



**BANCO CENTRAL DO BRASIL**

**Apresentação do Diretor de Assuntos Internacionais e Gestão de Riscos Corporativos do Banco Central do Brasil, Tiago Couto Berriel, no evento *Investor Seminar*, organizado pelo *J.P. Morgan*, na cidade de Washington, Estados Unidos.**

**Washington, 7 de outubro de 2016.**



# ***Challenges for Monetary Policy***

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**Tiago Berriel**

Deputy Governor for International Affairs  
and Corporate Risk Management

Investor Seminar – JP Morgan  
Washington DC

October 7<sup>th</sup> 2016

# Overview

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1. Brazilian Context: Regaining confidence in a virtuous transition
2. Monetary Policy: Inflation Convergence and Risks
3. Resilience Factors in the recovery

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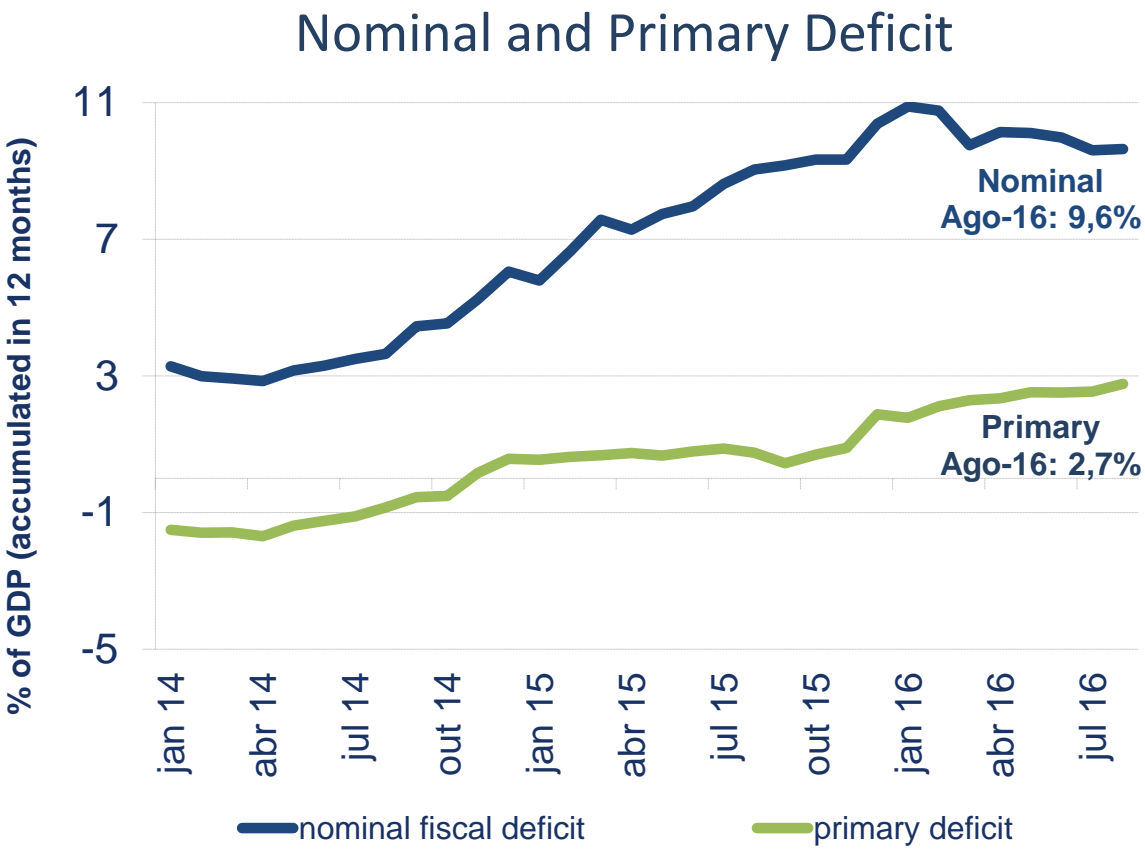
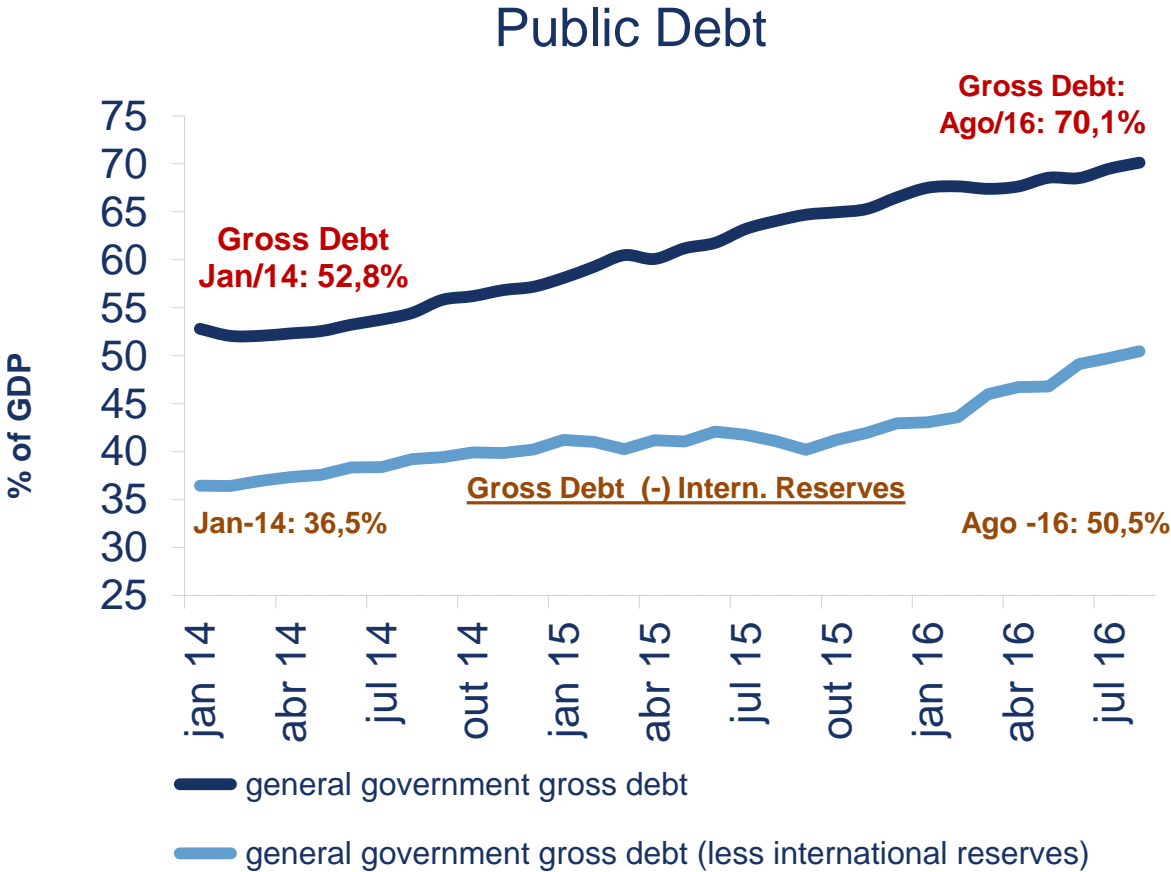
# Starting Point

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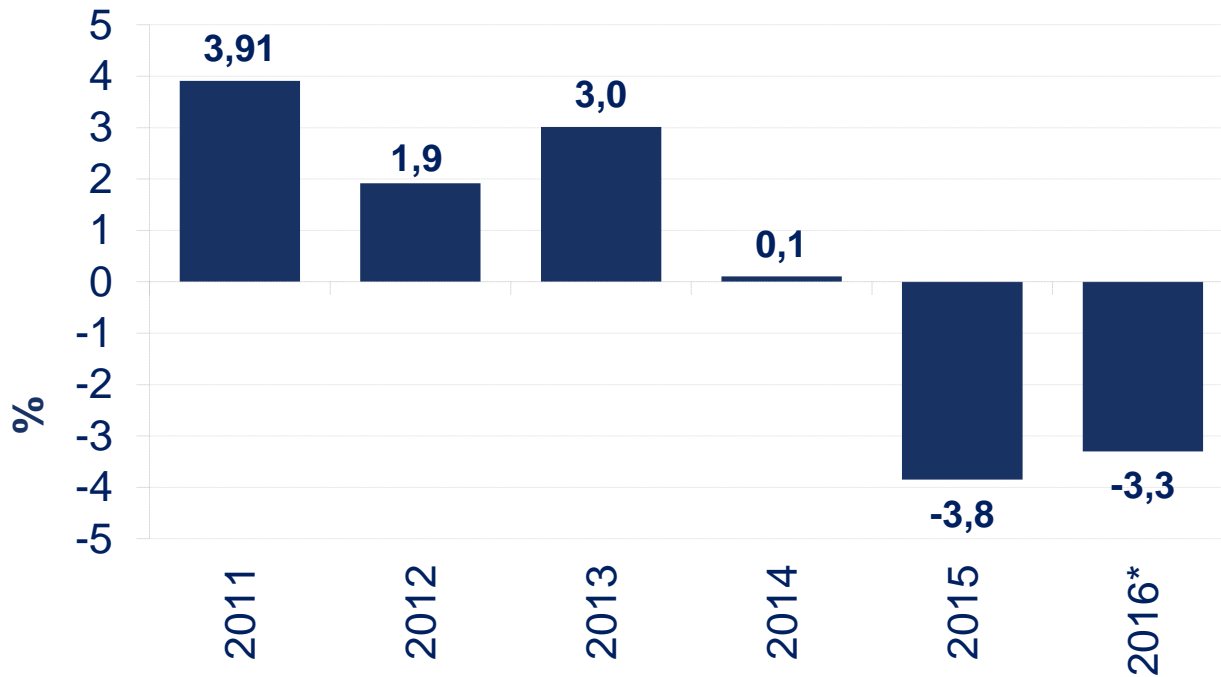
- Improving scenario after economic and political turmoil
- Recent changes in the economic policy agenda and a **recover in confidence** are changing the outlook

