC DEBT EXPENDITURES

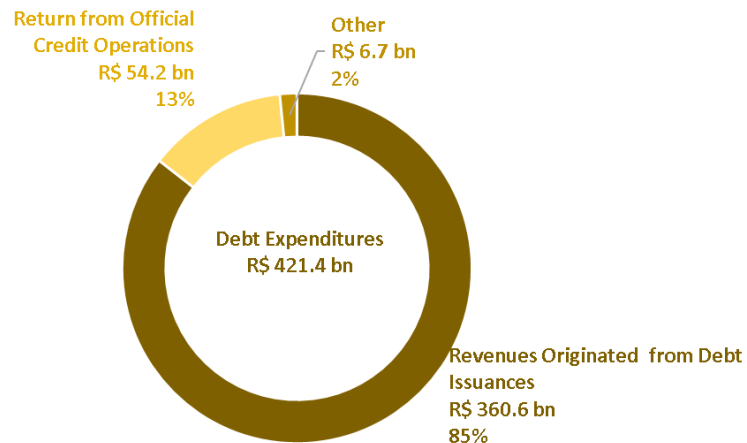


PUBLIC DEBT EXPENDITURES MATURITIES– FINANCING

As discussed, most debt is serviced with new debt issued to the market. Although that not necessarily diminishes the outstanding debt, this type of operation allows debt managers to reshape the debt profile, according to financing conditions and types of bonds, such as inflation linked, floating rate linked and fixed rated. The maturity profile may also change, depending on the tenures of those securities. Part of the debt is serviced with other revenues – as seen in page 7, leading to an amortization.

As of 1Q20, R\$ 421 bn was spent with public debt.

DEBT EXPENDITURES BY ORIGIN OF REVENUES



IMPORTANT CONCEPTS

RETURN FROM OFFICIAL CREDIT OPERATIONS AND DIVIDENDS

Although we are analyzing the government from the debtor perspective, it can also be creditor on the other side. This is because it has assets against SOE- State Owned Enterprises – and local governments. When these entities pay their obligations with the Treasury a stream of cashflows comes in and is used to pay debt down.

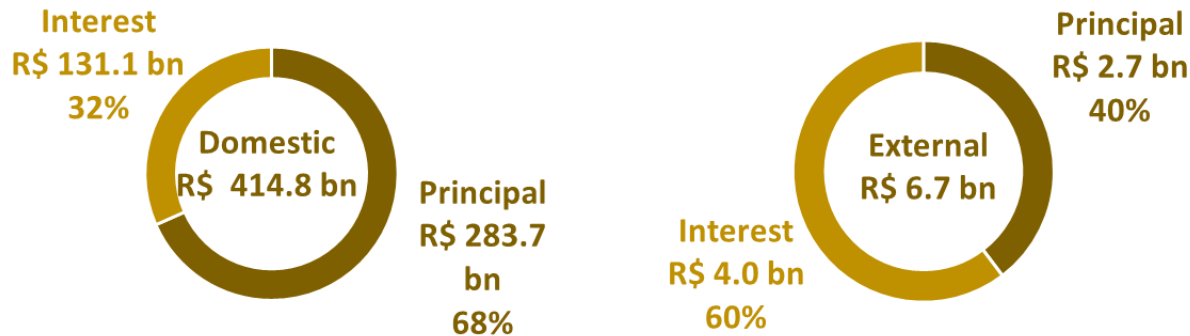
PUBLIC DEBT EXPENDITURES MATURITIES– BREAKDOWN

As in any other loan, public debt expenditures are broken-down into principal (adjusted by inflation) and interest.

Part of that is due domestically (domestic debt) and a small part, abroad (external debt).

The charts below show the breakdown of the R\$ 421 bn in the 1Q20.

INTEREST AND PRINCIPAL - EXTERNAL x DOMESTIC – 1Q20



IMPORTANT CONCEPTS

A BIT MORE ON INTEREST

To better understand the concept of interest, answer the following: would you prefer to receive \$ 1,000 today or within a year? You'd probably want to get it today. What if someone offered you to receive \$ 1,200 within a year instead? You'd might change your mind.

