

## Domestic Debt Growth: Still the Interest Payments

The evolution of public debt is an economic factor of utmost importance, closely scrutinized by rating agencies and financial analysts. The most widely used definition of public debt is **net public debt**, which deducts most of the public assets from the liabilities. Among the several public liabilities, the most significant are the domestic and the external debts. When President Cardoso started his first term in office in January 1995, the two debts were about the same size. Since then, the federal domestic bonded debt has grown much more than the external debt: the former was multiplied by ten in nominal terms, while the latter displayed a much more modest growth, most of which caused by the depreciation of the BRL vis-à-vis the USD. Domestic debt increased from 11.95% to 49.69% of GDP, while external debt increased from 12.95% to 17.67% of GDP.

Therefore, it is only natural that very close attention is paid to the evolution of the domestic debt. In order to access its future evolution, it is important to decompose its growth in the last few years. Here, the tables in Bevilaqua & Garcia [1999]<sup>1</sup> are updated to show what were the main culprits of such enormous growth.

Basically, the resources obtained from an increase in the domestic debt may have three different uses. First, it may pay for governments' outlays in excess of governments' revenues, i.e. financing the public deficit.<sup>2</sup> Second, it may finance the purchase of an asset. Finally, it may repay another previous liability. This decomposition is implemented in the two tables below.

Table 1 shows the decomposition of the federal domestic debt uses in nominal BRL. This is useful because one can check the calculations, since the figures add up to the total. However, the most insightful figures for economic analysis are expressed as a percentage of GDP, since the country repayment capacity grows *pari passu* with GDP. Unfortunately, in this case, the figures no longer add up.<sup>3</sup>

Table 2 shows the decomposition of the federal domestic debt uses as % of GDP. The federal bonded debt increased from 11.95% of GDP in Dec-94 to 49.69% in Sep-01; a growth of almost 38 points of GDP.

As shown in table 2, interest payments are the main culprit for the fast increase of public debt as a percentage of GDP. They added up to 33.1 points of GDP. The primary surpluses of the federal government and the central bank contributed for the fall in the domestic debt with 7.1 points of GDP. States and municipalities also contributed for the domestic debt decrease, although negligibly. State owned enterprises were an expansion factor, with 2.5 points of GDP. Hidden liabilities (so called skeletons in the closet) that were uncovered during the period contributed for the debt expansion with 13.4 points of GDP, while privatizations were a contractionary factor of 6.0 points of GDP. As pointed out before, these factors' contributions do not add to the increase of the Federal net debt, which was 21.1 points of GDP.

Asset accumulation increased by 18.9 points of GDP. Most of it, however, were credits to states (13.8 points of GDP) a result of a broad reaching debt reschedule agreement settled with the Federal Government. An interesting point is that the much criticized PROER (bail out of private banks) and other credits extended to failed financial institutions contributed to a fall in the domestic debt of 2.3 points of GDP. The other debts grew very modestly, by 2.2 points of GDP.

This decomposition suggests two main lessons for the future. First, it is important to keep the current fiscal stance, obtaining substantial primary surplus, and avoiding the creation of new hidden liabilities that may jeopardize the fiscal performance in the future. Second, it is imperative to reduce real interest rates paid on the debt. Of course, this is easier said than done, since interest rates are endogenous variables that incorporate multiple sources of risks. Nevertheless, it remains a challenge for the future.

Márcio Garcia

*The statements and opinions above do not necessarily express the views and opinions of Banco BBM S/A, its directors and/or managers.*

**Macroeconomic Research**  
**macro@bbmbank.com.br**  
**(55 21) 2514-8341**

<sup>1</sup> Debt Management in Brazil: evaluation of the Real Plan and challenges ahead available at <http://www.econ.puc-rio.br/pdf/td408.pdf>. I thank Fernanda Feitosa for superb research assistance.

<sup>2</sup> In theory, the nominal deficits should add up to the increase in the net public debt. In practice, many adjustments are required. For further details, see the paper referenced in note 1.

<sup>3</sup> For example, suppose the initial debt is \$100, and the interest rate is 5%. Assume also that no debt is repaid. The final debt value is the initial debt value (\$100) plus the interest accrued (\$5), that is, \$105. However, if the initial GDP was \$1,000, and GDP also grew 5% (to \$1,050), the initial and final debt/GDP ratios would be both equal to 10%. Nevertheless, there would be a positive interest accrual of 0.5% (\$5/\$1,000).