# Fiscal Problem since 2014

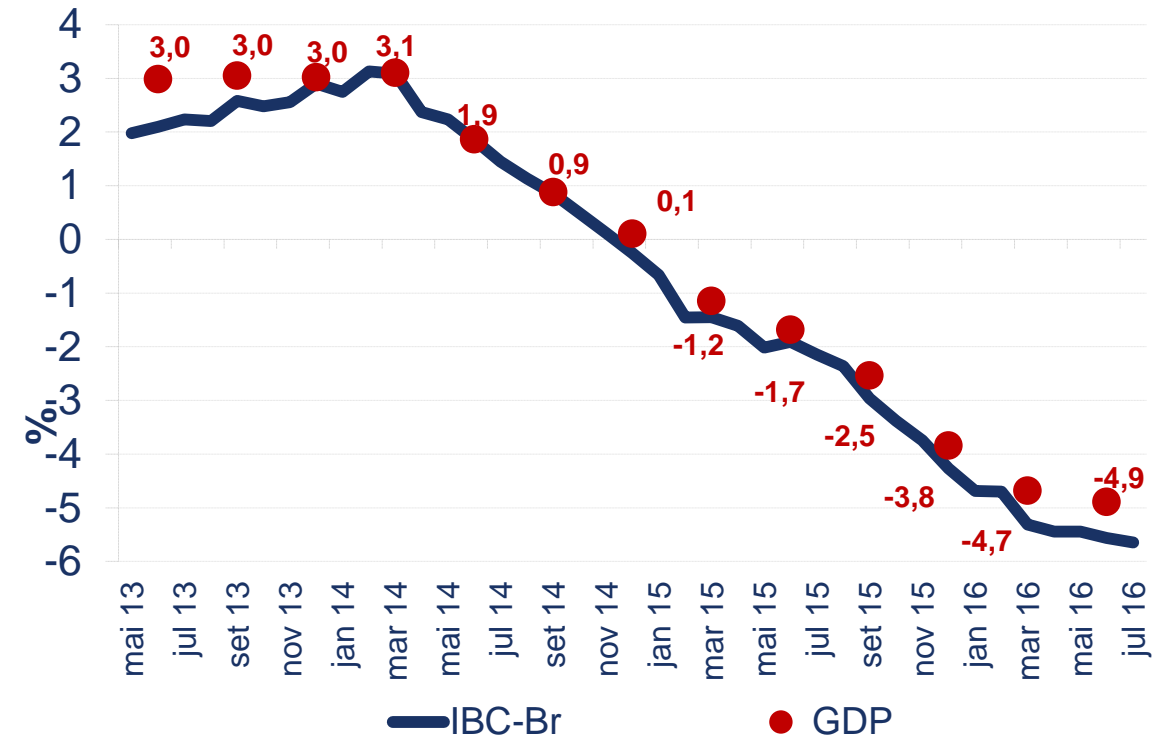


# Economic Activity has been Decreasing

## GDP Growth - %



## Annual Growth



\*average of 12 months/average of the previous 12 months

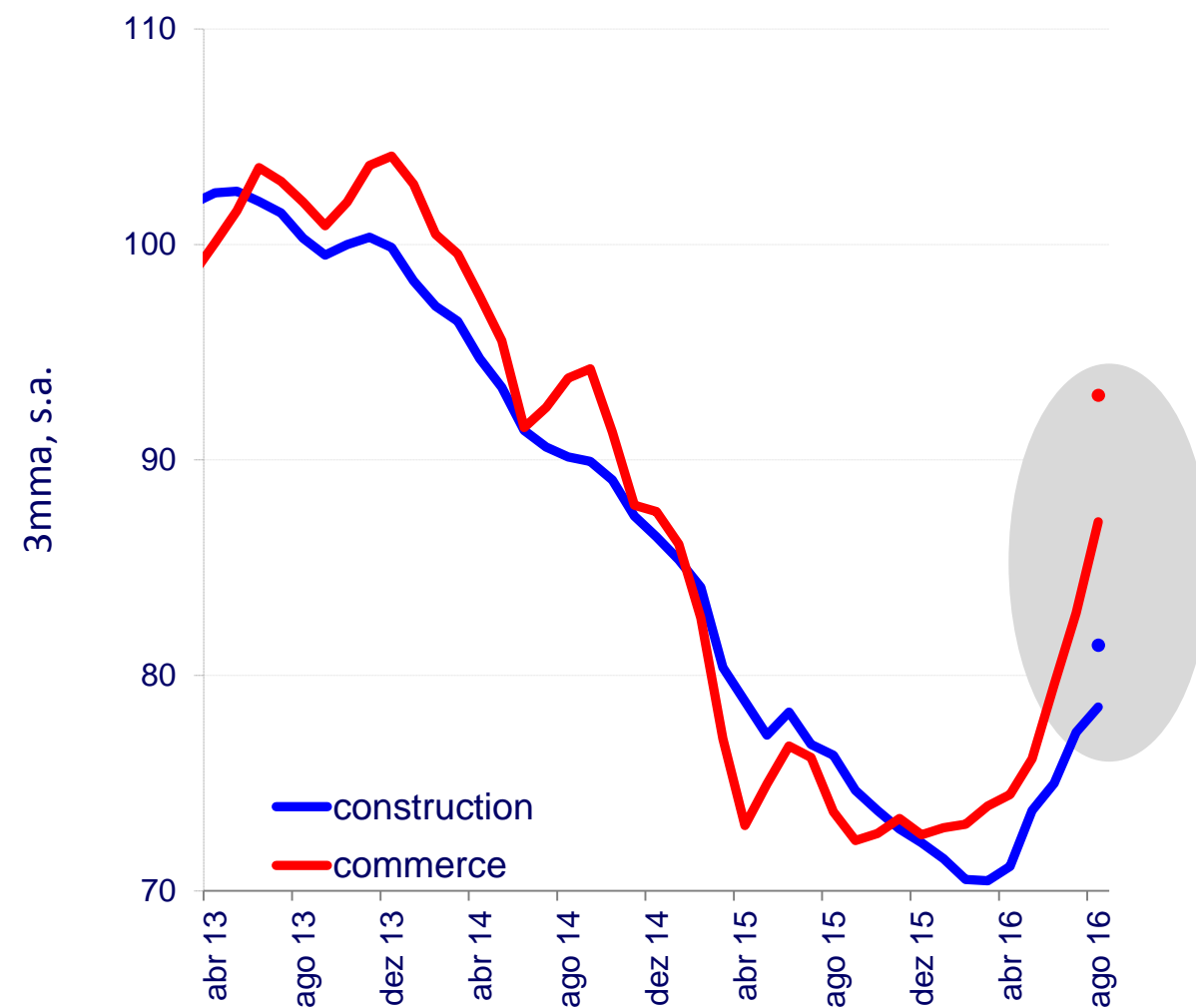
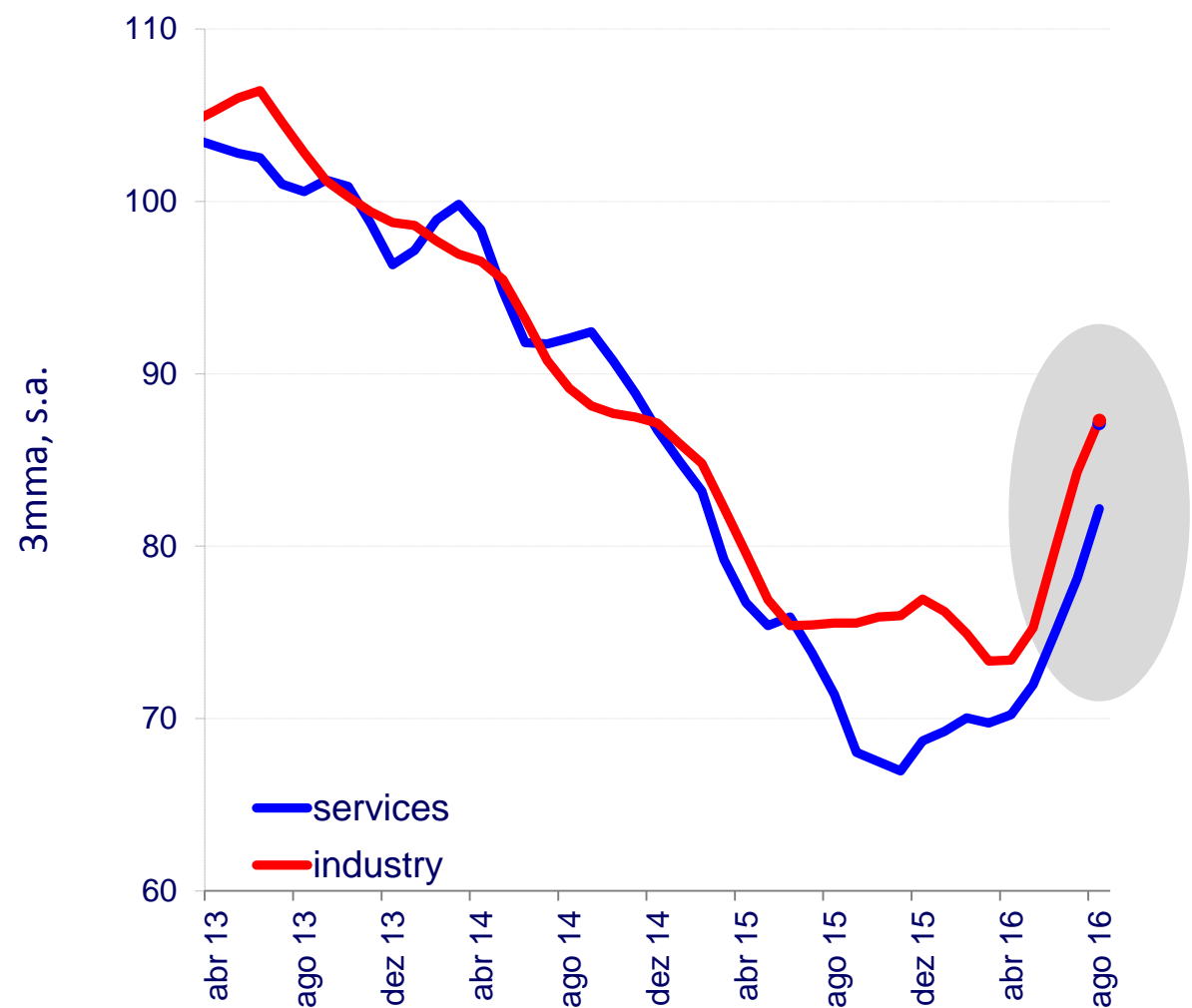
# New Economic and Political Outlook

