



Brazil: “Scorecard” on Adjustment Process

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Deputy Governor

J.P. Morgan Investor Seminar

Spring Meetings

USA, Washington – April 15th, 2016

1. At the beginning of 2015 Brazil faced a complex adjustment process along three dimensions: external, monetary, fiscal;
2. Adjustments depend on endogenous (i.e. market based) and exogenous (i.e. policy) factors;
3. Each adjustment dimension depends differently on endogenous and exogenous factors: external mostly dependent on market factors; monetary a mix of market and policy; fiscal mostly dependent on policy factors;
4. Due to nominal, or “Keynesian” rigidities (such as price and wage indexation) and real, or “Austrian” rigidities (transaction costs in reallocating resources across sectors, liquidation of malinvestments), adjustment process will *cause* a period of recession.

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Thesis

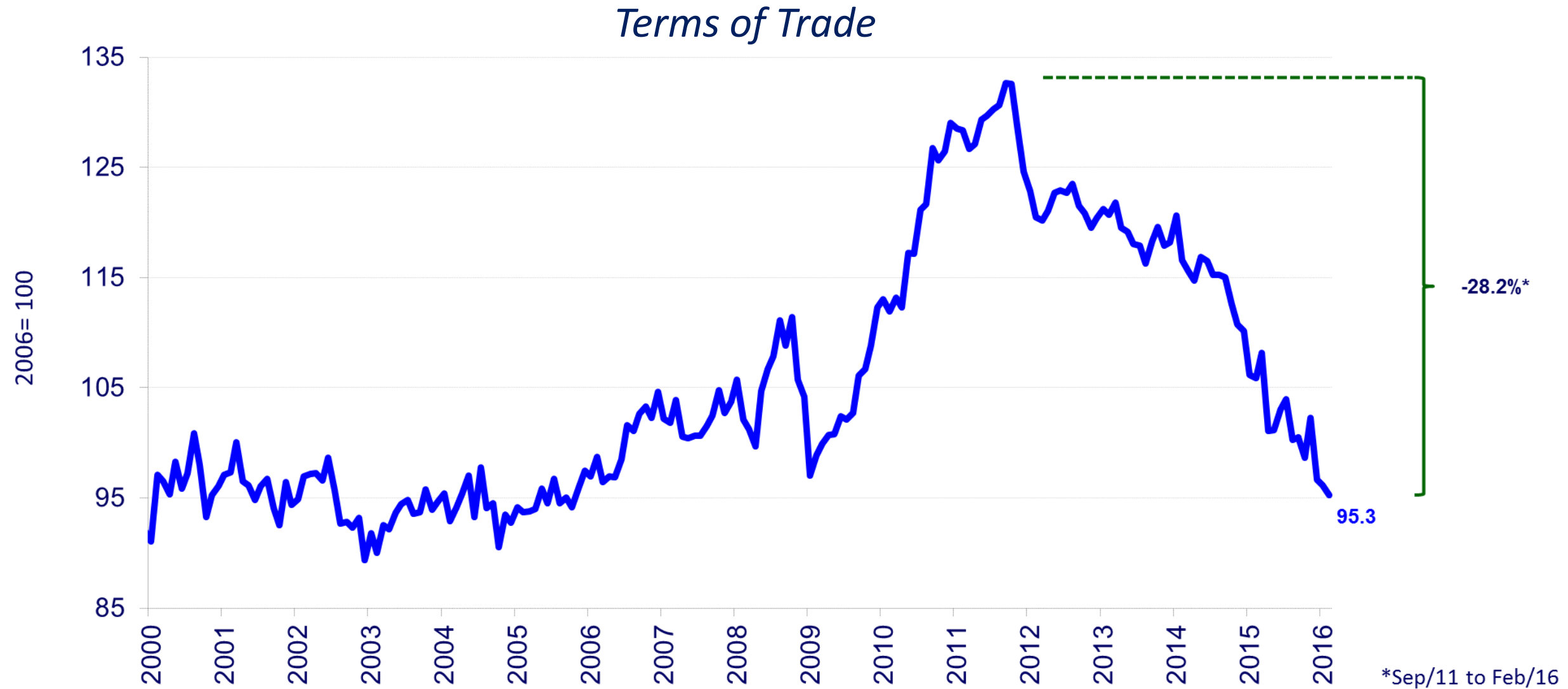
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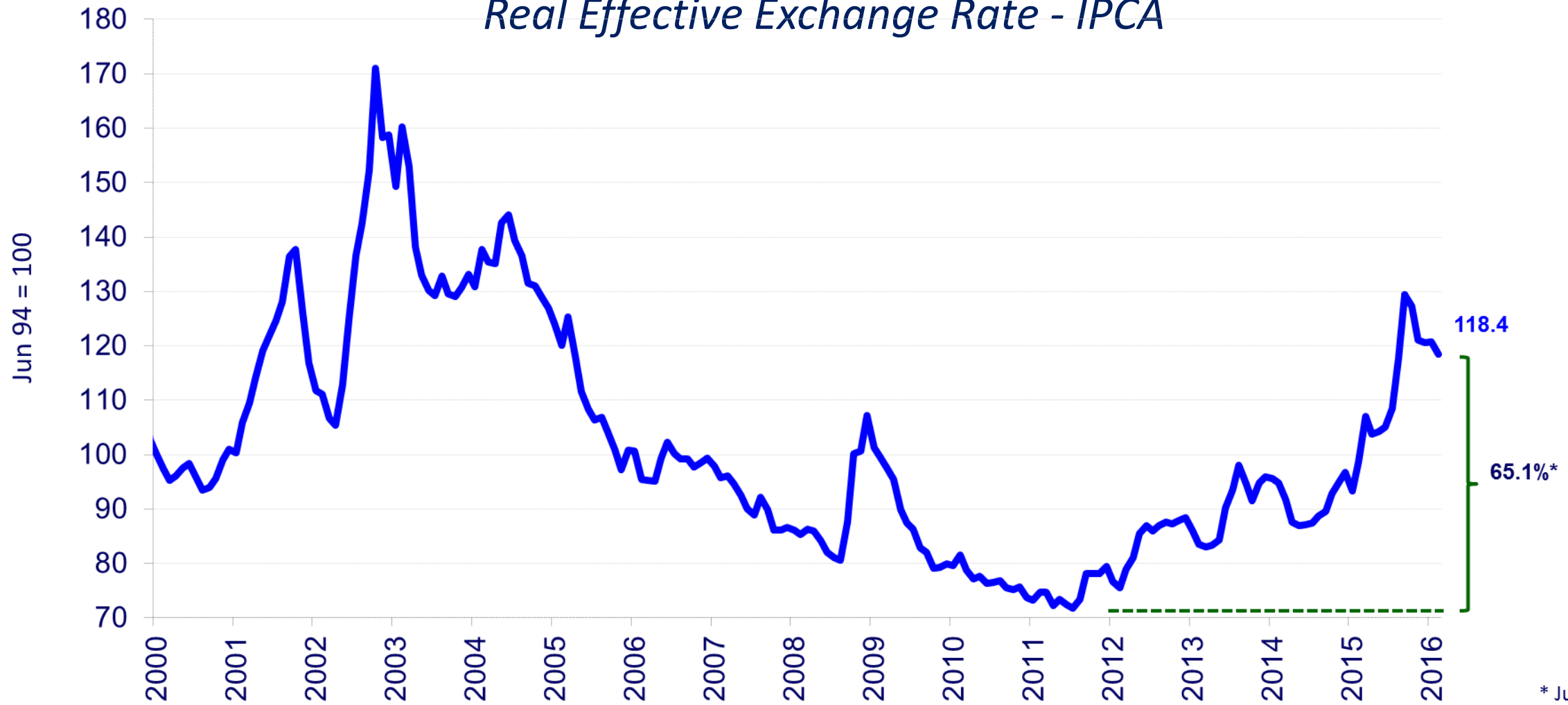
* In an Austrian school's perspective.