*The statements and statistics contained herein were obtained from sources that Banco BBM S/A believes to be reliable but Banco BBM S/A cannot represent that they are complete or accurate. This publication is for the information of investors and does not constitute an offer to sell or a solicitation to buy the securities referred to herein. Banco BBM S/A or its affiliates together with their Directors and Officers may, from time to time, have a position in the securities mentioned and may, from time to time, provide investment banking services, or other services, including underwriting, for any company mentioned in this report and/or affiliates or subsidiaries of such company. Copyright reserved. This document may not be reproduced or published for any purpose.*

TABLE 1. FEDERAL DEBT USES: December-94 to September-2001 (BRL million)

	Dec-94	Sep-01	Variation	Percentage Share
Federal Net Debt (+ CB)	65836	414858	352621	64.25%
Nominal Interests (Federal Government + CB)			334216	60.89%
Primary Deficit (Federal Government + CB)			-77185	-14.06%
Nominal Deficit minus Net Debt Variation of the States and Municipalities			-13381	-2.44%
Nominal Deficit minus Net Debt Variation of the State Owned Enterprises			19994	3.64%
Balance Sheet Adjustment Variation			140690	25.63%
Privatization Adjustment Variation (-)			-59977	-10.93%
Adjustment not Computed by the Central Bank			8264	1.51%
<b>Assets</b>	<b>106308</b>	<b>490950</b>	<b>384314</b>	<b>70.02%</b>
1. Domestic	73478	383953	310147	56.51%
1.1. FAT	12800	59785	46985	8.56%
1.2. CB's credits to the financial institutions	20561	21715	1154	0.21%
1.3. Federal Government's credits (Law 8727 /93)	8276	17951	9675	1.76%
1.4. Debt Renegotiations with the states	0	169446	169446	30.87%
1.5. Others	32169	115056	82887	15.10%
2. Foreign Reserves	32830	106997	74167	13.51%
<b>Other Debts (-)</b>	<b>112217</b>	<b>300312</b>	<b>-188095</b>	<b>-34.27%</b>
1. Domestic	46947	83715	-36769	-6.70%
1.1. Monetary Base	17685	45482	-27797	-5.06%
1.2. Others	29262	38233	-8972	-1.63%
2. Foreign	65271	216597	-151326	-27.57%
<b>TOTAL</b>			<b>548840</b>	<b>100.00%</b>

TABLE 2. FEDERAL DEBT USES IN percent OF GDP: December-94 to September-2001

	Dec-94	Sep-01	Variation
<b>Federal Net Debt (+ CB)</b>	<b>13.06%</b>	<b>34.14%</b>	<b>21.08%</b>
Nominal Interests (Federal Government + CB)			33.09%
Primary Deficit (Federal Government + CB)			-7.14%
Nominal Deficit minus Net Debt Variation of the States and Municipalities			-0.85%
Nominal Deficit minus Net Debt Variation of the State Owned Enterprises			2.53%
Balance Sheet Adjustment Variation			13.42%
Privatization Adjustment Variation (-)			-6.02%
Adjustment not Computed by the Central Bank			1.22%
<b>Total</b>			<b>36.25%</b>
<b>Assets</b>	<b>21.25%</b>	<b>40.05%</b>	<b>18.90%</b>
1. Domestic	14.64%	31.32%	16.68%
1.1. FAT	2.54%	4.88%	2.34%
1.2. CB's credits to the financial institutions	4.08%	1.77%	-2.31%
1.3. Federal Government's credits (Law 8727 / 93)	1.64%	1.46%	-0.18%
1.4. Debt Renegotiations with the states	0.00%	13.82%	13.82%
1.5. Others	6.38%	9.39%	3.01%
2. Foreign Reserves	6.51%	8.73%	2.22%
<b>Other Debts (-)</b>	<b>22.26%</b>	<b>24.50%</b>	<b>-2.24%</b>
1. Domestic	9.31%	6.83%	2.48%
1.1. Monetary Base	3.51%	3.71%	-0.20%
1.2. Others	5.80%	3.12%	2.68%
2. Foreign	12.95%	17.67%	-4.72%
<b>Federal Bonded Debt (+ CB)</b>	<b>11.95%</b>	<b>49.69%</b>	<b>37.74%</b>