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- The announcement of a **new Economic Policy** Agenda and the **reduction of uncertainty** changed expectations for 2016 and 2017.

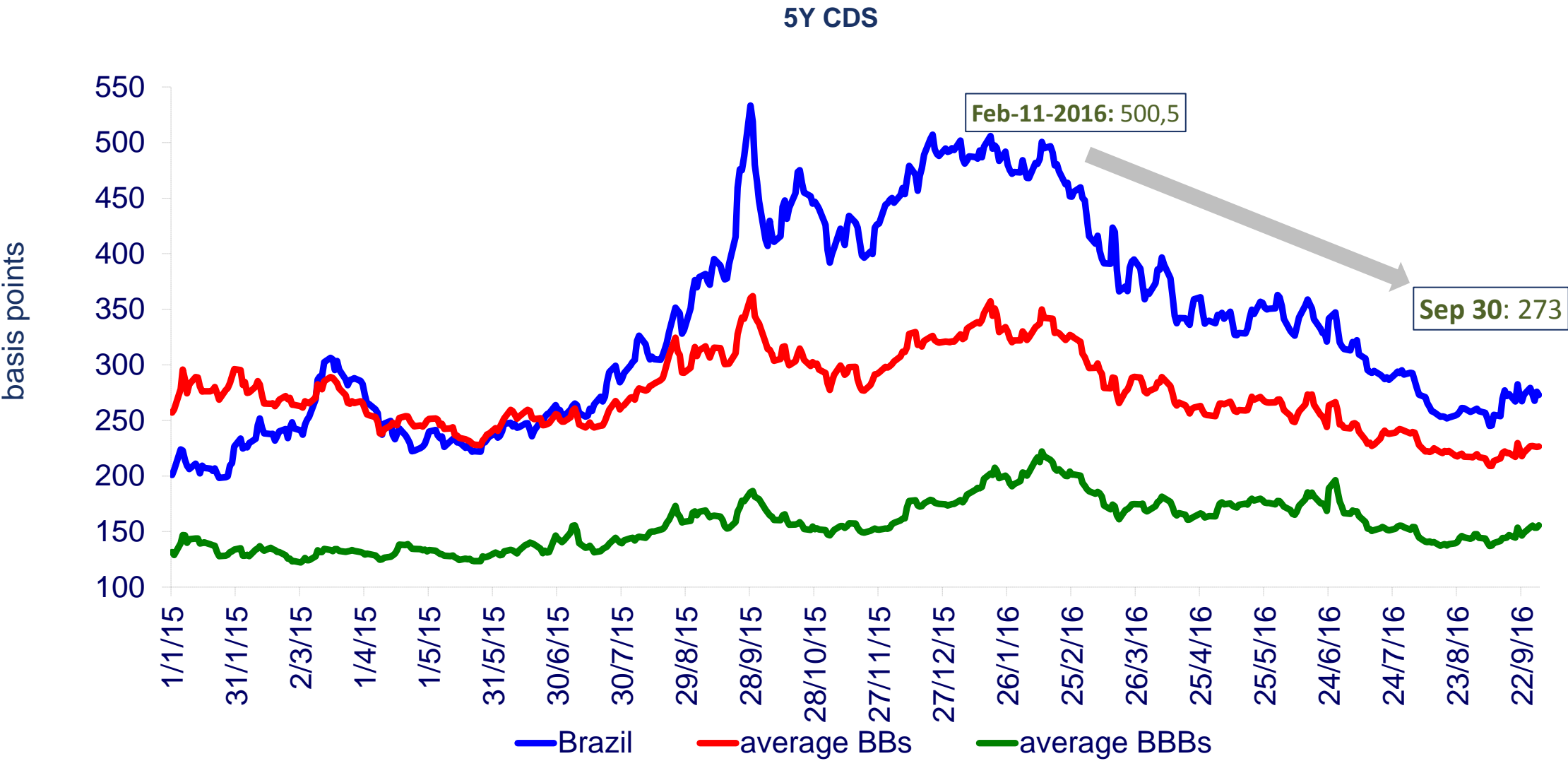


# Regaining Confidence: Businessmen Expectations

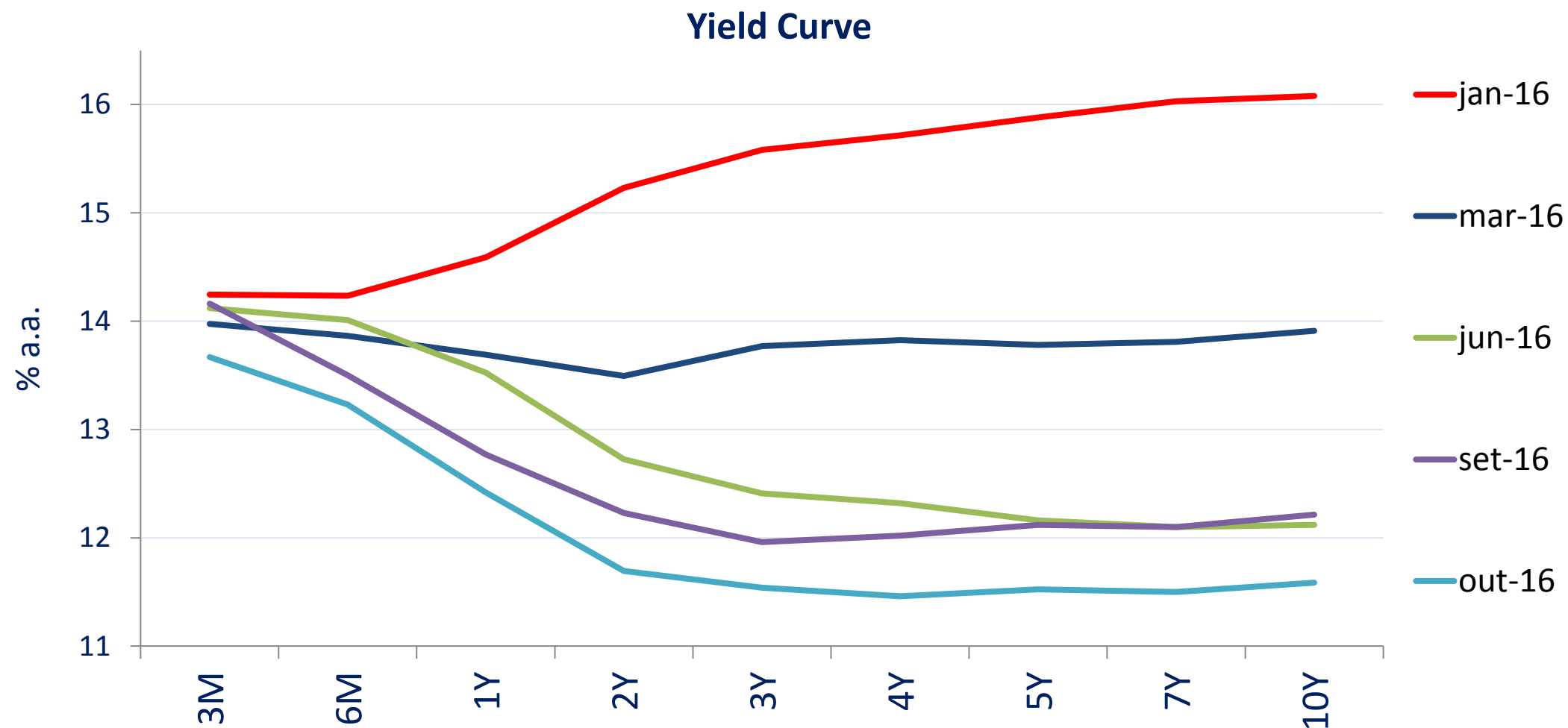


Obs.:  $\text{proportion of favorable answers} - \text{proportion of unfavorable answers} + 100$  (100=neutral)