External Adjustment

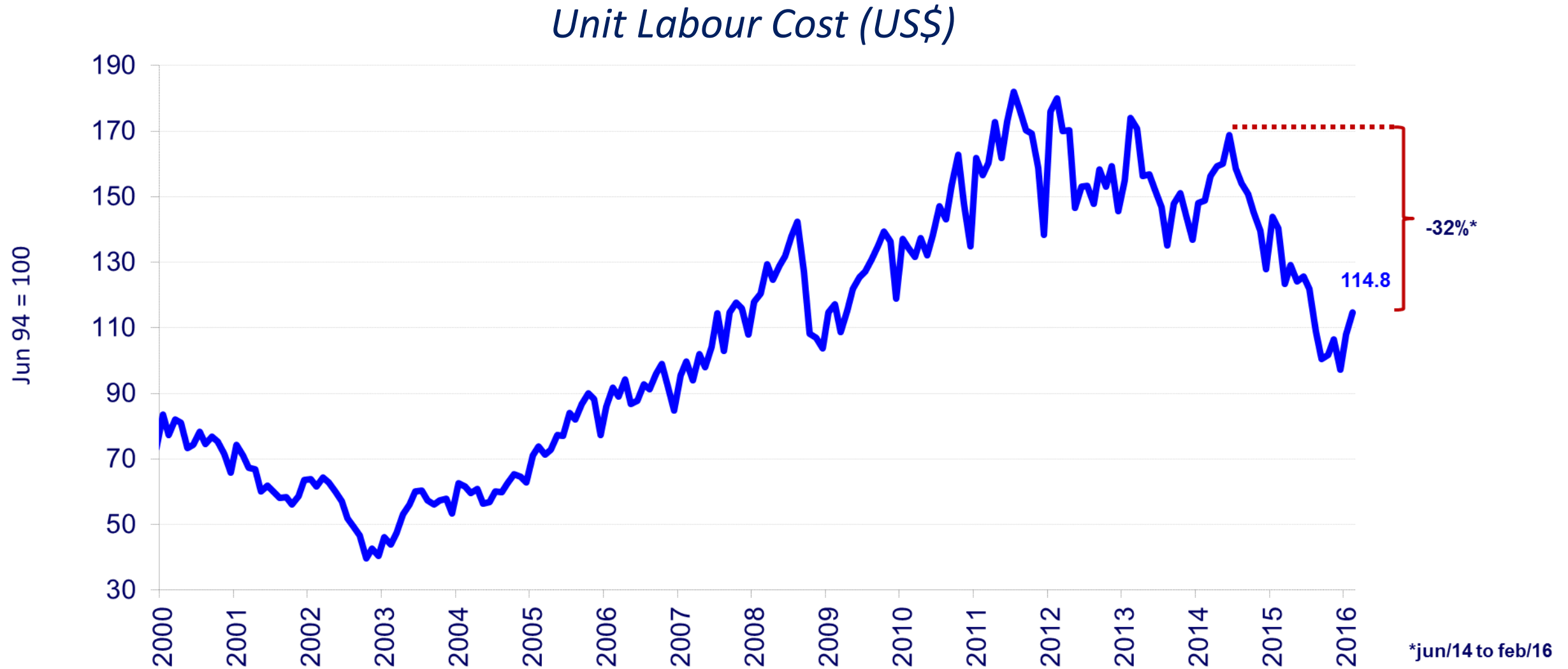


External Adjustment

Real Effective Exchange Rate - IPCA

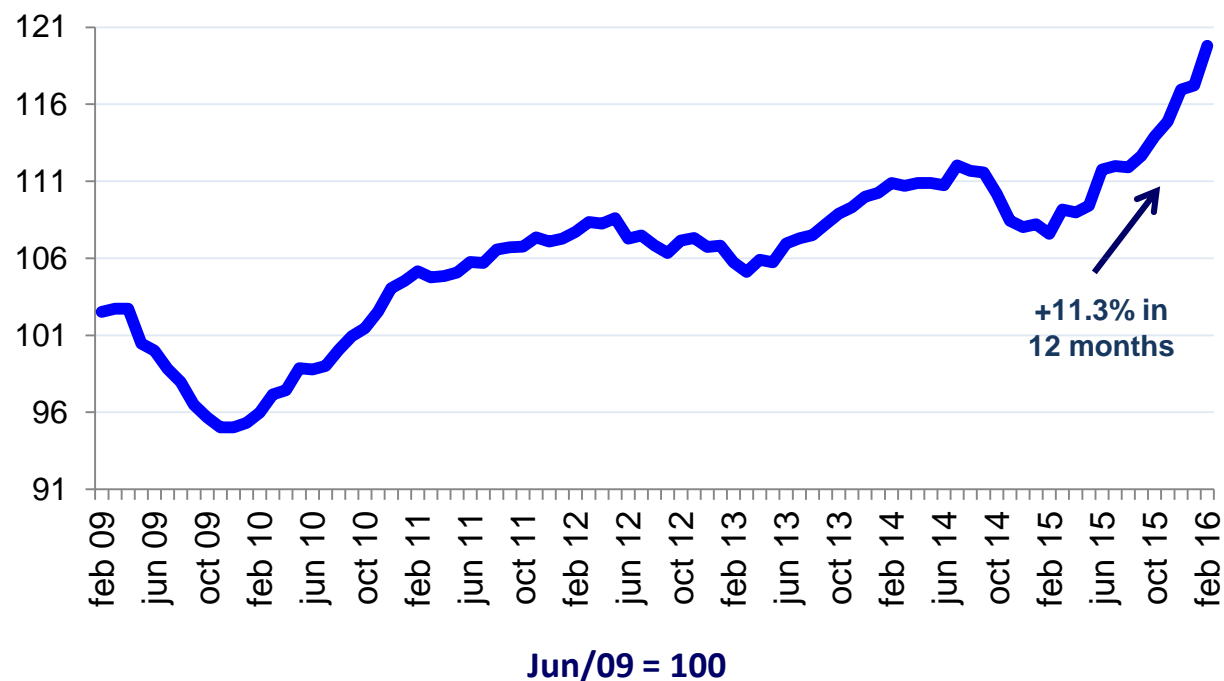


External Adjustment

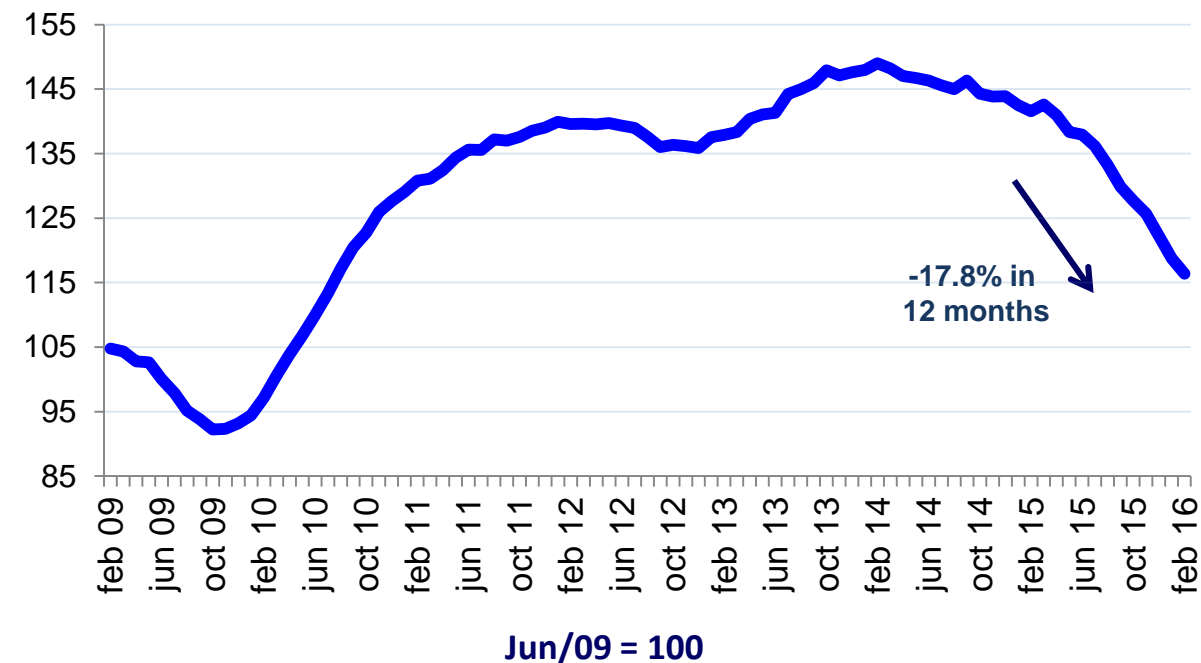


External Adjustment

Exports Volume – 12mma

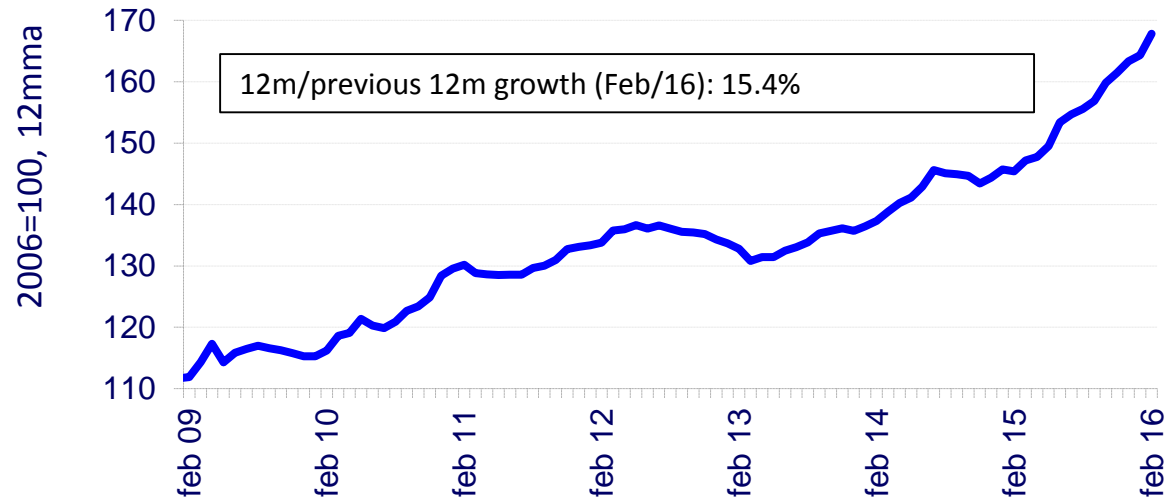


Imports Volume – 12mma

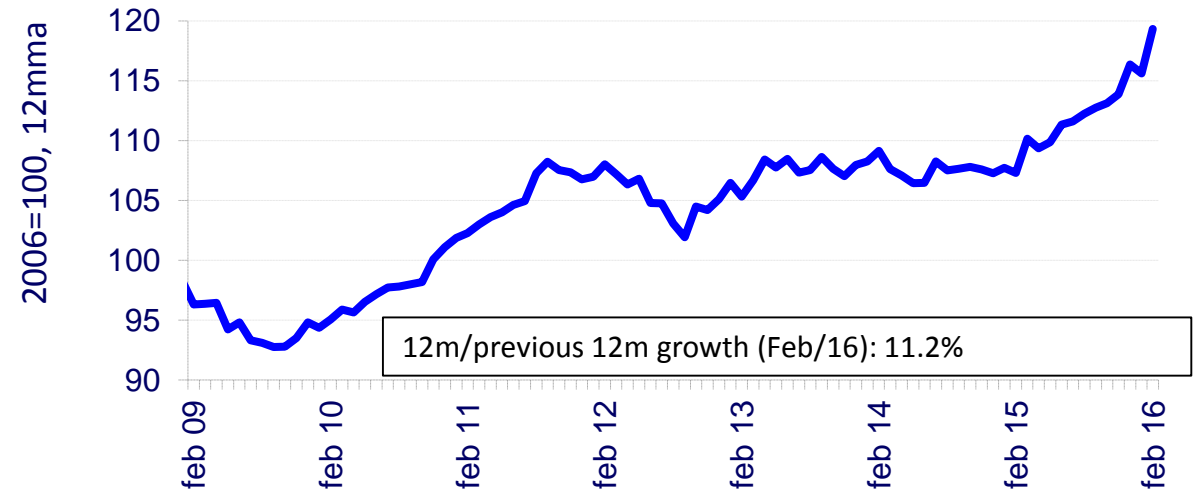


External Adjustment: Export Quantum – Sector Decomposition

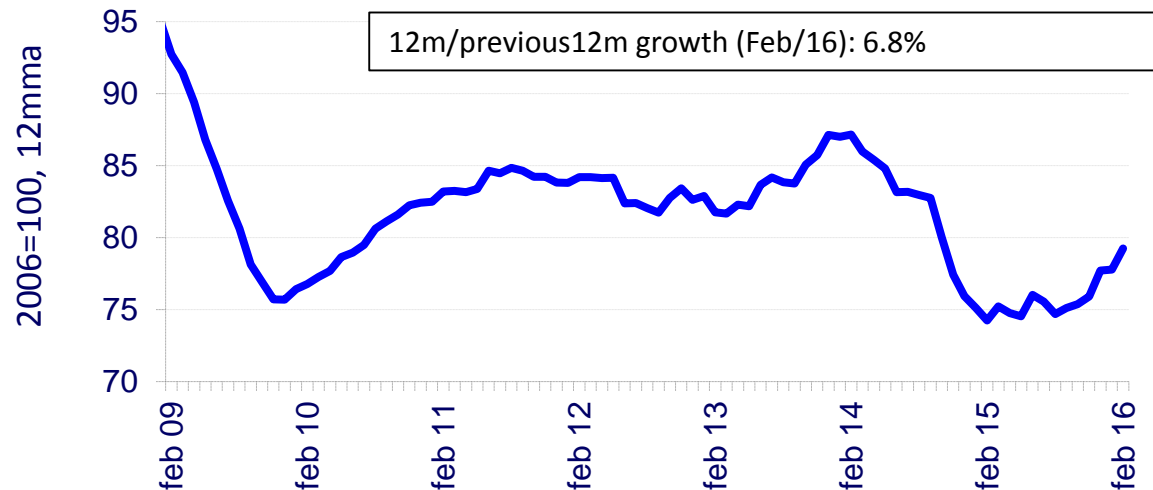
Primary



