

# The challenge of Brazilian pension funds imposed by the international crises

By **Adriana Inhudes, André Albuquerque Sant'Anna, Ernani Teixeira Torres Filho** and **Gilberto Rodrigues Borça Junior**<sup>1</sup>

Economists in APE

**Retirement and pension fund portfolios may turn into a stable source for financing the productive sector**

Pension funds are closed entities for complementary retirement (EFPC, in Portuguese) aimed at supplementing the social security benefits of its contributors. For this reason, EFPCs are institutions which invest their resources in long-term purposes (to achieve its actuarial targets) abiding by the

regulatory limitations to which they are subject.

Despite their common aim, EFPCs are quite different from one another, either in size or in the composition of their portfolio, when comparing developed and emerging countries. In 2007, pension funds from OECD member countries managed some US\$ 18 trillion dollars in resources. In the same year, the amount of assets in pension funds from all other countries reached only US\$ 0.8 trillion, that is, 22 times less.

Brazilian Economic Insights is a publication by the Economic Research Division (APE) of the Brazilian Development Bank. The opinions in this publication are the responsibility of the authors and do not necessarily reflect the point of view of the BNDES' management.

<sup>1</sup> The authors acknowledge Ricardo Weiss and Ana Marta for their comments and suggestions.

Such differential can also be seen when it comes to analyzing the importance of EFPC assets compared to GDP in different economies. Chart 1 shows that in 2007, OECD member countries showed an average coefficient of 75%, while non-OECD countries reached a little less than 28%. Nevertheless, there are some important exceptions. The Netherlands, with 132%, stands out among developed countries, whereas Chile, with 64%, presents a profile which resembles that of a developed country.

Another major characteristic of emerging countries is the striking variance. Many countries, such as Russia and China, have very low coefficients – lower than 2% – because their complementary retirement systems were implemented only recently.

Besides the fact that the dissemination of pension funds began fairly recently, there are other factors that help understand the differences between the relative importance of EFPCs, such as: a) per capita income; b) history of macroeconomic stability; and c) average age of participating population.

Thus, the purpose of this issue of *Brazilian Economic Insights* is to make it clear that the current global financial crisis, together with a consistent scenario of reduction in the Brazilian economy's basic interest rate, offers great

perspectives for pension funds to diversify their investments.

### **Pension funds in Brazil and the world**

The composition of the asset portfolios of pension funds also shows great variation among countries. Chart 2 displays that, among developed countries, there is a predominance of investments in company assets, either in variable-income or fixed-income securities. In the US, Japan, and Germany, at least 2/3 of assets are invested in the private market. Considering the magnitude of pension funds and the amount of assets managed, it is, undoubtedly, a significant sum at the companies' disposal.

Among developing countries, there are considerable differences in the composition of pension funds' portfolios. Russia and Chile stand out because their pension funds' portfolios resemble those in developed countries, with the predominance of private fixed-income securities and stocks. Public bonds are hardly present. In the cases of Brazil, Mexico, the Czech Republic and Turkey, there is a 50% to 75% concentration in government bonds.

Such difference points to the fact that the investment standard of funds is closely related to both the development of domestic capital markets and the characteristics of the

public debt of these countries. The predominance of short-term public bonds with financial indexation seems to be a key factor in describing the reduced demand for long-term private securities. According to BIS 2007 data, almost 50% of Brazil's public debt had a maturity of less than a year, while in Chile and Russia such share corresponds to 12% and 8%, respectively.

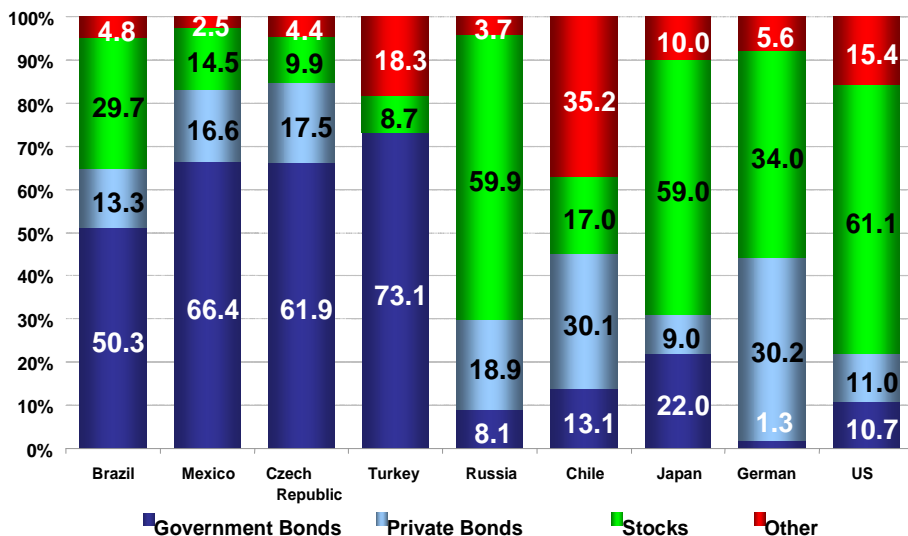
### Brazilian pension funds today

Brazilian pension funds are still distant from the stage of counterpart funds in developed

countries. However, over the last few years, the pension fund industry has shown rapid growth. Between 2002 and 2007, the relation between pension funds' assets and GDP increased approximately 5 percentage points, from 12.8% to 17.6% (Chart 3).