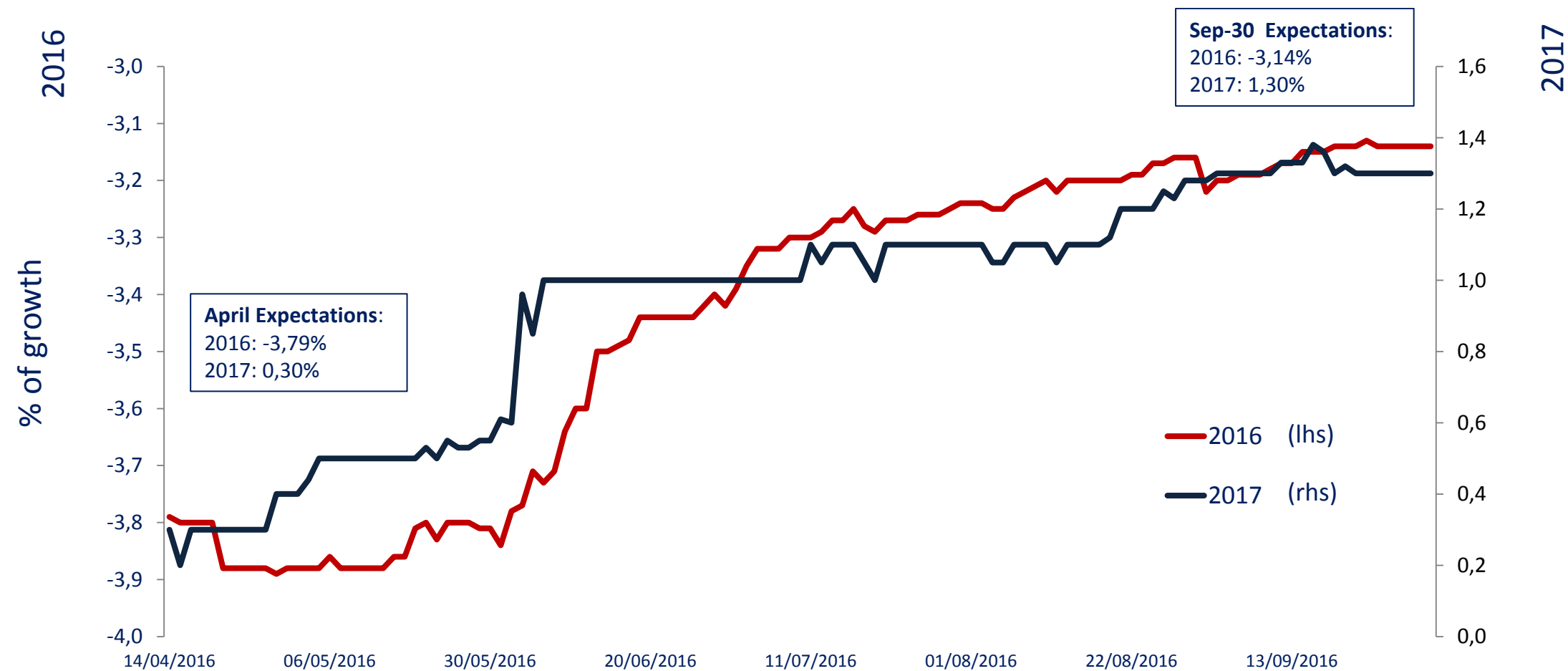
# Regaining Confidence: Lower Risk Premmia