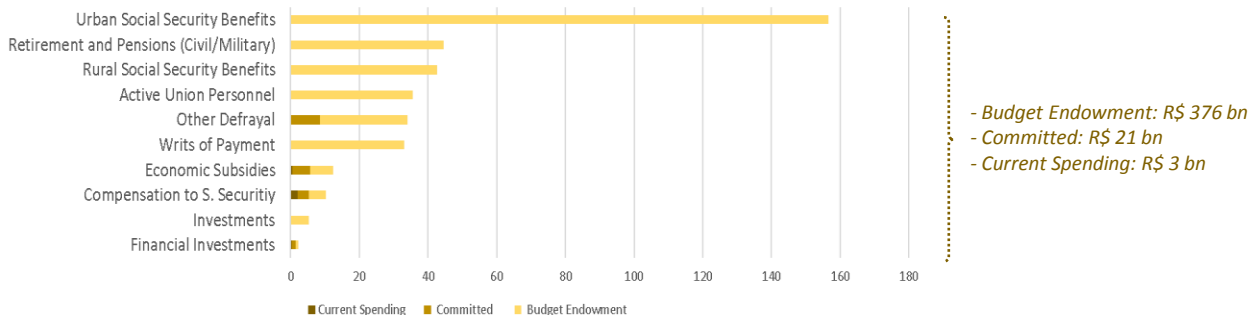
This example shows that your waiting must be remunerated. In fact, the \$200 is a compensation for your money not being available to you right away, in case you lend to someone. That's your interest on the loan.

PUBLIC DEBT EXPENDITURES

OTHER FINANCING

In 2020, budgetary expenditures surpassed revenues by R\$ 376 bn. To finance that, the Federal Budget Office allocated cash coming from debt issuances. Because debt issuances are accounted as budgetary resources, the overall budget is balanced, despite the fact the economic imbalances remain present. This is a consequence of the fiscal deficit.

DEBT ISSUANCES TO COVER THE BUDGETARY DEFICIT – 1Q20 (R\$ bn)



IMPORTANT CONCEPTS

THE GOLDEN RULE

The allocation of cash raised through debt issuances to finance current spending such as energy bill, payroll, retirement, social security, is very worrisome. It's analogous to getting a loan with your bank to pay for your food or energy bill in your house – that is, one is assuming a future obligation during various months/years to meet other current obligations.

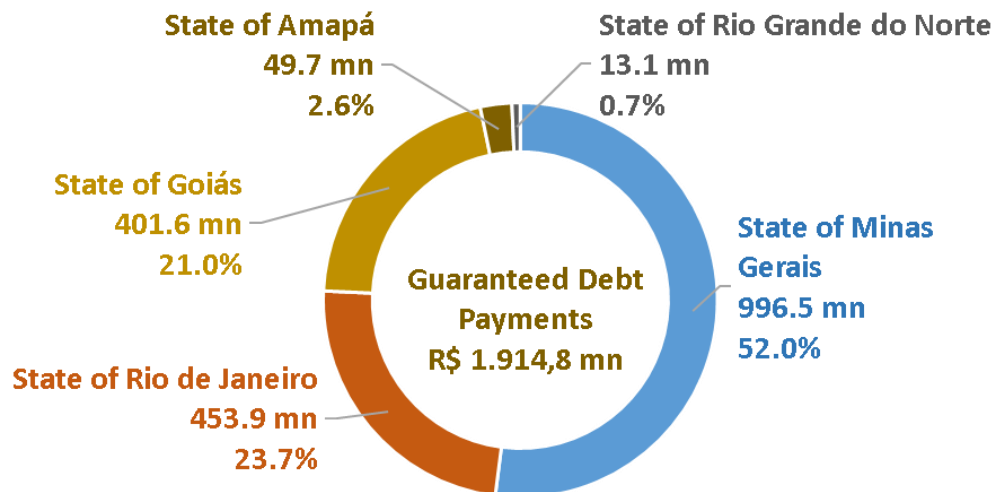
Although not advisable, could the government still do it?

In fact, there is no prohibition to use debt to cover current spending. However, the Federal Constitution, prohibits the government, by the end of the year, to perform more credit operations than capital expenditure (investments + debt refinancing + amortization). This is the so called "Golden Rule", article 167, III, from the Federal Constitution.

GUARANTEED DEBT - Subnational and SOE Debt

The Treasury acts as the guarantor in a portion of Local Government and SOE debt with financial institutions. In case these entities default on their debt, the Treasury becomes the responsible for those obligations.

SUBNATIONAL GUARANTEED DEBT EXECUCED BY THE TREASURY– 1Q20



IMPORTANT CONCEPTS

MORE ABOUT GUARANTEES

As the guarantor, the Treasury notifies the original debtor that its obligations have come due, in case of a credit event, requiring the entity to respond to the obligation in the grace period, alerting to the penalties evolved. In case the debtor confirms its default, the Treasury steps in and fulfills the obligation with the creditor.

After that, the Treasury initiates the process to recover the loss and access the collateral embedded in the operation.

In case of regional governments, the collateral consists in blocking constitutional transfers towards them and other flow of taxes until the financial values are recovered, including fines and interest.

HAVE A LOOK...

GUARANTEED DEBT REPORT

<https://www.tesouro.fazenda.gov.br/documents/10180/0/RQG+1+QUADRI+2019+iNGLES/61e973a4-7808-4cfa-9603-93abc842a9a9>