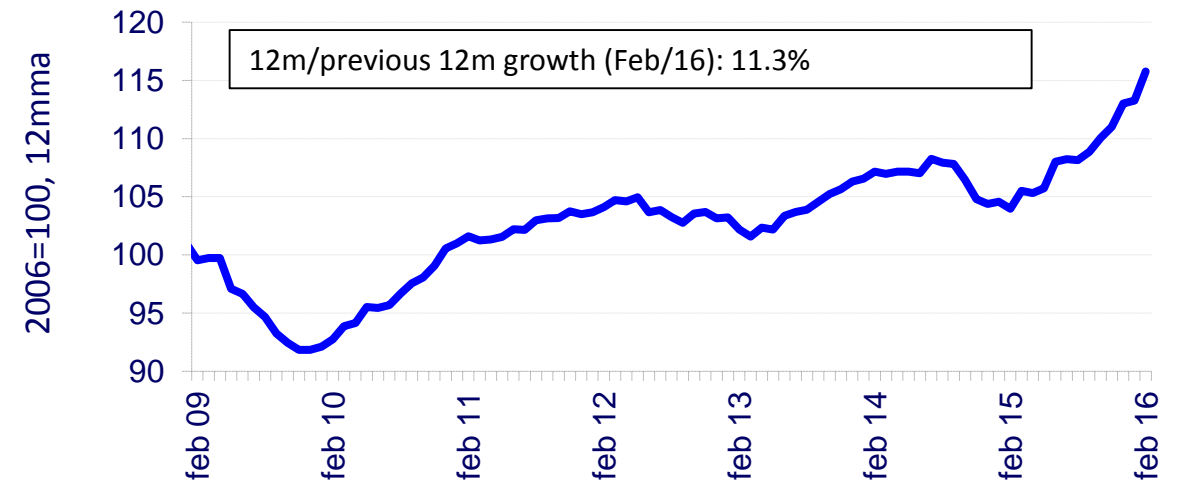
Semi-Manufactured



Manufactured

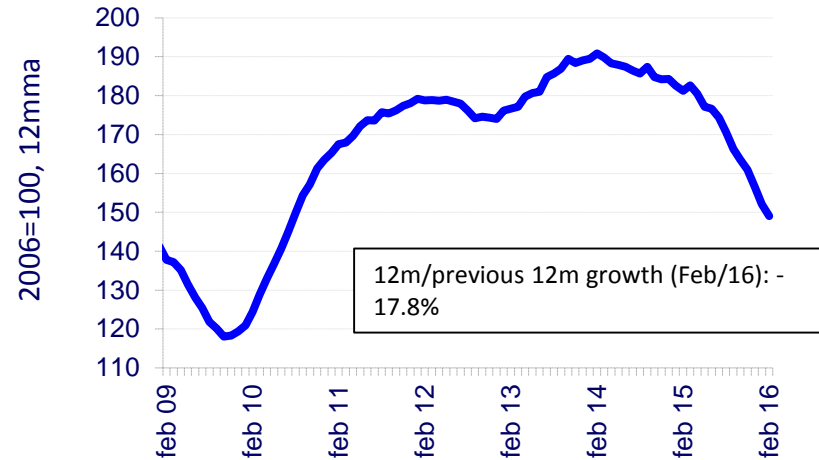


Total

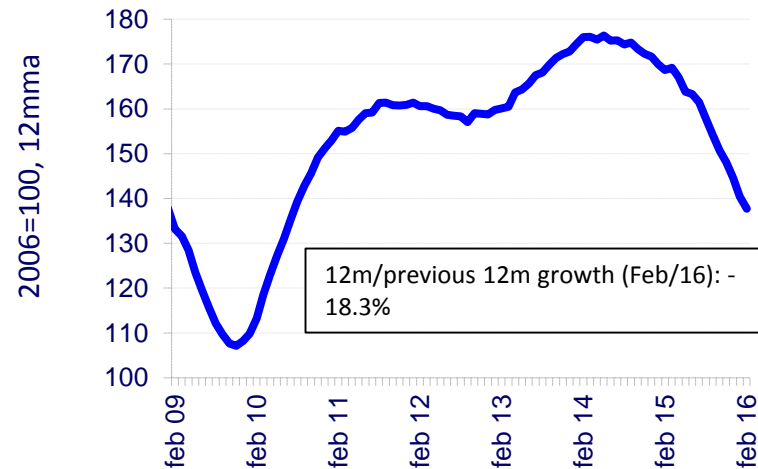


External Adjustment: Import Quantum – Sector Decomposition

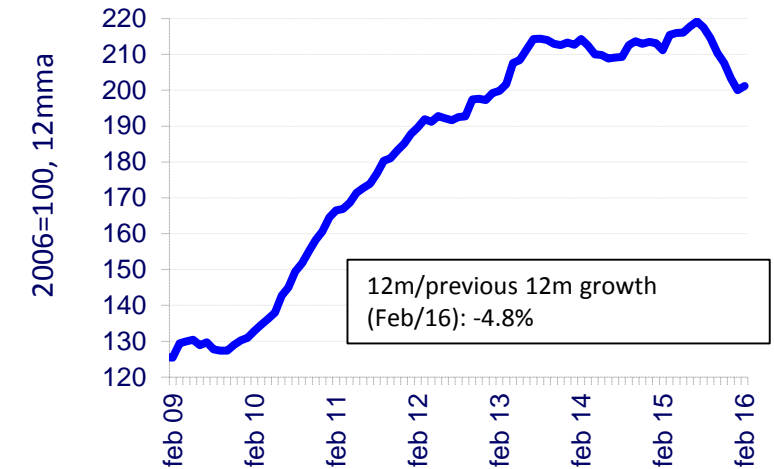
Total



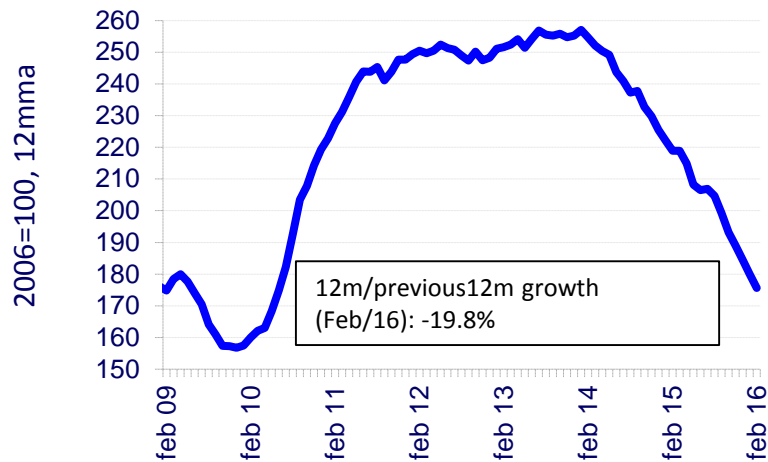
Intermediate



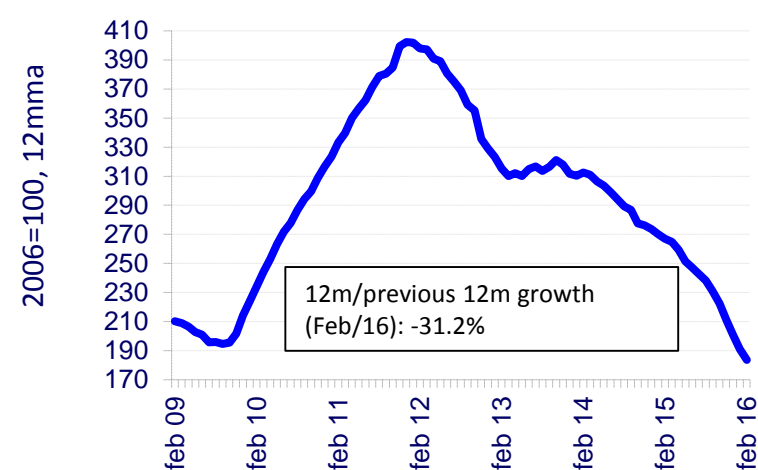
Non-Durable Consumer Goods



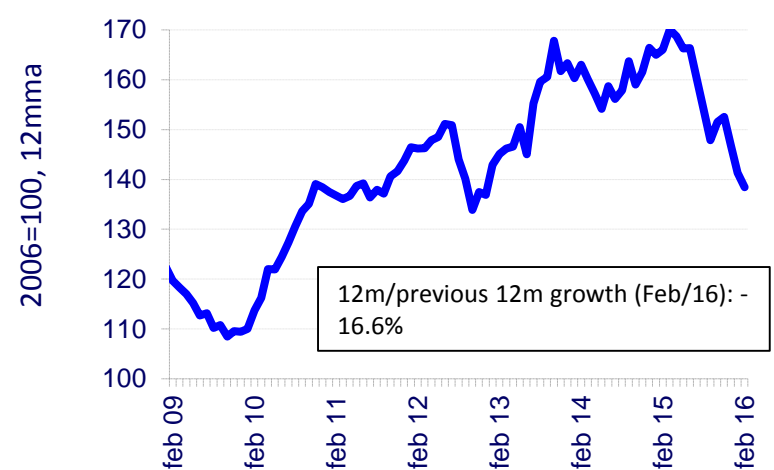
Capital Goods



Durable Consumer Goods