# Nominal Interest Rates have been falling

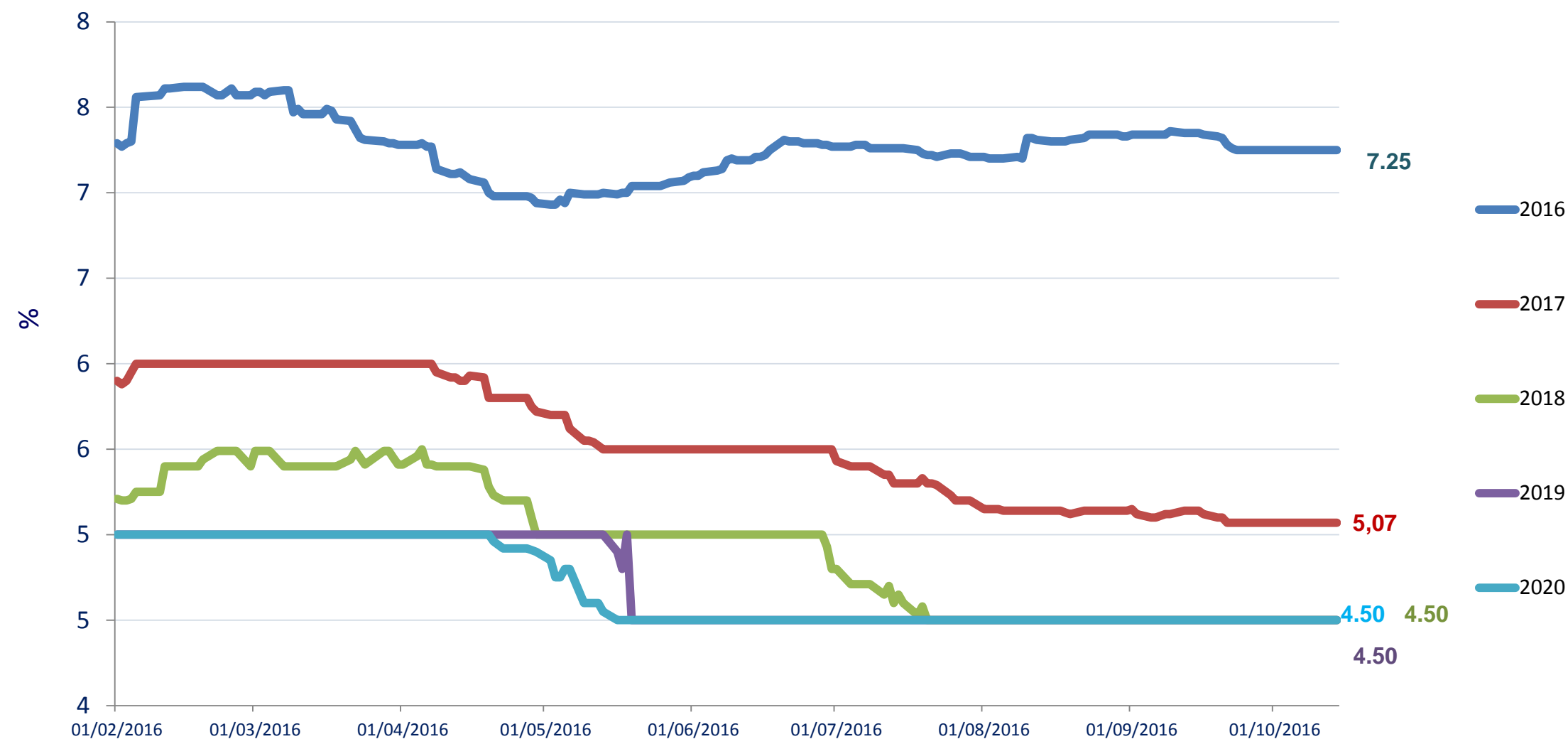


# Regaining Confidence: Market Expectations for 2016/17 GDP



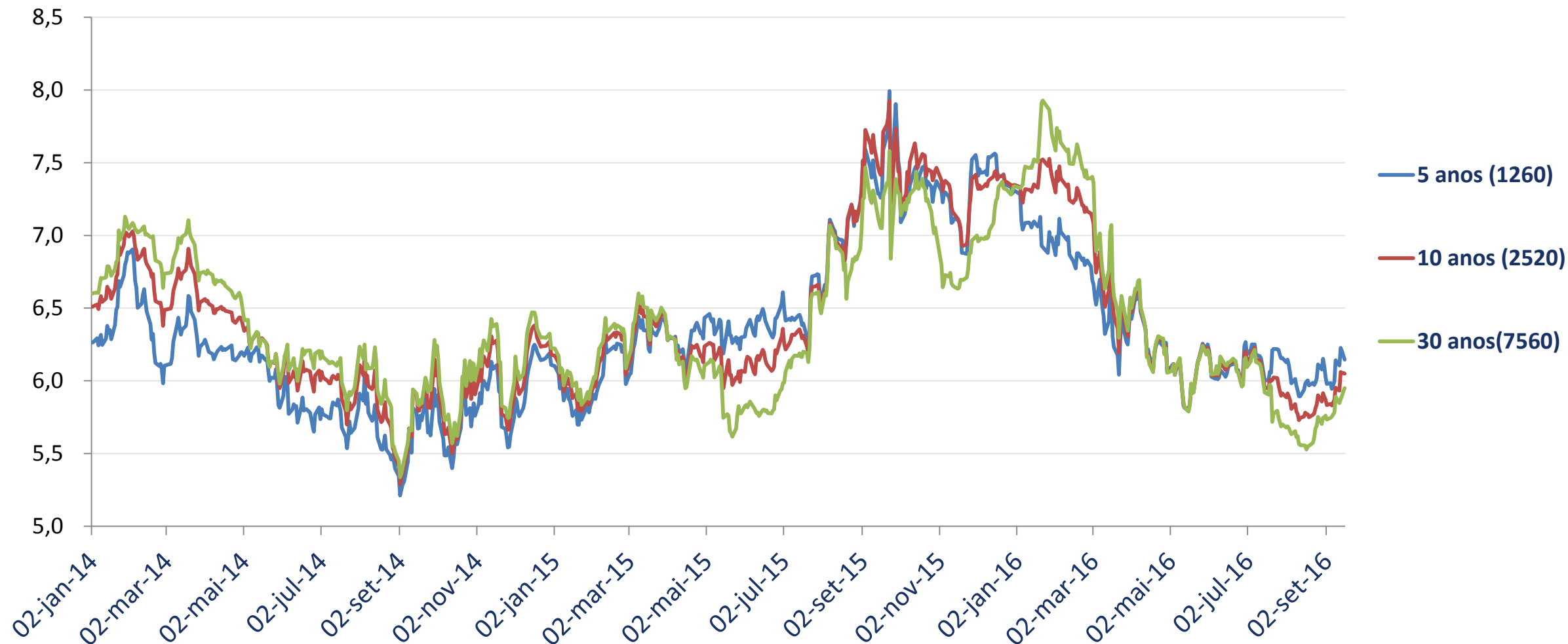
through Sep 30<sup>th</sup>

# IPCA Market Expectations are Being (Re)Anchored



through Sep 23<sup>rd</sup>

# Falling Real Interest Rates after 1Q-2016 peak

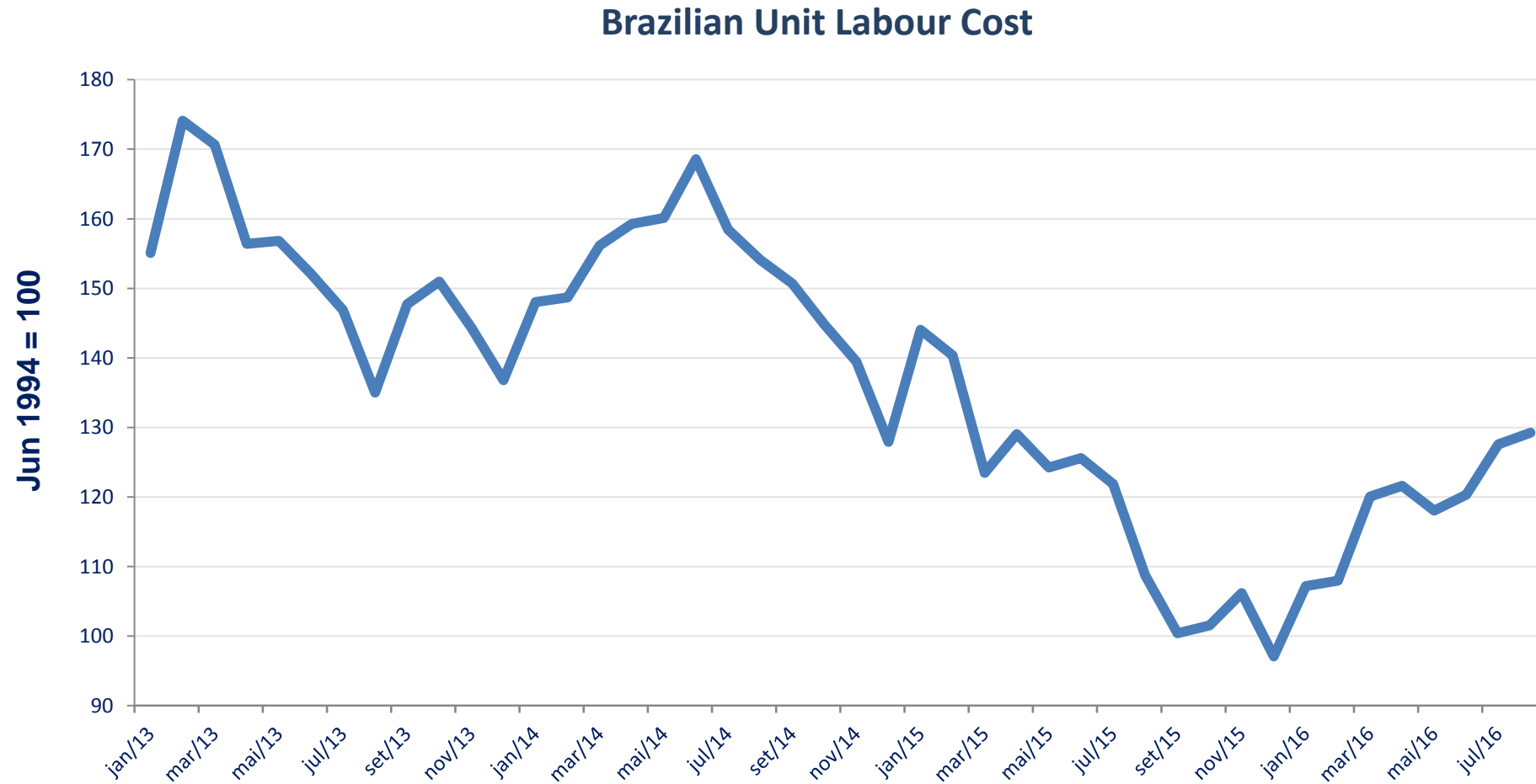


# External Accounts: Fast Adjustment despite Global Scenario

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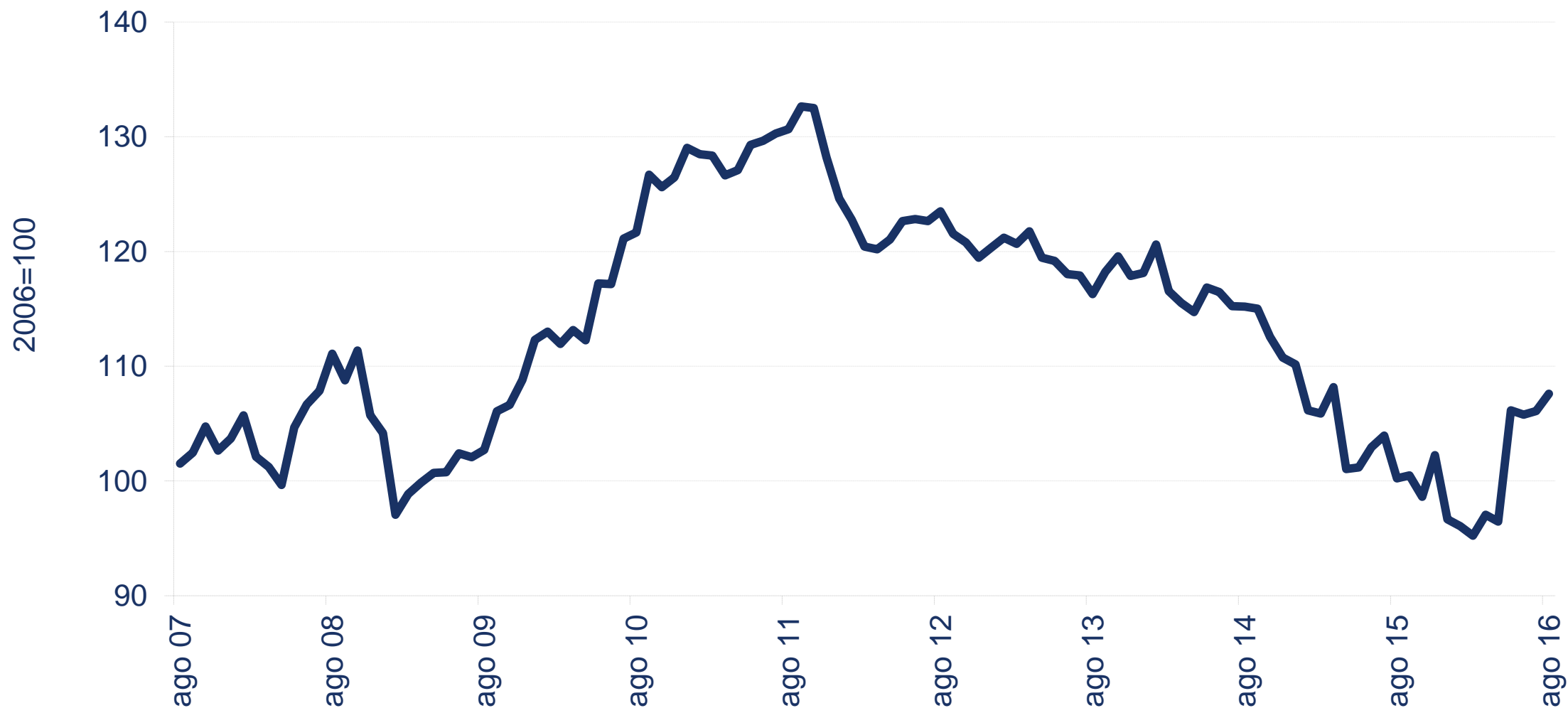
- Price adjustments favors external competitiveness recovery
- External adjustment evolves even facing unfavorable terms of trade deterioration
- Comfortable current account financing