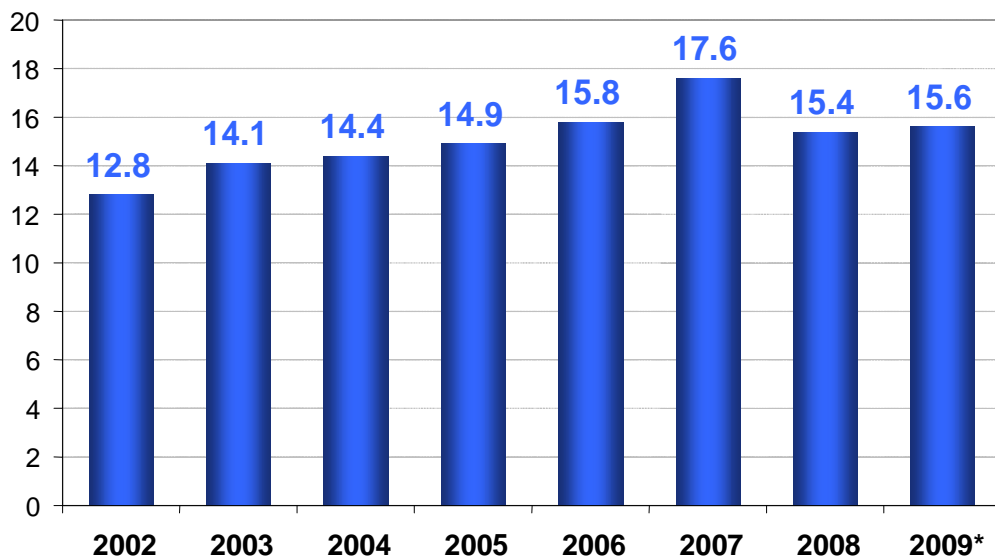
Between 2007 and 2008, this number dropped to 15.4%, a loss of 2.2 percentage points, or 12.5%. This is mainly a reflection of losses due to the worsening of the current global economic crisis, which caused a decrease in the price of financial assets – particularly stocks. According to the Brazilian Association of Closed Entities for

**Chart 2: Composition of Pension Funds' Portfolios in Selected Countries (2006)**



Source: OECD (2007)

**Chart 3: Brazil – Pension Funds' Assets/GDP (2002/2009)**  
(in %)



Source: Abrapp

\* Up to Feb./09

Complementary Pensions (ABRAPP), from December 2007 to October 2008 – immediately after the worsening of the international crisis in September 2008 – the total amount of assets in the portfolio of pension funds fell from R\$ 457 billion to R\$ 439 billion.

In the first few months of 2009, there was a small recovery. Whether such tendency will be confirmed throughout the year basically depends on the recovery of the Stock Market and the economy growth rate.

Despite the rapid growth between 2002 and 2008, investments of Brazilian pension funds were concentrated on fixed-income assets, particularly public debt bonds. According to Chart 4, from 2000 to 2008, such assets accounted for around 50% of the institutions' assets.

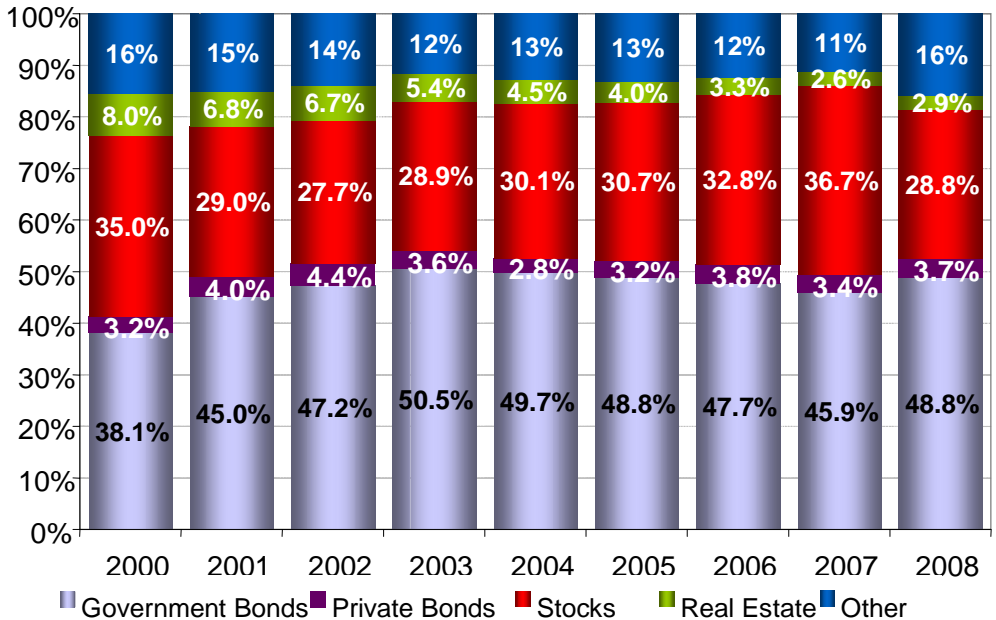
As we highlighted in *Brazilian Economic Insights N. 57*, there are some characteristics in the Brazilian public debt that increase the demand for government bonds. The Brazilian State has a debt structure