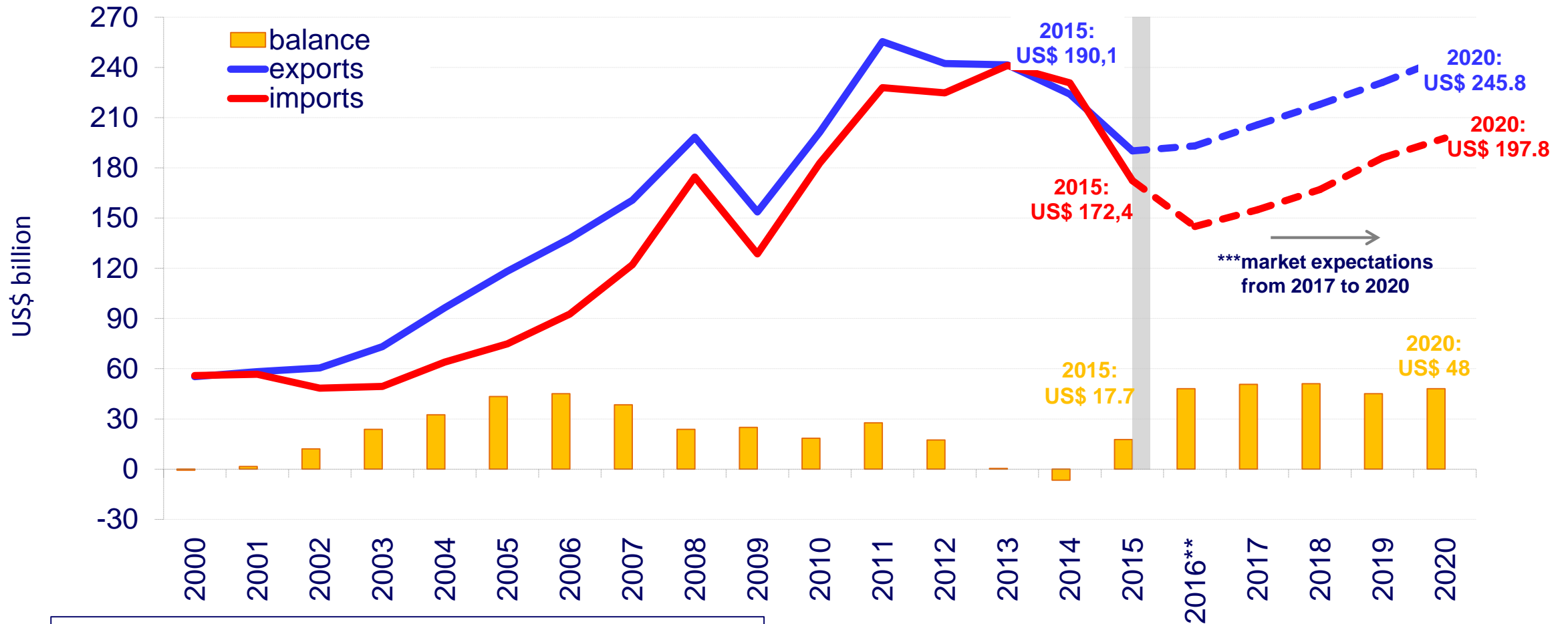


Fuels



External Adjustment

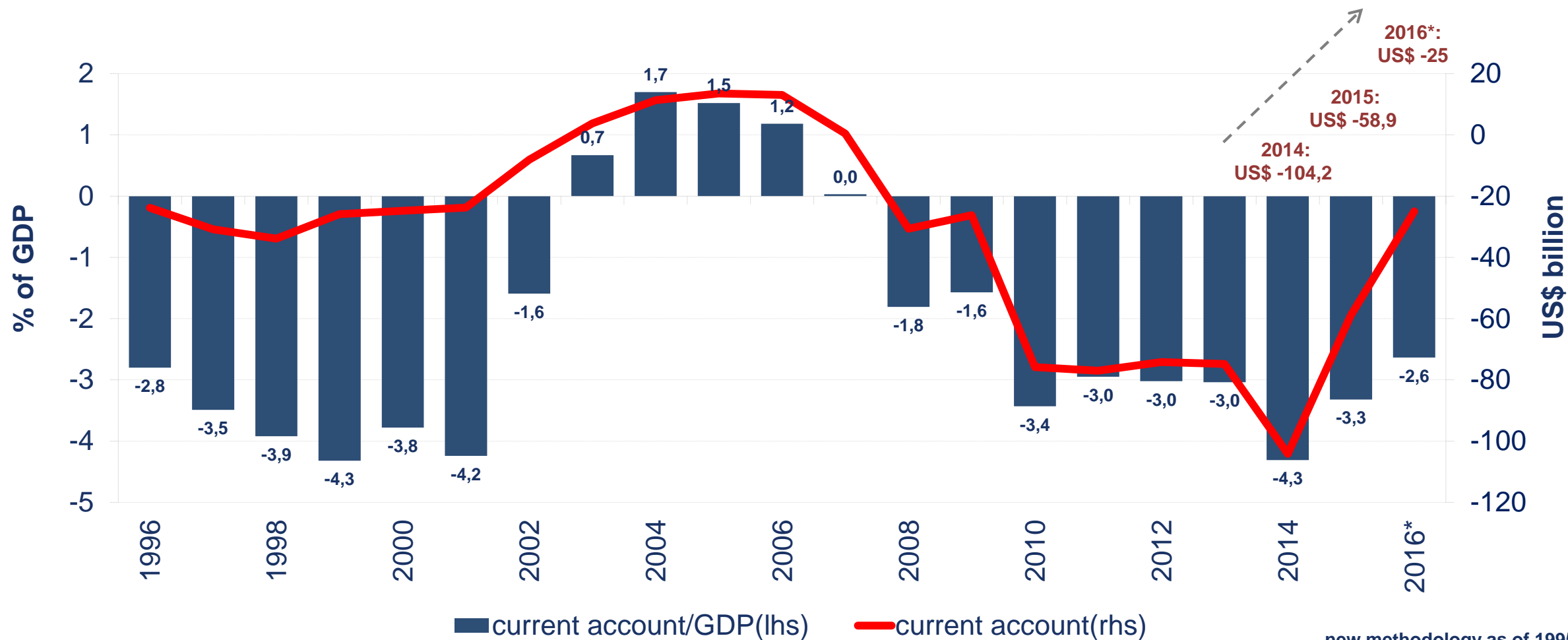
Trade Balance – Exports and Imports



** BCB projection; *** medians as of Mar 24th (balance calculated by difference)

External Adjustment

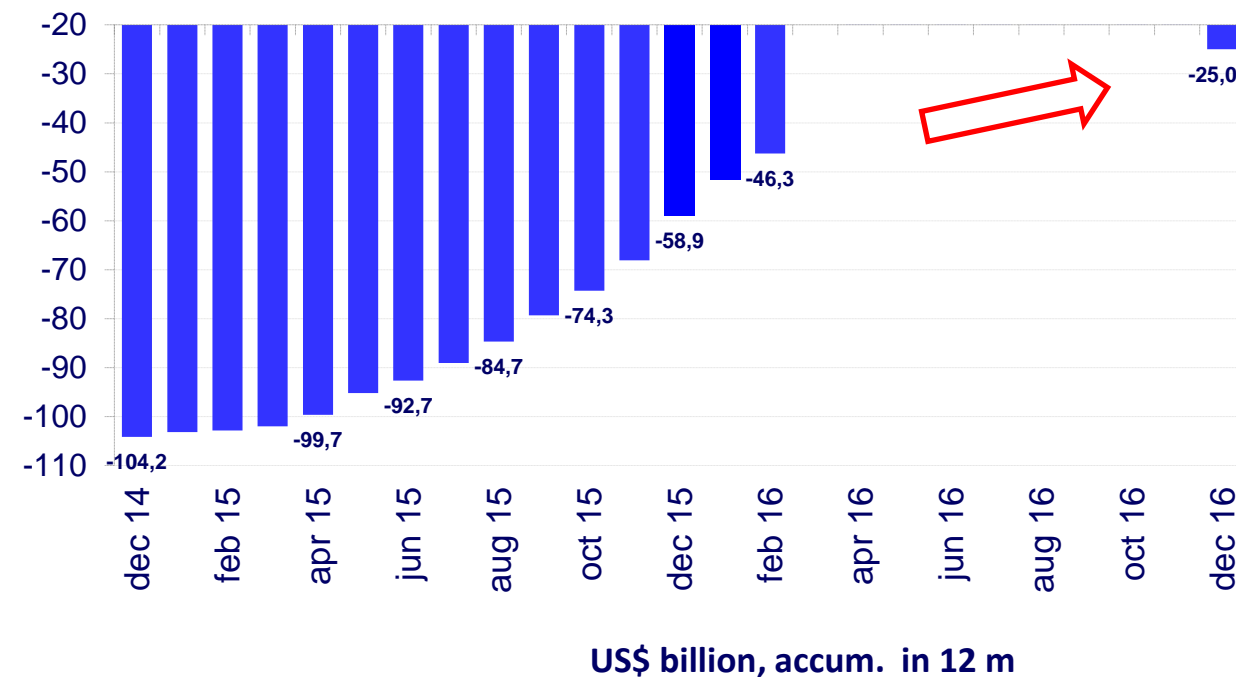
Current Account



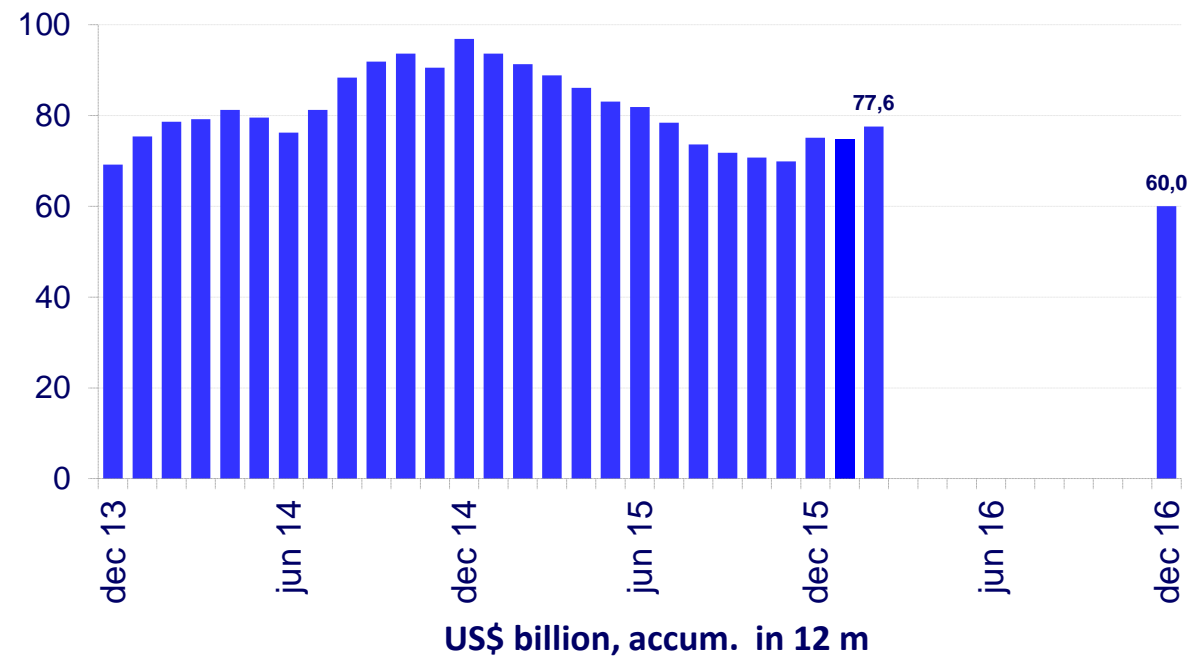
new methodology as of 1995
*forecast

External Adjustment

Current Account Balance

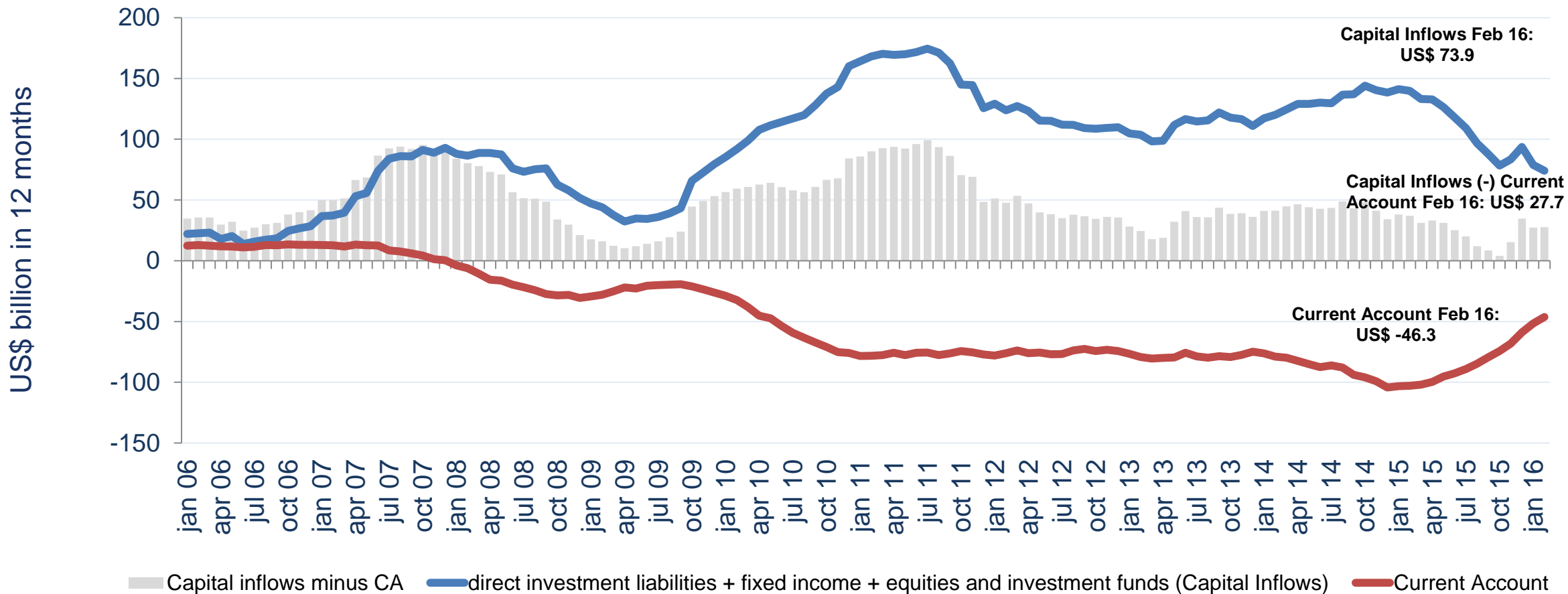


Foreign Direct Investment (FDI)