# External Adjustment: Unit Labour Cost Decreasing

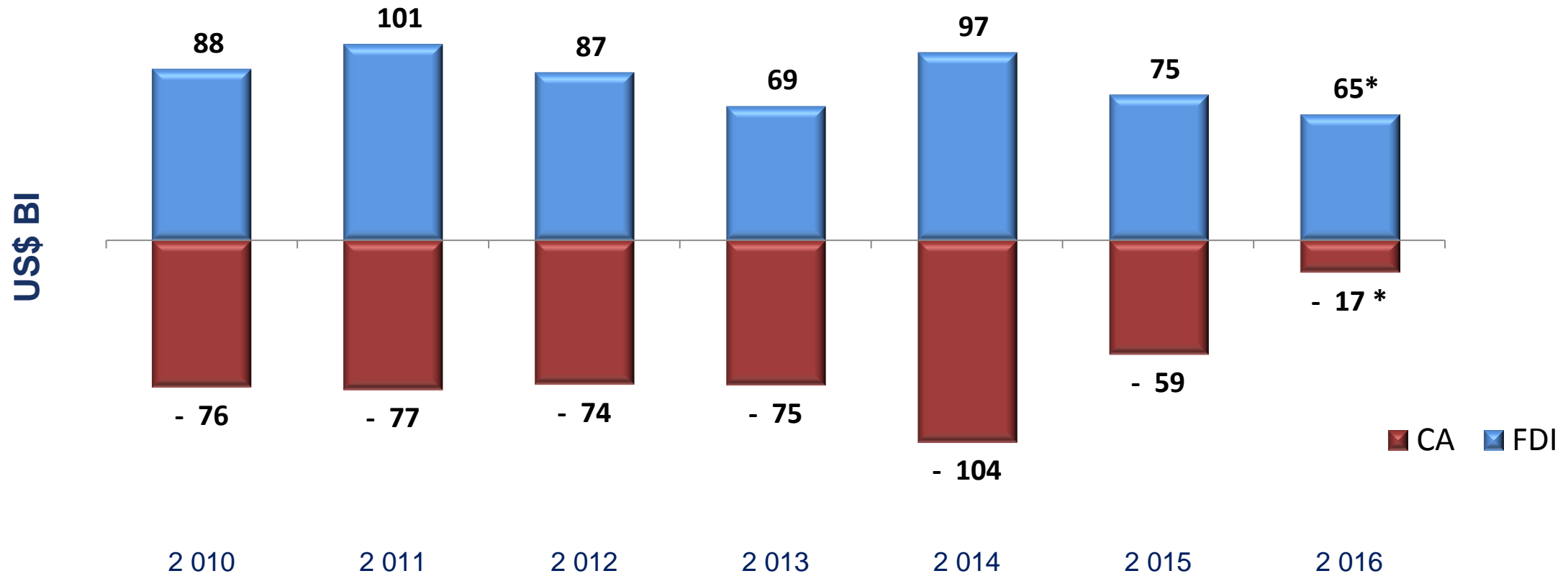




# External Adjustment: Terms of Trade



# External Adjustment: Current Account x FDI



\* Focus (median of projections) as of Sep-30th.

# Comprehensive New Economic Policy Agenda: Structural Fiscal Reform

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- Structural Fiscal Reform: Spending Ceiling - Constitutional Amendment  
sent to Congress as of Jun-16
- Social Security Reform is a Priority
- Review in Government Programs

# Fiscal Reforms: Main Initiatives

## 1. Spending Ceiling – Constitutional Amendment sent to Congress as of Jun-16

- 2007-2015: net revenues decreased from 19.0% to 17.7% GDP, while primary spending increased from 16,9% to 19.6 % GDP (in the Federal Gov't level)
- 2008-2015: revenues decreased 7.8%, while spending grew 51% in real terms
- Curbing discretionary spending is insufficient

## 2. Social Security Reform is a Priority

- Increase minimum retirement age
- Shrink the gap between gender and public vs private sector workers

## 3. Review in Government Programs

- Since 1988 Constitution every administration have been creating Programs – Need to reassess them
- Crucial item in the spending review agenda

# New Fiscal Regime Proposal: set a limit for spending growth over time

***New Fiscal Regime Proposal:*** Amendment to Constitution to limit public spending increases for the next 20 years to strengthen the public finances.

## Concepts

- ✓ **Total Primary Expenses:** real growth will not be allowed from 2017 on;
- ✓ **All Government Expenses readjustments** (including Legislative and Judicial) will be **limited by 12 month CPI** of last year ( $IPCA_{t-1}$ ).

## Duration

- ✓ **20 years.** Possibility of reviewing the correction criteria from the 10th year ahead.

## General

- ✓ On the first year (2017), the expenses limit will be equal to the last year expenses corrected by the last year inflation;
- ✓ Minimum **health and education expenses** will be readjusted by variation of last year inflation, and no more by revenues, protecting the expenses from falling revenues.

\* All information are available on <https://www.fazenda.gov.br/novo-regime-fiscal>

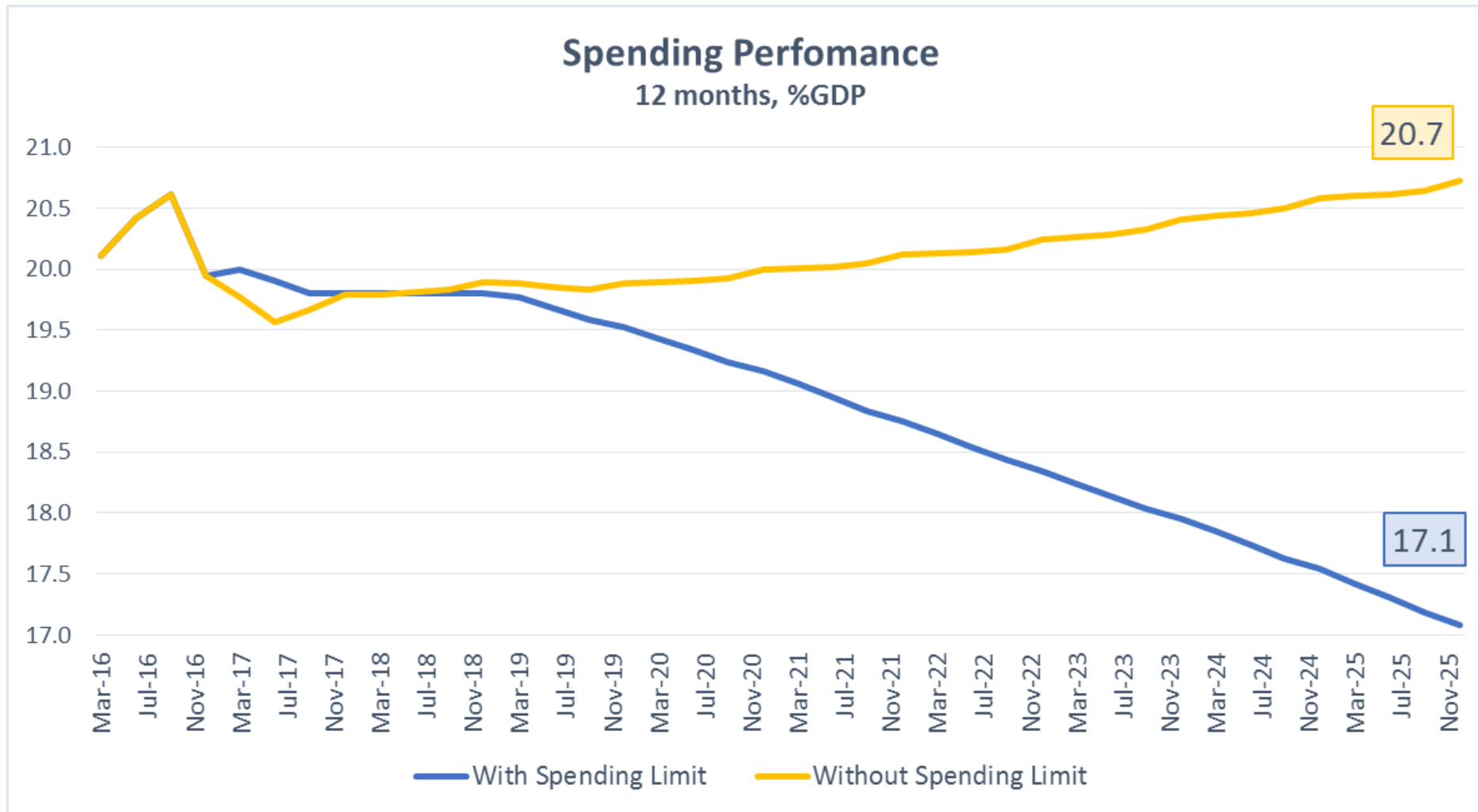
and <https://www.fazenda.gov.br/novo-regime-fiscal/pec-241/perguntas-e-respostas#o-que-e-o-novo-regime-fiscal>