based on short-term bonds, indexed by fluctuating (and high) interest rates, which simultaneously offers market liquidity, safety, and profitability to investors. Private securities are actually restricted by higher capital costs and lower market liquidity. The reduced share of corporate bonds within pension funds' assets – roughly 3.6% in February 2009 – is a consequence of this.

It can also be seen in Chart 4 that

the share of stocks in total assets went through major changes from 2002 to 2008. Such changes were brought about, to a great extent, by the appreciation of the IBOVESPA index between 2002 and 2007 – going from some 11,000 points to 64,000 points – and the following decrease, from 2007 to 2008, to 37,000 points. In this sense, the variation in the share of stocks in the composition of pension funds' assets should be attributed not only

**Chart 4: Brazil – Composition of Pension Funds' Assets (in %) (2000-2008)**



Source: Brazilian Economic Insights, based on Abrapp and Anbid (Brazilian Association of Investment Banks) data

to the price effect, as mentioned above, but also to the actual preference of pension funds for this class of assets.

Between 2002 and 2007, the fluctuation of the IBOVESPA index would have increased the value of pension funds by 70% if they had kept their stock portfolios. In this period, however, the increase in the Stock Market stimulated pension funds to sell part of their stock portfolios. The opposite occurred throughout 2007 and 2008. In this period, pension funds bought stocks because of the decrease in the Stock Market. If pension funds had not done so, their portfolio of stocks would be 21% lower than the value at the end of 2008.

### **Conclusion and perspectives**

Due to the characteristics of their liabilities—future benefits to contributors—, pension funds naturally demand long maturity assets. In this sense, they can play an important role as a financing source for long-term investments.

In Brazil, in spite of over a decade of macroeconomic stability and the return to swifter economic growth over the last few years, funds still invest the majority of their resources in public bonds.

Such a scenario, however, may go through some key changes in the coming years. The current global financial crisis had a very distinct impact on the Brazilian economy when compared to other crises over the past 10 years. Wage earners managed to keep their jobs and purchasing power, thus maintaining the consumption level of most households and allowing internal demand to play an important role in minimizing the negative impact of financial shock and of the fall in exports.

Furthermore, inflation has not increased; instead, it is expected to maintain lower levels over the coming months.

The government, besides becoming a creditor of foreign currency, was not affected by a fiscal crisis and was able to adopt anticyclical measures. In such a scenario, the process of reducing public debt compared to GDP is expected to accelerate in the following years, particularly if interest rates continue to fall.

A more likely scenario for coming years is the increase in liquid fundraising by EFPCs – most of the Brazilian population is still comprised of young people –, together with a slowdown in the growth of public debt and the

change in its profile – longer terms, and pre-fixed or inflation-indexed rates.

In such a case, pension funds will probably feel stimulated to introduce changes in their investment portfolios, particularly if the current actuarial targets are not lowered. There is a trend to invest less in public bonds, which are predominant in pension fund portfolios today.

Therefore, not only will capital markets have a new source for development, but the Brazilian investment in production, in its turn, will also be able to rely on a stable source for financing, which should become even more relevant during periods of credit restriction.

Such changes, however, will not occur automatically. There is a comprehensive set of issues and challenges for Brazilian pension funds. It is vital to invest more in technical know-how and management in order to improve EFPC's risk assessment of sectors, companies and projects. Corporate governance of supported companies, as well as the choice of partners – particularly during project implementation – are also issues that should be taken into account.

There is, at the same time, a strong similarity of interests

between pension funds and the BNDES. The former needs assets to provide long-term profitability, which can maintain benefits for its contributors. The latter, as a long-term financier, supports not only industry and infrastructure projects to accelerate the development of the Brazilian economy, but also provides the structure that companies may need to open their capital.

In such a sense, long-term projects, particularly infrastructure projects, naturally become candidates to raise those funds. Electric energy and transport, for instance, are very

attractive, since they do not only provide more predictable profitability, but also more stable

cash flows. Such investments increase both the systemic competitiveness of the economy – generating widespread positive effects abroad – and also the potential for long-term growth. Ultimately, the current global financial crisis may provide new opportunities to pension funds, with positive effects for the Brazilian economy as a whole.





If you wish to receive the following editions of  
this publication send an e-mail to  
*[visao.do.desenvolvimento@bndes.gov.br](mailto:visao.do.desenvolvimento@bndes.gov.br)*.