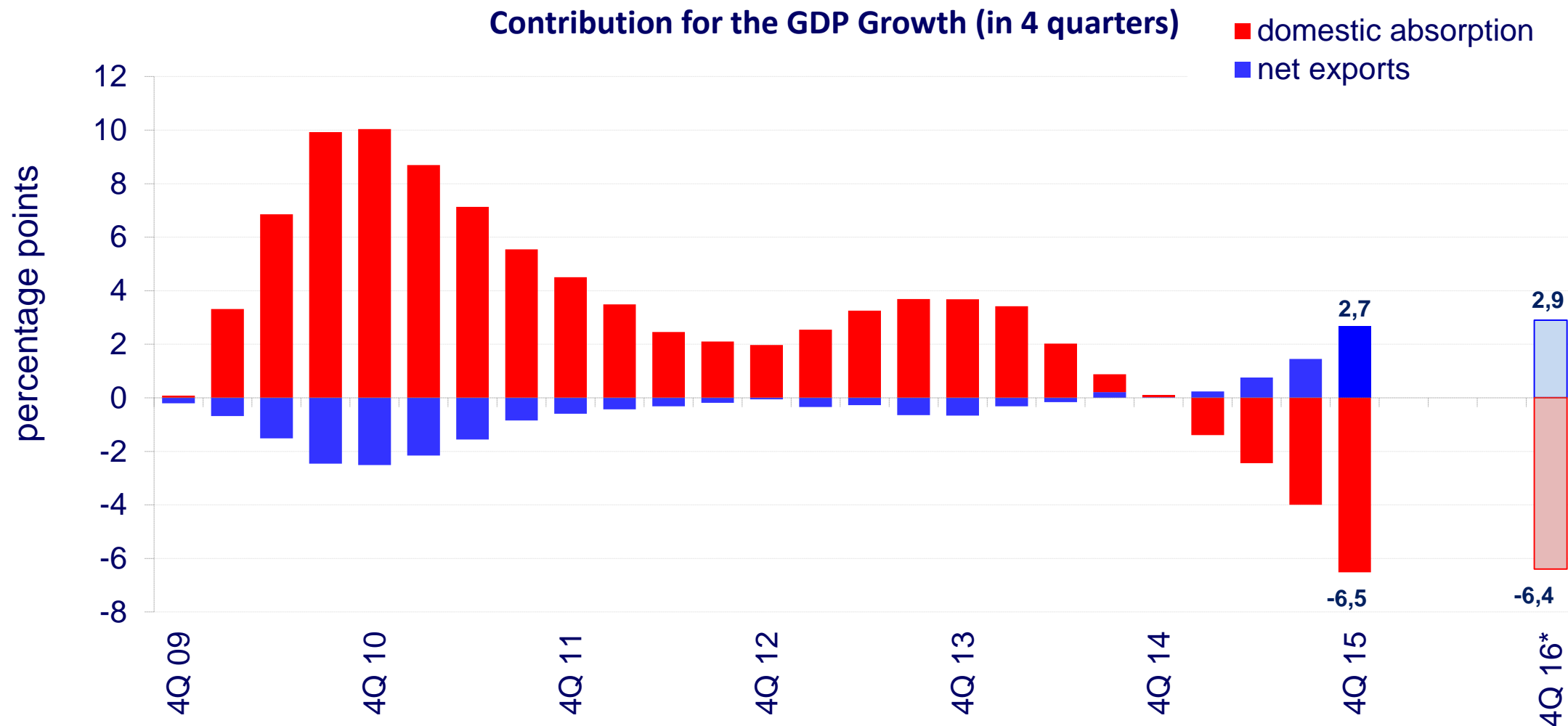
External Adjustment

FDI + Fixed Income + Equities and Investment Funds vs. Current Account



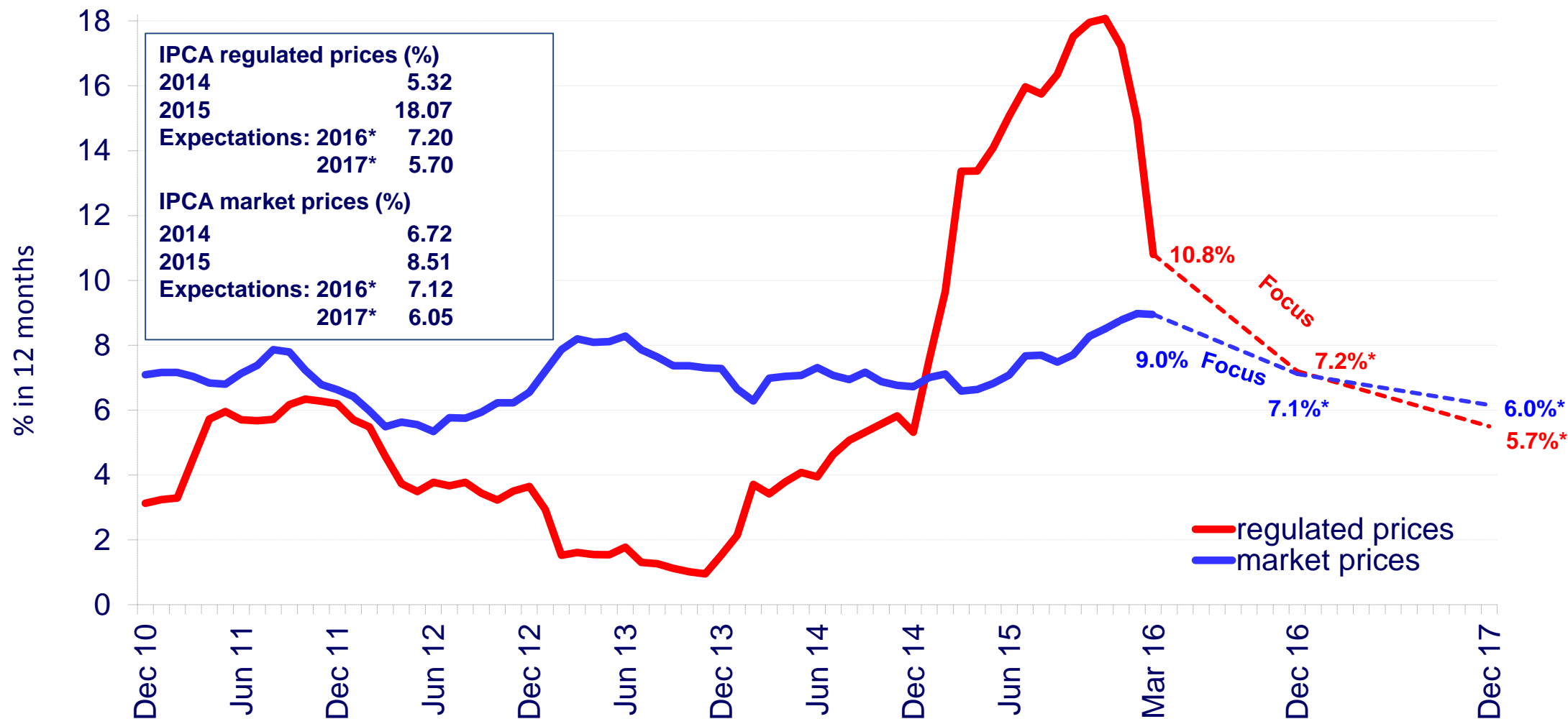
External Adjustment

Contribution of the External Sector for the GDP



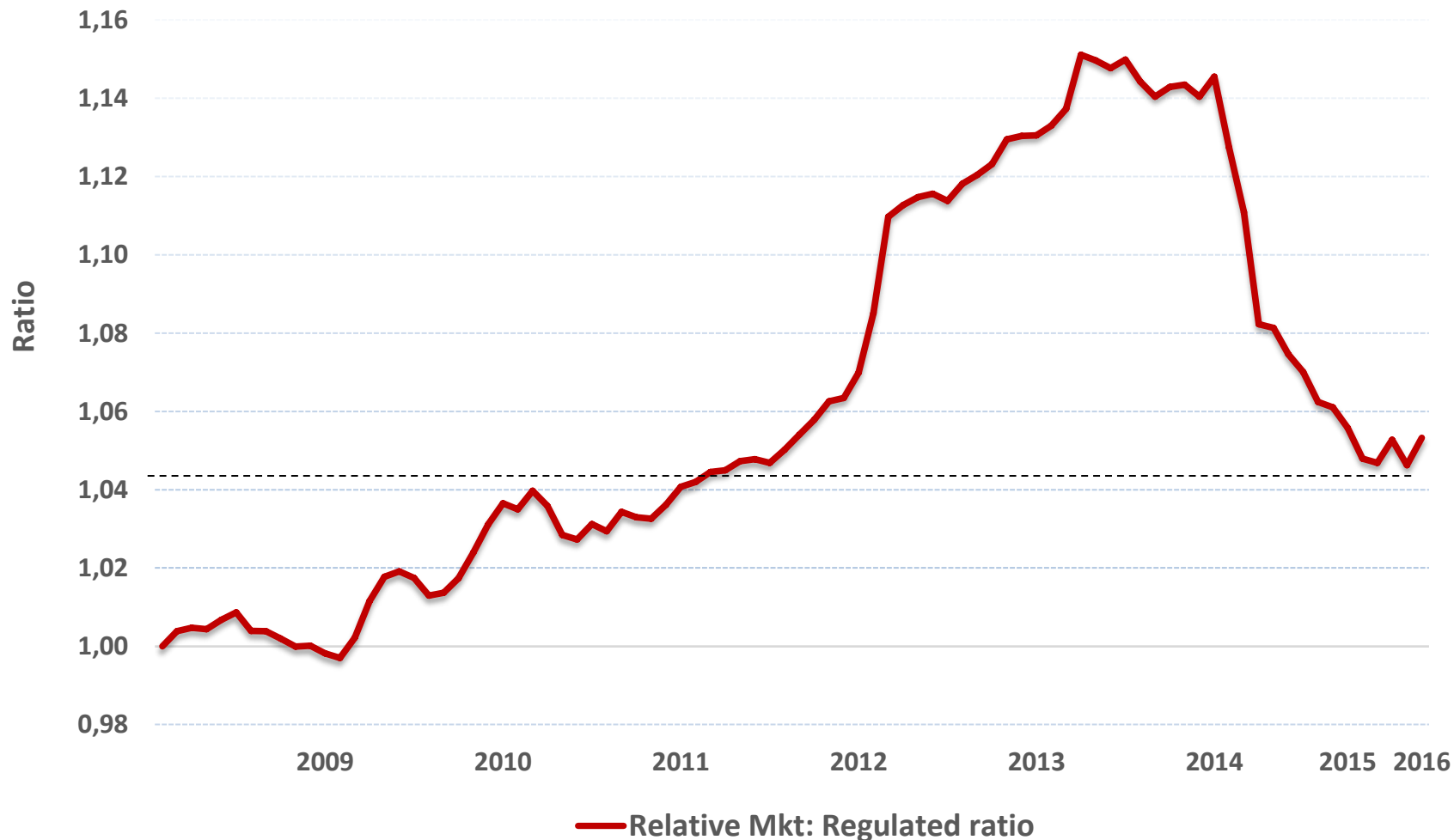
Monetary Adjustment