# Structural Fiscal Reform Agenda

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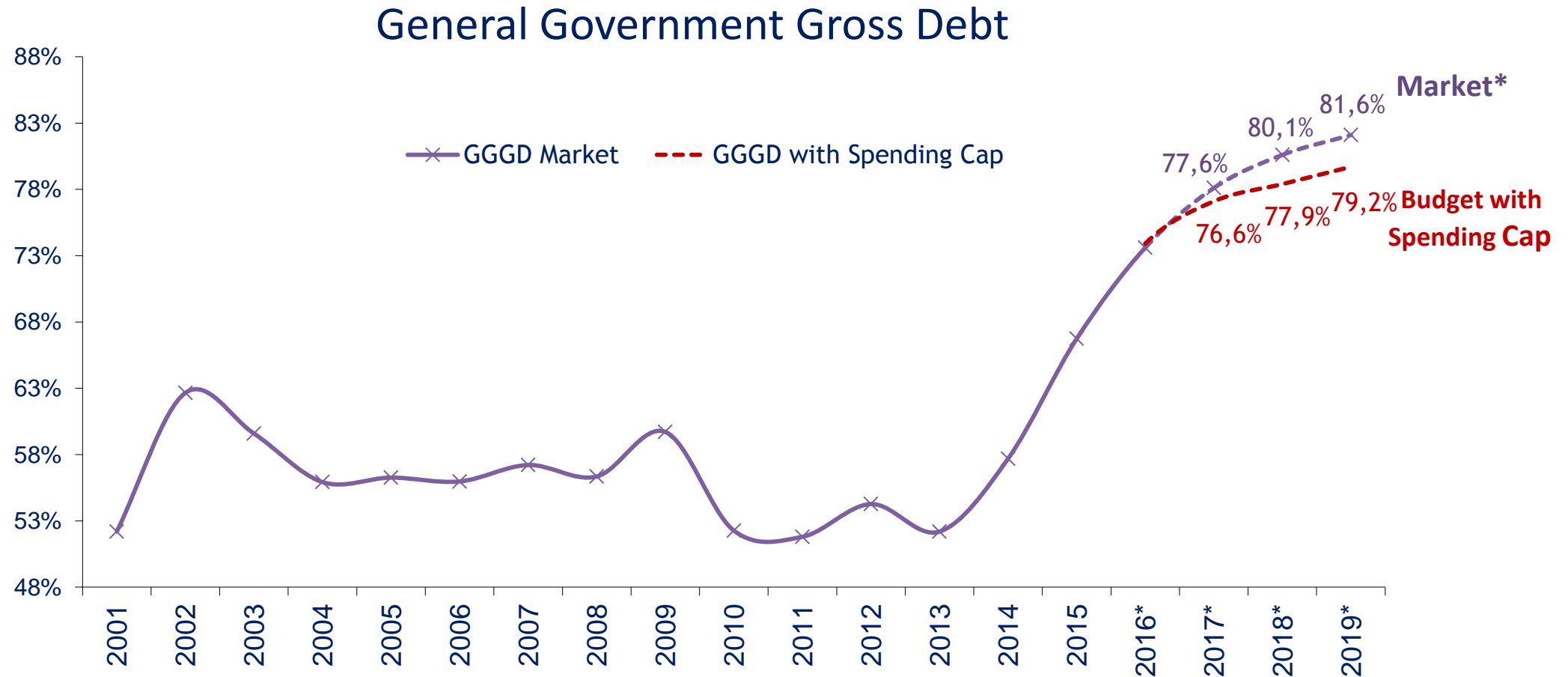
- Ongoing Fiscal Reforms: Initiatives are already under consideration or being prepared for discussion and presentation to society
- Simulations show that implementation of these policies can bring fiscal equilibrium and assure debt sustainability
- When reforms are delivered a virtuous cycle will be reinforced

# Spending on the long run with and without Limits



\* National Treasury Model's Projections

# (Gross) Debt Dynamics with and without Spending Cap

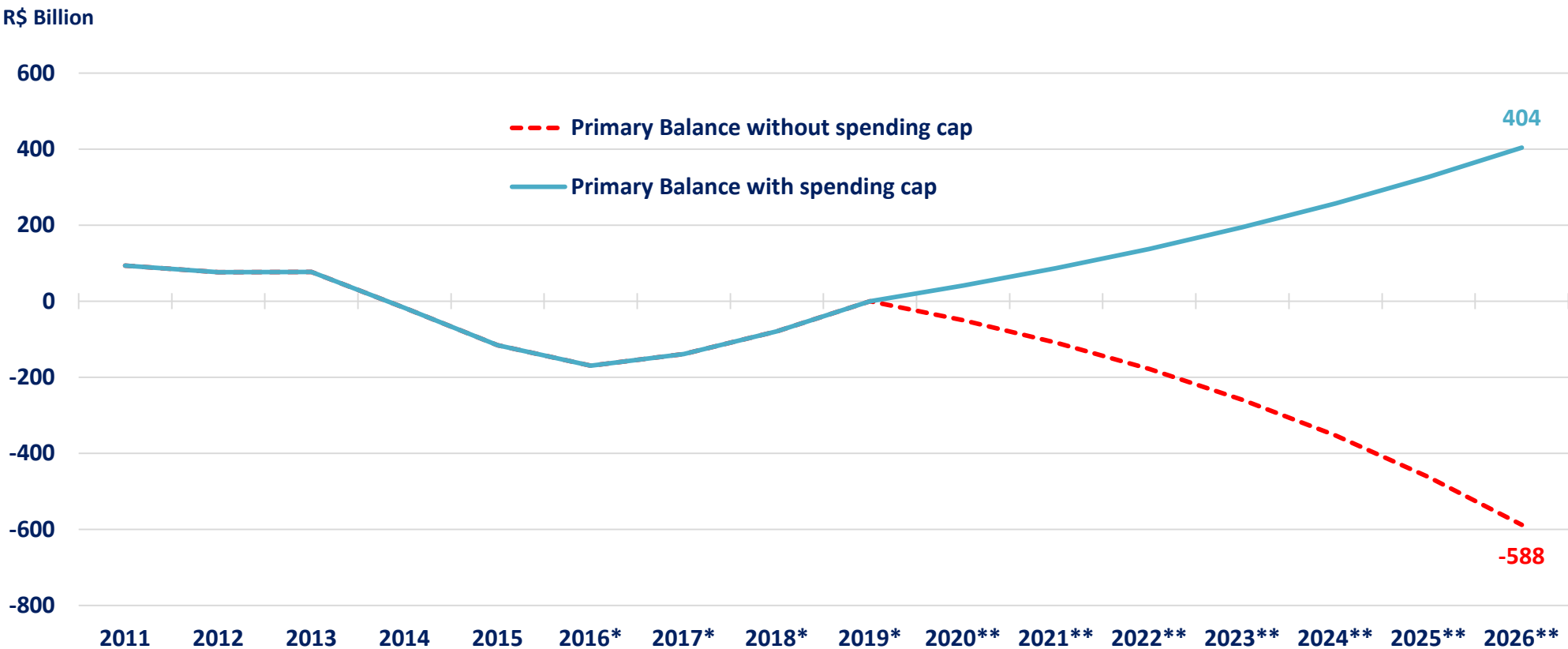


» A significant part of the GG Gross Debt responds to:

1. Loans to Public Banks → This policy has been reversed as of Jan-2015 → which represents 9.6% GDP
2. REPO Operations → Collateral for sterilization → Increase in FX-reserves → which represents 20.8% GDP

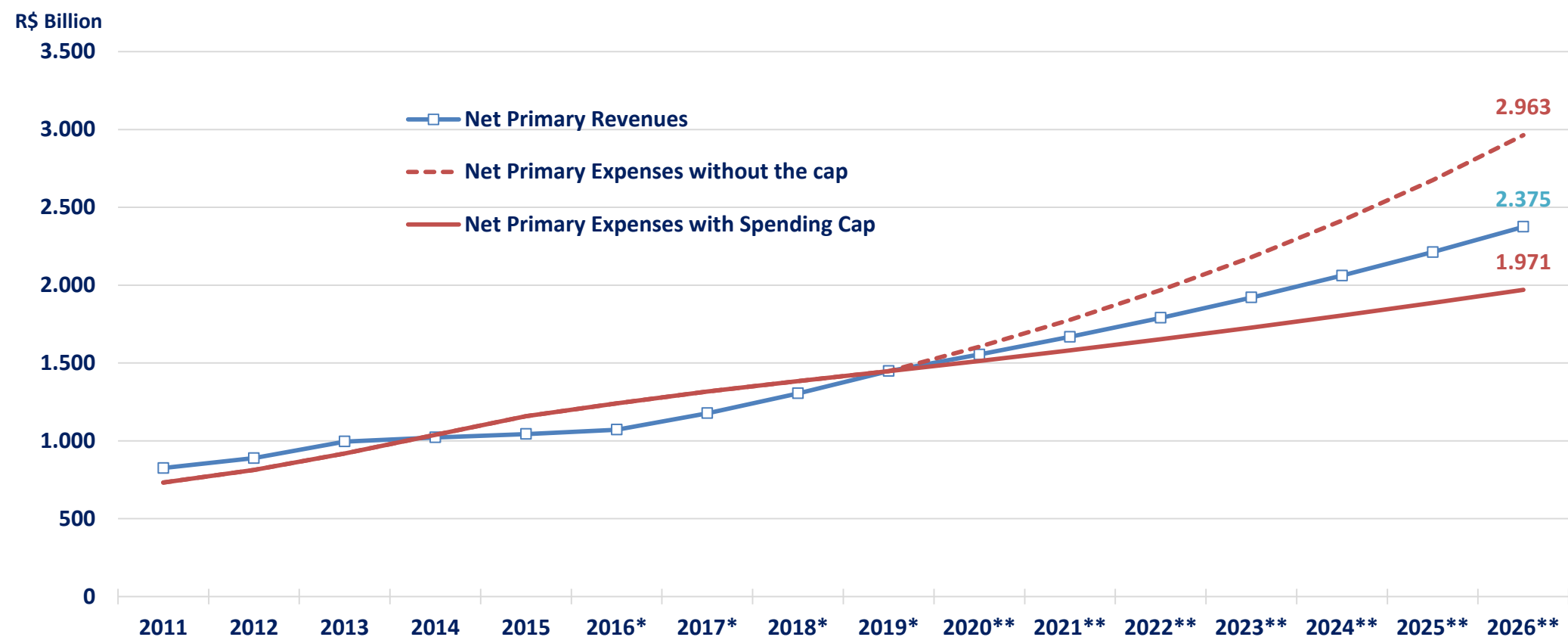


# Primary Balance on on the long run: with and without Limits



\* LDO 2016 Data and PLDO 2017.  
\*\* From 2020 data Simulator (SEPLAN / MP: Real GDP + 2.5% and Primary Expenditure + 6.0%)