Market and Regulated Prices



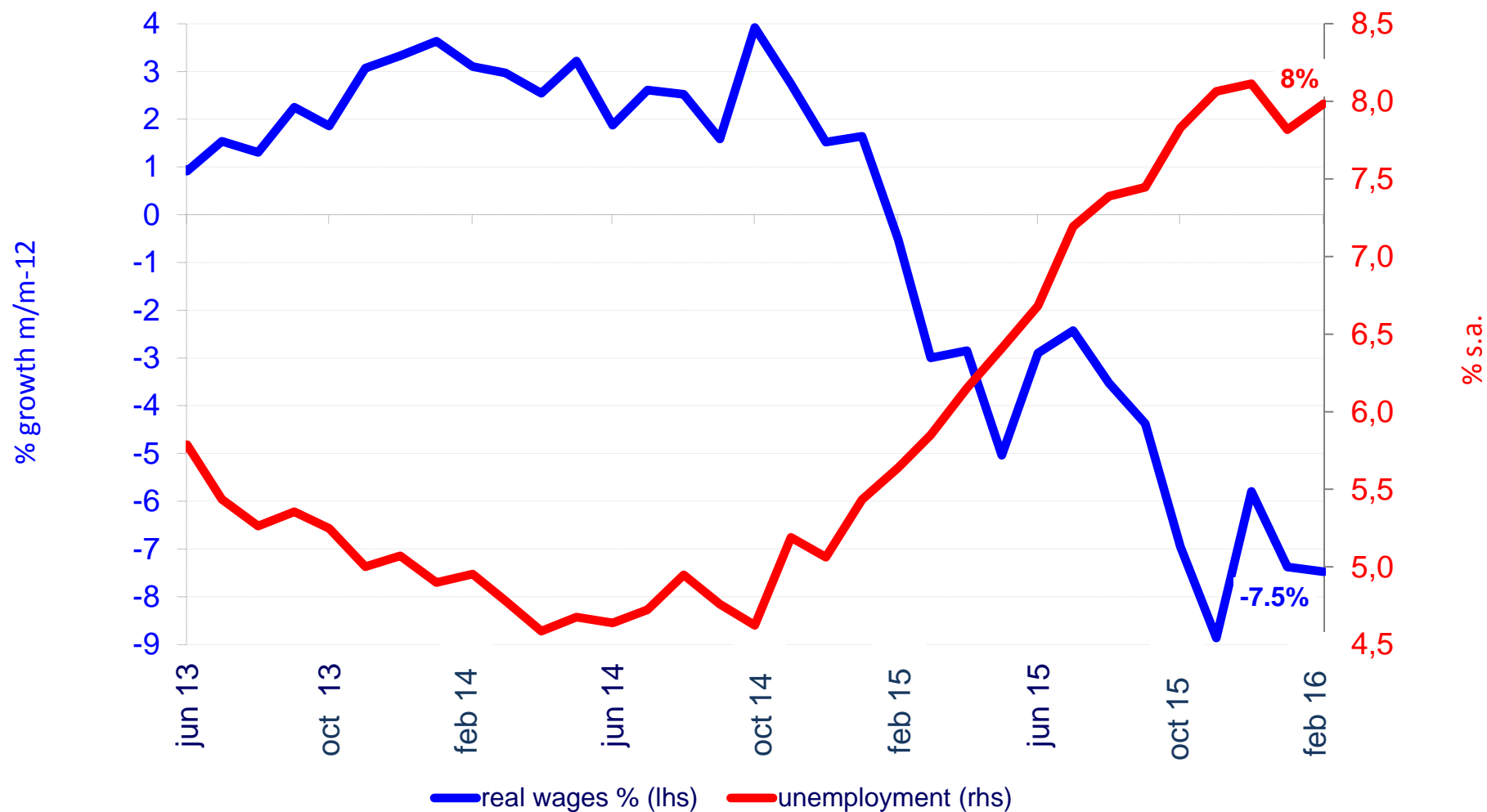
Monetary Adjustment

Market Prices Vs. Regulated Prices Ratio



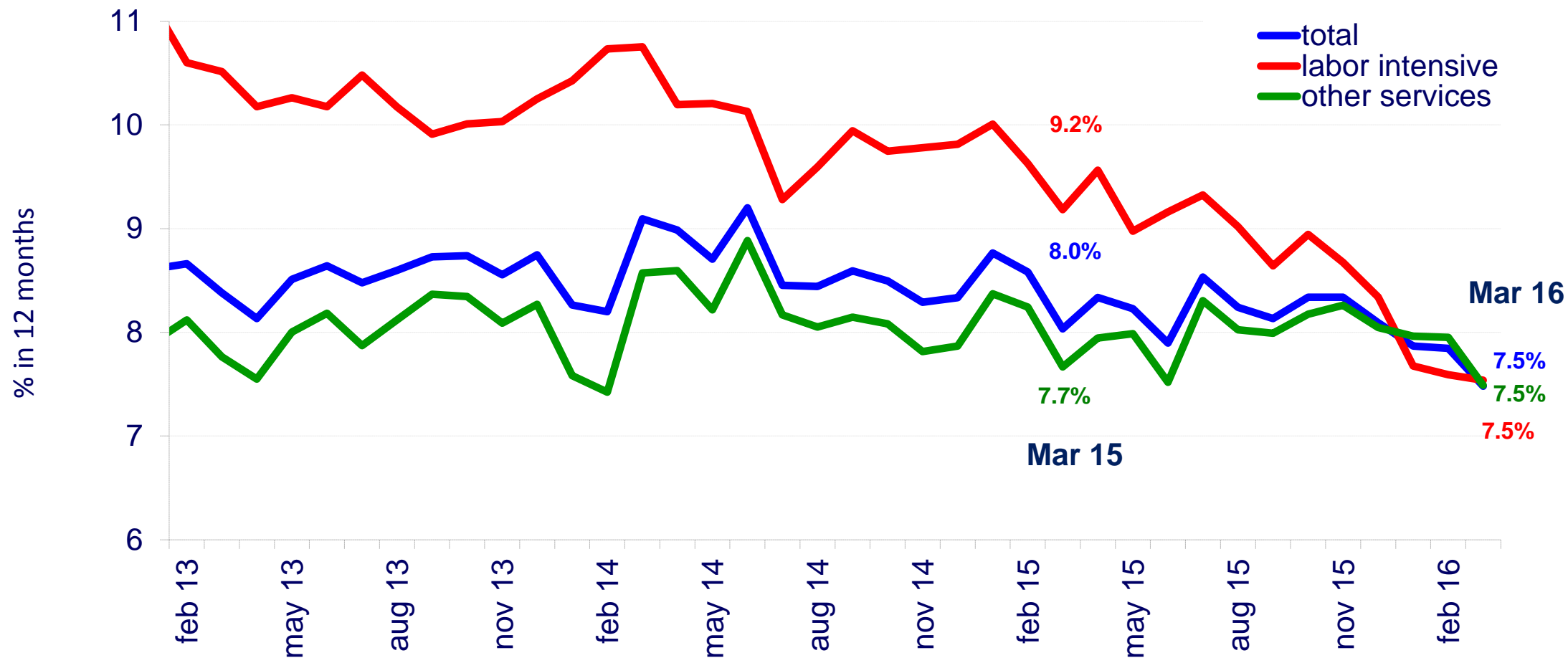
Monetary Adjustment

Real Wages and Unemployment

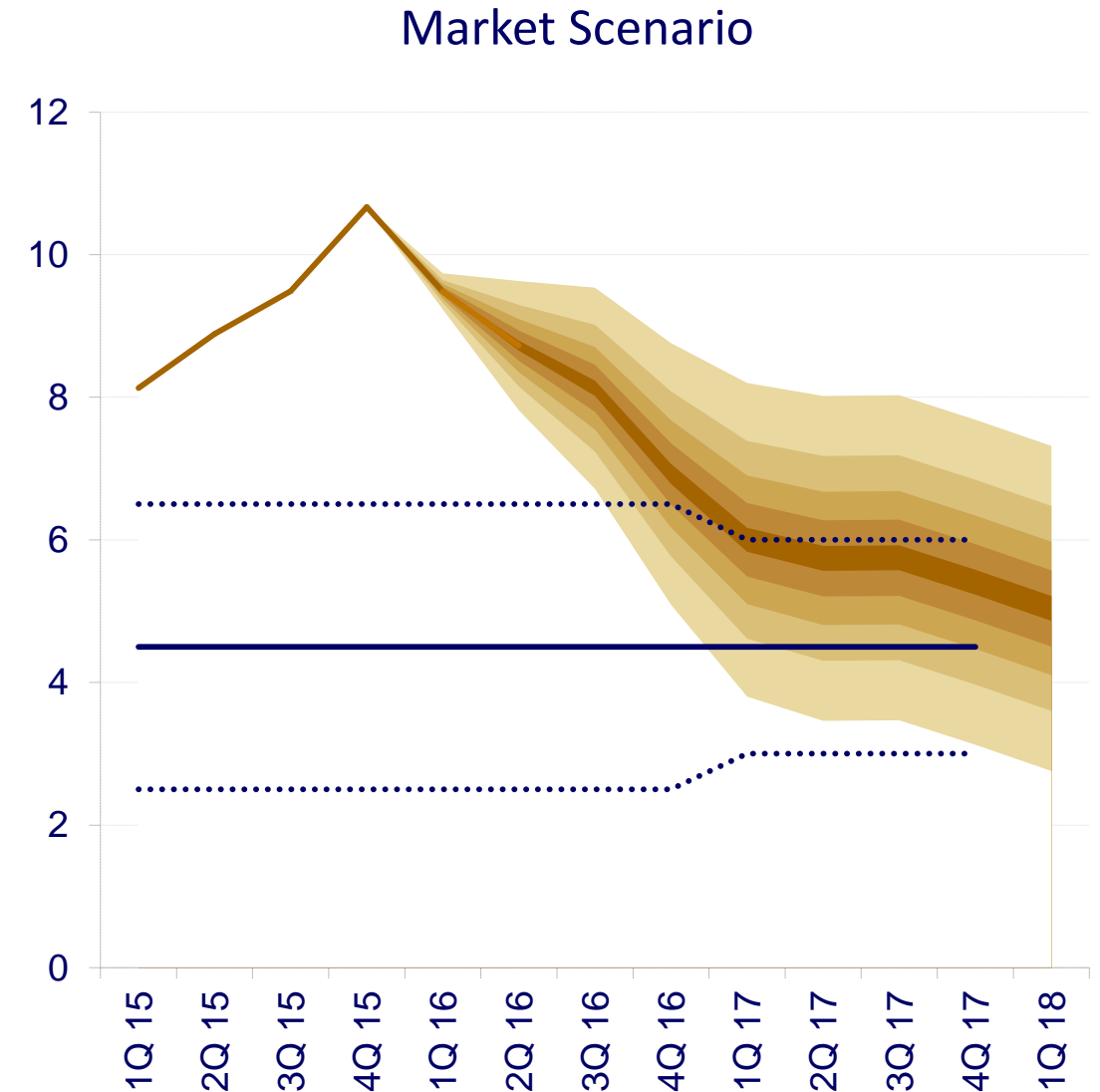
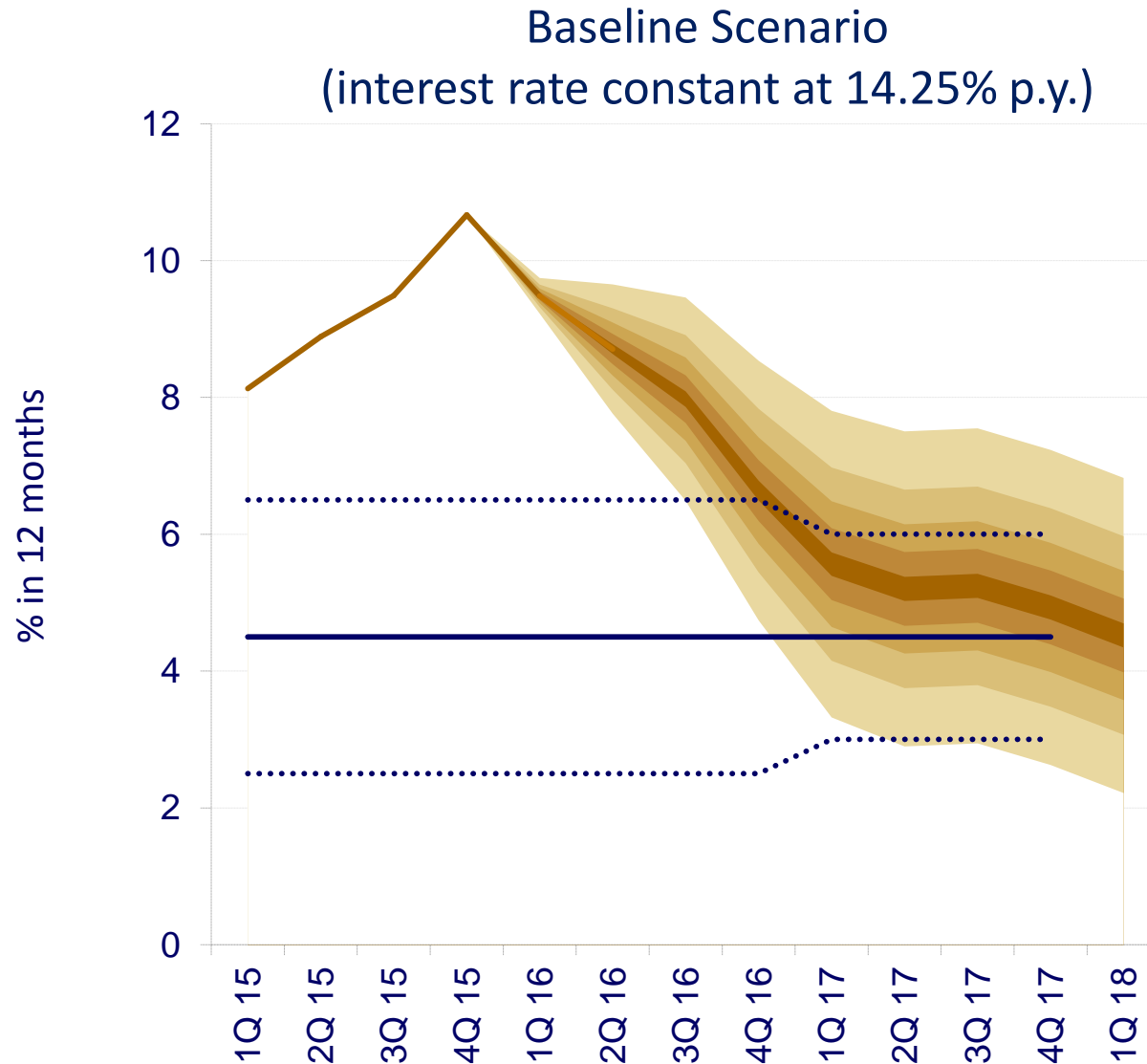


Monetary Adjustment

Services Inflation - IPCA

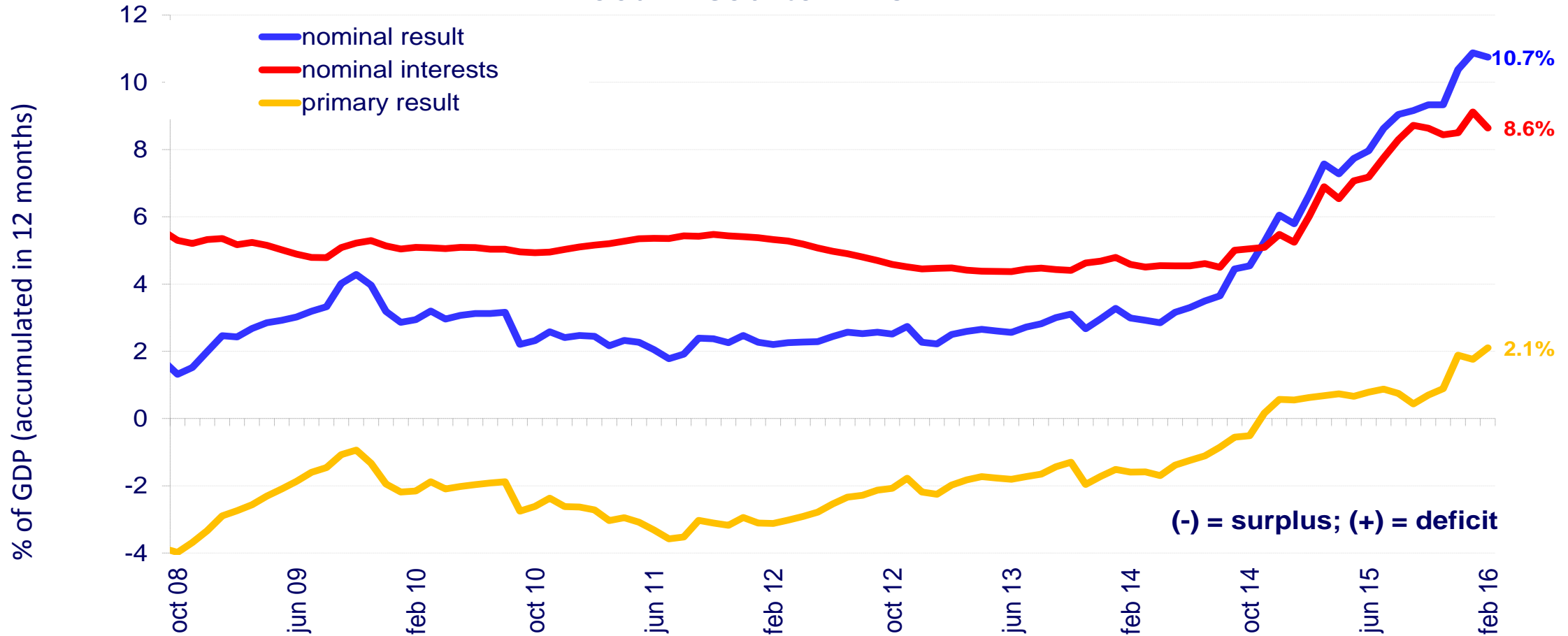


Monetary Adjustment: Inflation Projections



Fiscal Adjustment

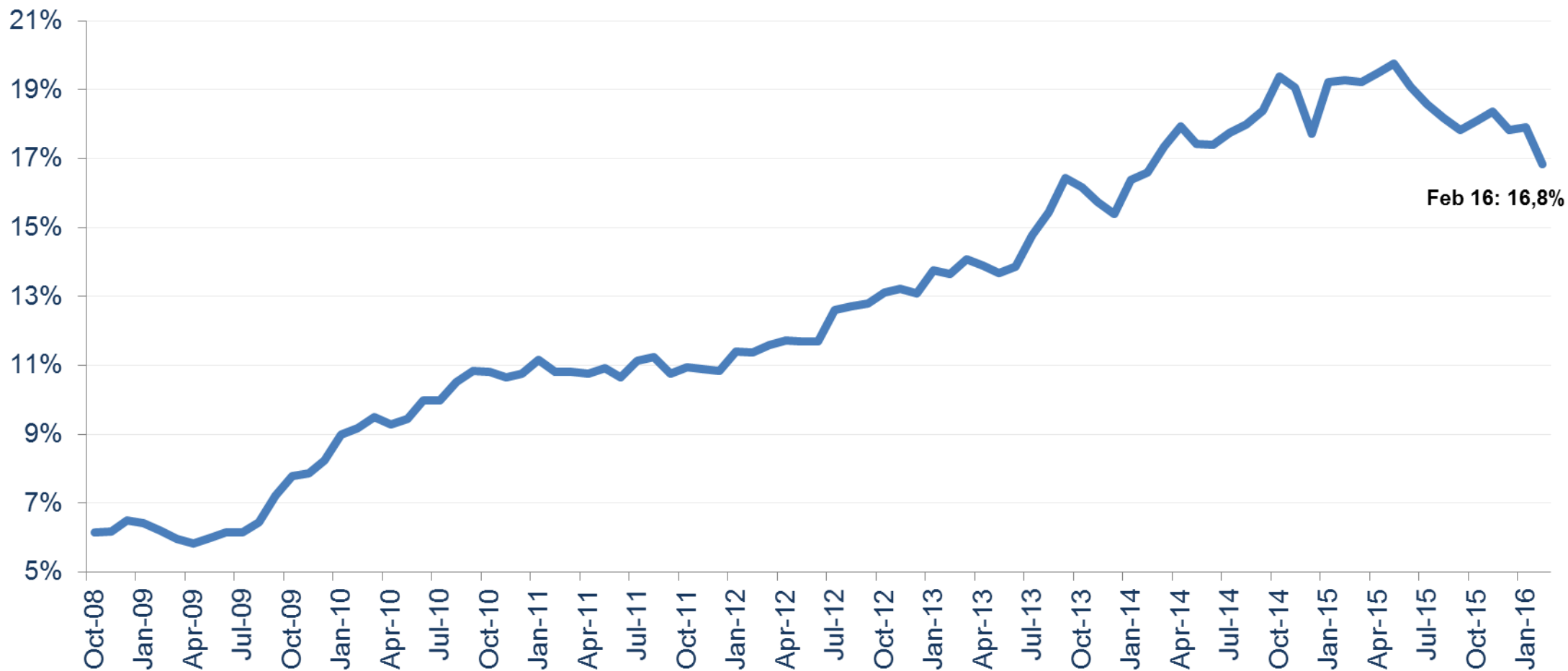
Fiscal Results – PSBR*



*Public Sector Borrowing Requirement (PSBR) - 'below the line' concept, which corresponds to the change in the total net debt (domestic or external) of the public sector

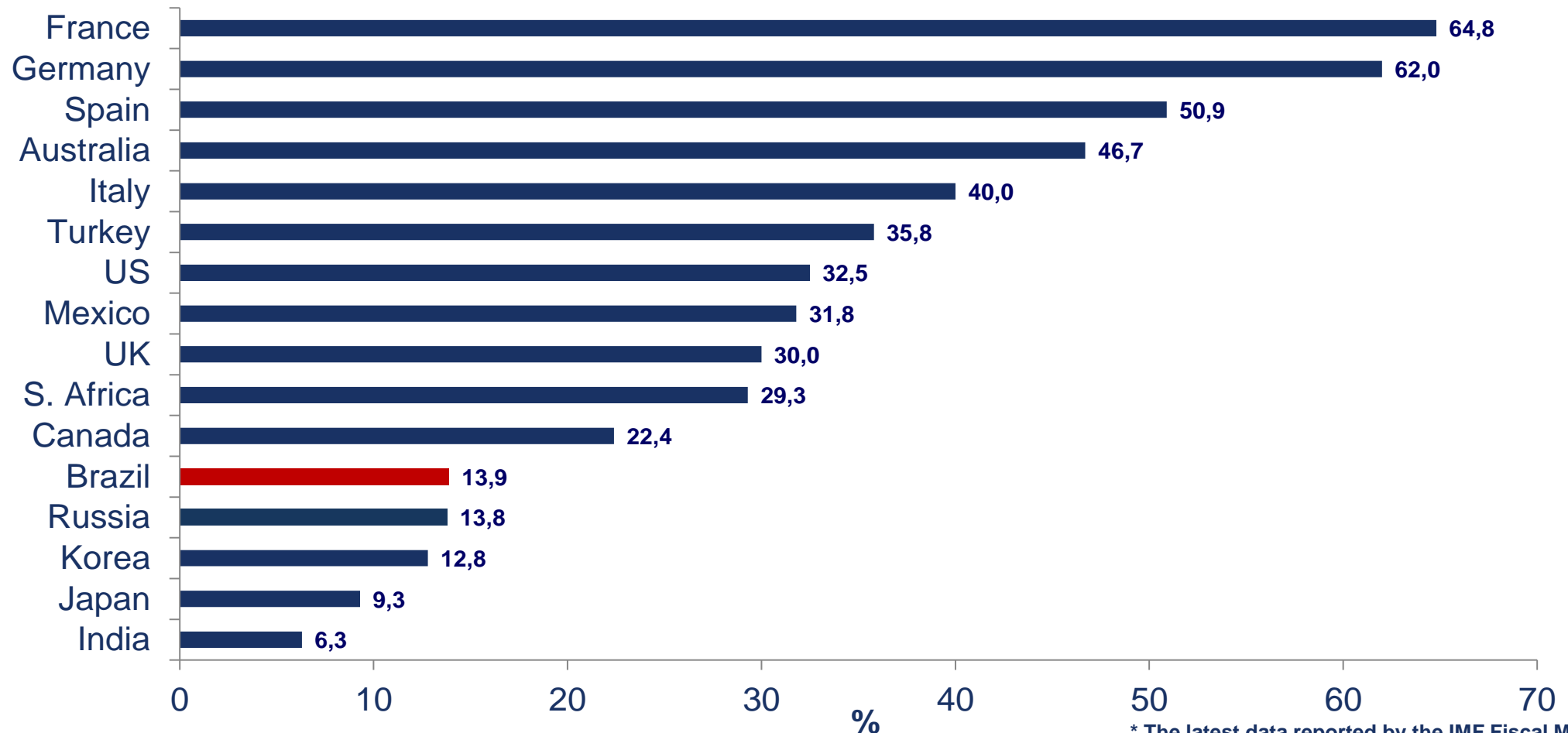
Fiscal Adjustment

Domestic Debt held by Non-Resident / Overall Public Debt



Public Debt Held by Non-Residents – International Comparison

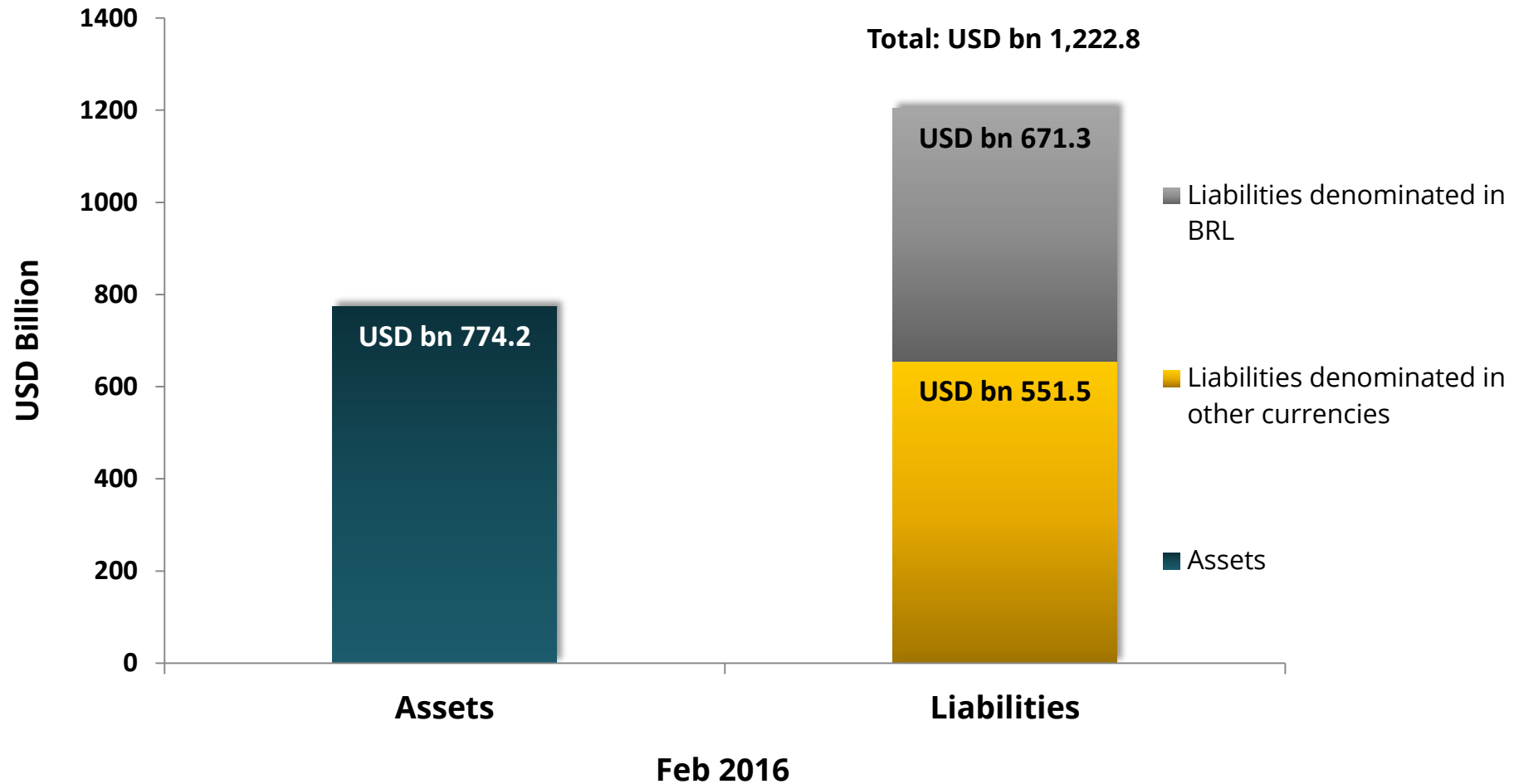
% of outstanding domestic public debt securities*



* The latest data reported by the IMF Fiscal Monitor in Apr 16

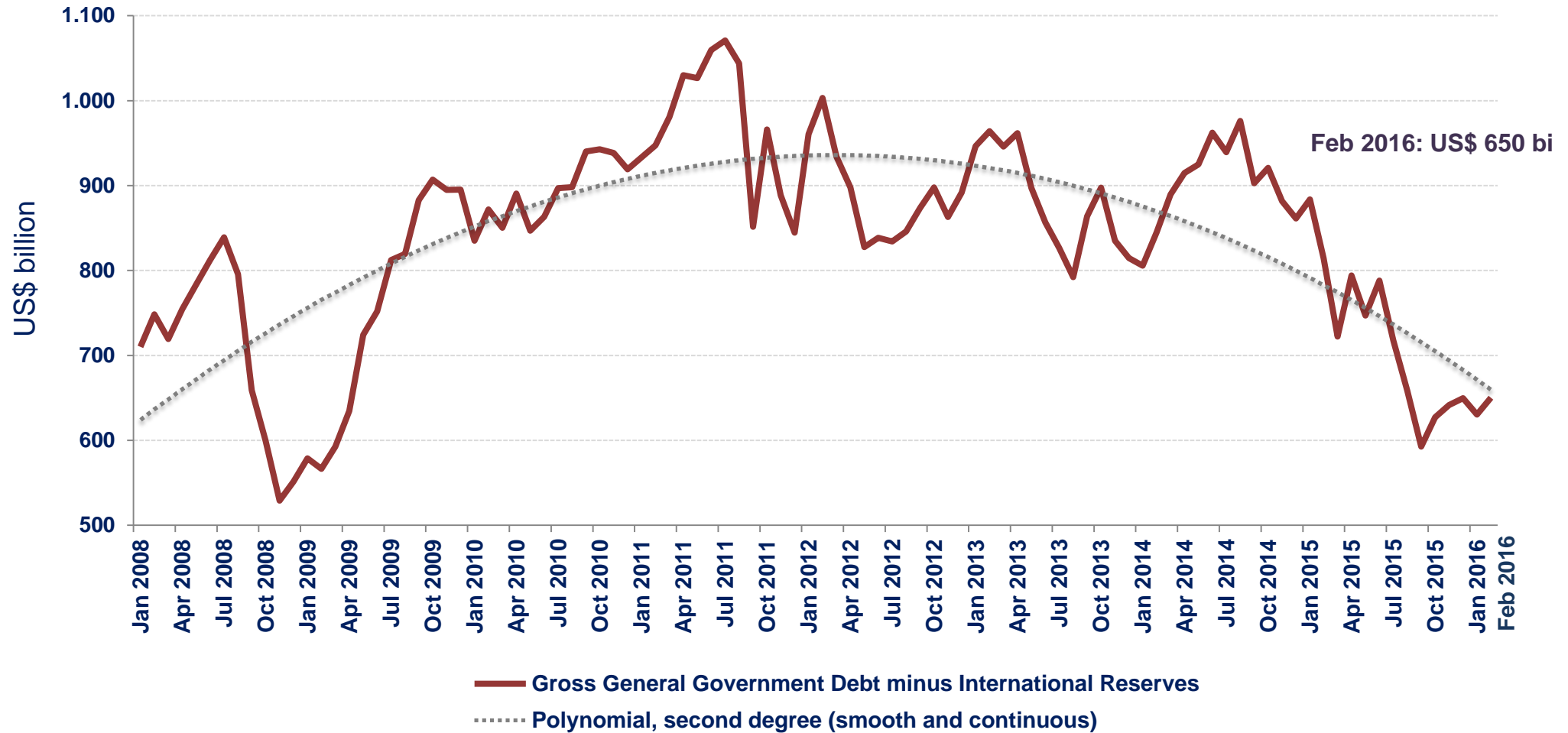
Fiscal Adjustment

Brazil's International Investment Position



Fiscal Adjustment

Gross Debt Minus International Reserves



Conclusions

- 1. External adjustment largely accomplished*** – Changes in relative prices (REER, ULC) guarantee a changing composition of aggregate demand (more net exports and eventually investments, less consumption) and smaller CA deficits – and so need for less capital inflows (adjustment to lower terms of trade and more hostile global financing environment for EM);
- 2. Monetary adjustment “on the way”* – Lower impact of relative price adjustments (regulated prices + FX in 2016); disinflationary output gap; policy rate above neutral: inflation will fall this year. BCB committed to maintain policy stance until probability of achieving guidance for 2016 and 2017 is sufficiently high.

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- **But:** Success of external adjustment, controlled levels of inflation (nominal stability despite fears of fiscal dominance/debt monetization), deep and local debt markets (small % of foreign investors), and strong “balance sheet” position (size and composition) lengthens time/space before fiscal limits “bind”;
- Despite all of this, *without convincing fiscal consolidation, these limits will likely begin to manifest themselves at some point, and the risk of a fiscally-induced financial crisis grows with time.*

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And: Progress in adjustment process means that continued cause of economic stress is due to **uncertainty** (a third cause of recession) due to non-economic reasons;

Decrease in uncertainty could imply a surprisingly rapid growth recovery;

The reverse is also true: if the level of uncertainty does not normalize, there is little chance of a sustained economic recovery.

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Thank you for your time

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