# Revenues/Expenses on the long run: with and without Limits



\* LDO 2016 Data and PLDO 2017.  
\*\* From 2020 data Simulator (SEPLAN / MP: Real GDP + 2.5% and Primary Expenditure + 6.0%)

# Comprehensive New Economic Policy Agenda: Productivity and Growth

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- Asset Sales and Privatization Agenda
- Improving Business Environment
- Concessions to the Private Sector: Logistics Investment Program (PIL)  
with regulatory stability

# Focus on addressing Constraints to productivity and growth

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## Asset Sales and Privatization Agenda

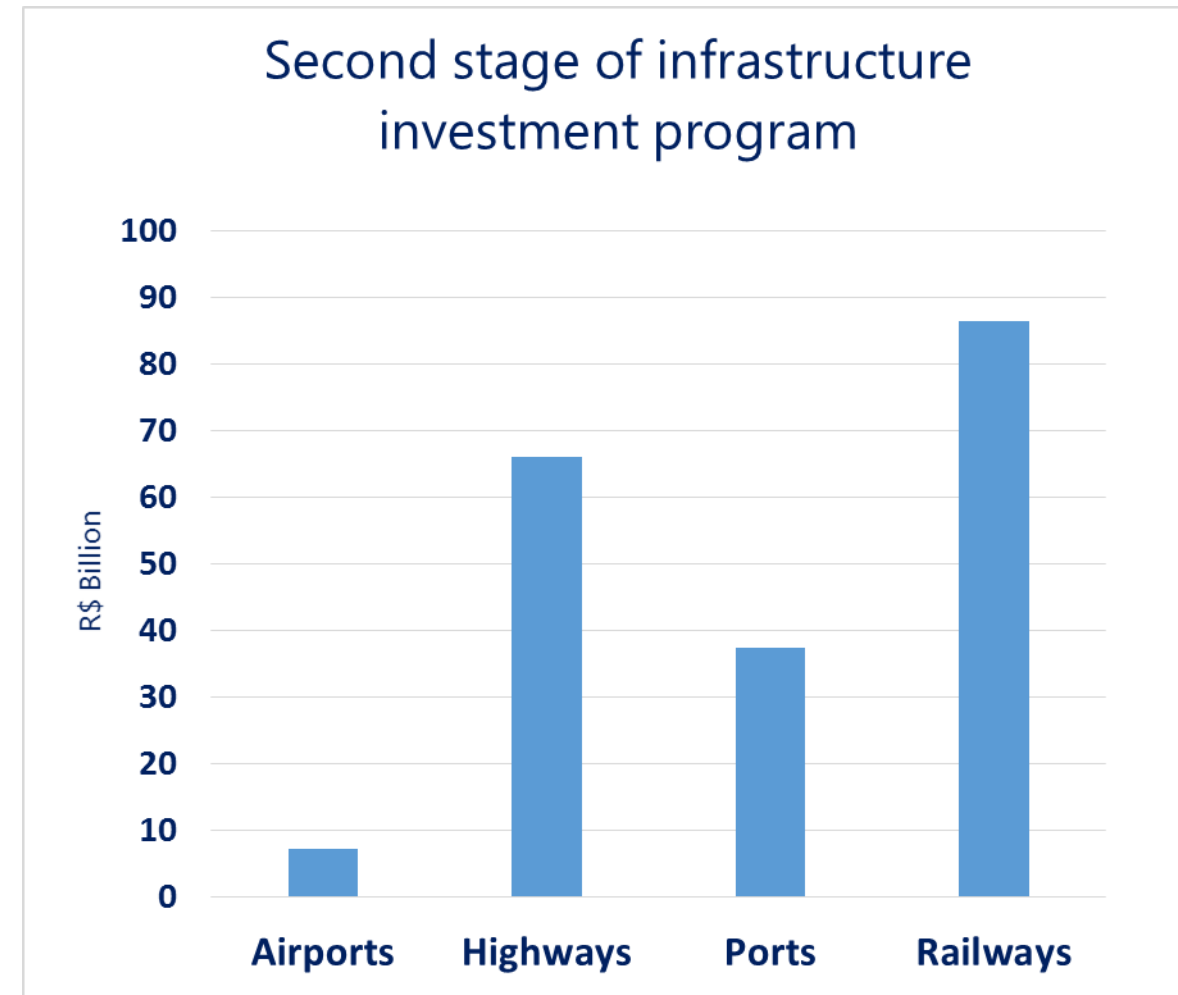
- Encompasses Federal and Local Gov't
- Local Gov't are encouraged to reach BNDES to seek technical support

## Improving Business Environment

- Tax reform
- Reinforce regulatory framework
- Diminishing red tape constraints
- Increasing productivity

# Logistics Investment Program (PIL)

- Brazil launched the second stage of infrastructure investment program: estimated investment of about R\$200 billion.
- Regulatory stability



# Comprehensive New Economic Policy Agenda: Monetary Policy

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- *Transparency and Clear Objectives in Monetary Policy*
- *Floating Exchange Rate Regime*

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# **Focus on Monetary Policy: Inflation Convergence and Factors Monitored**

# Regaining Confidence – CPI (IPCA) converging to the target



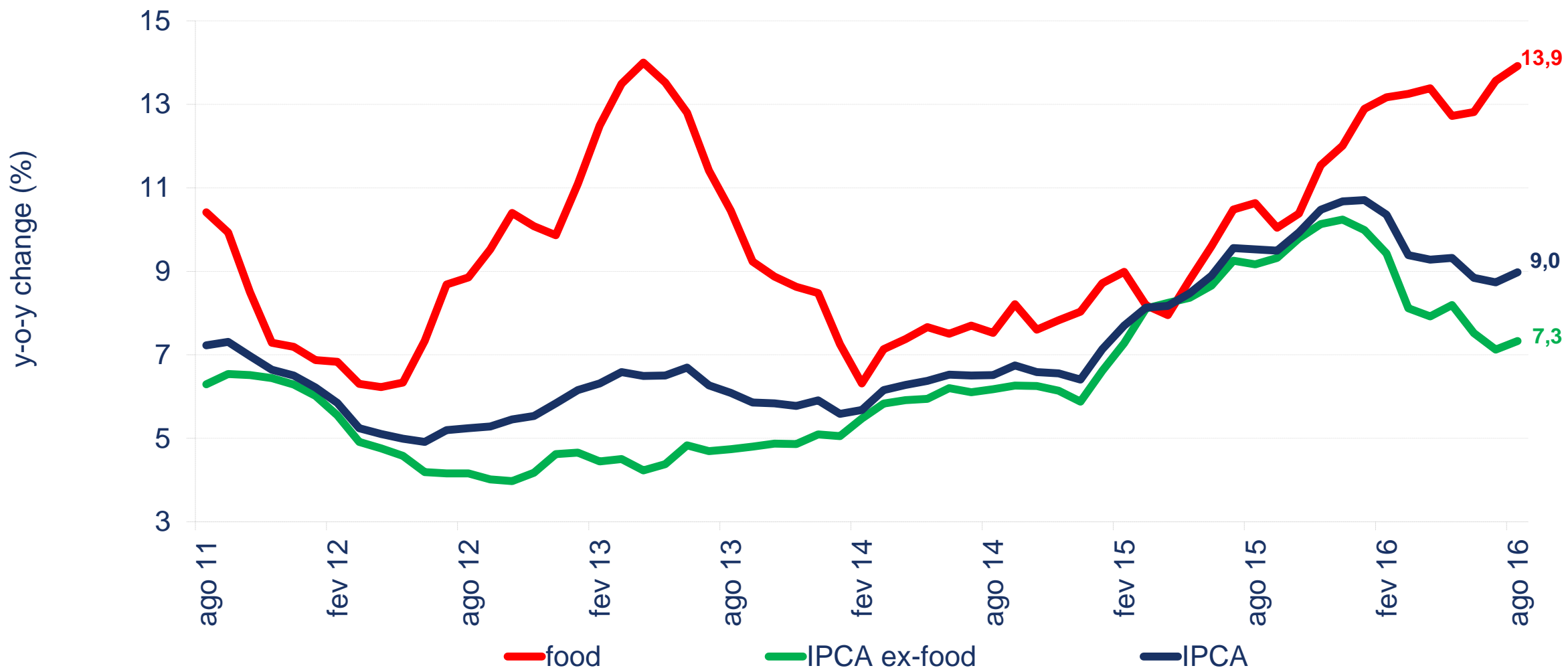


# Central Bank is monitoring the following factors for Monetary Policy

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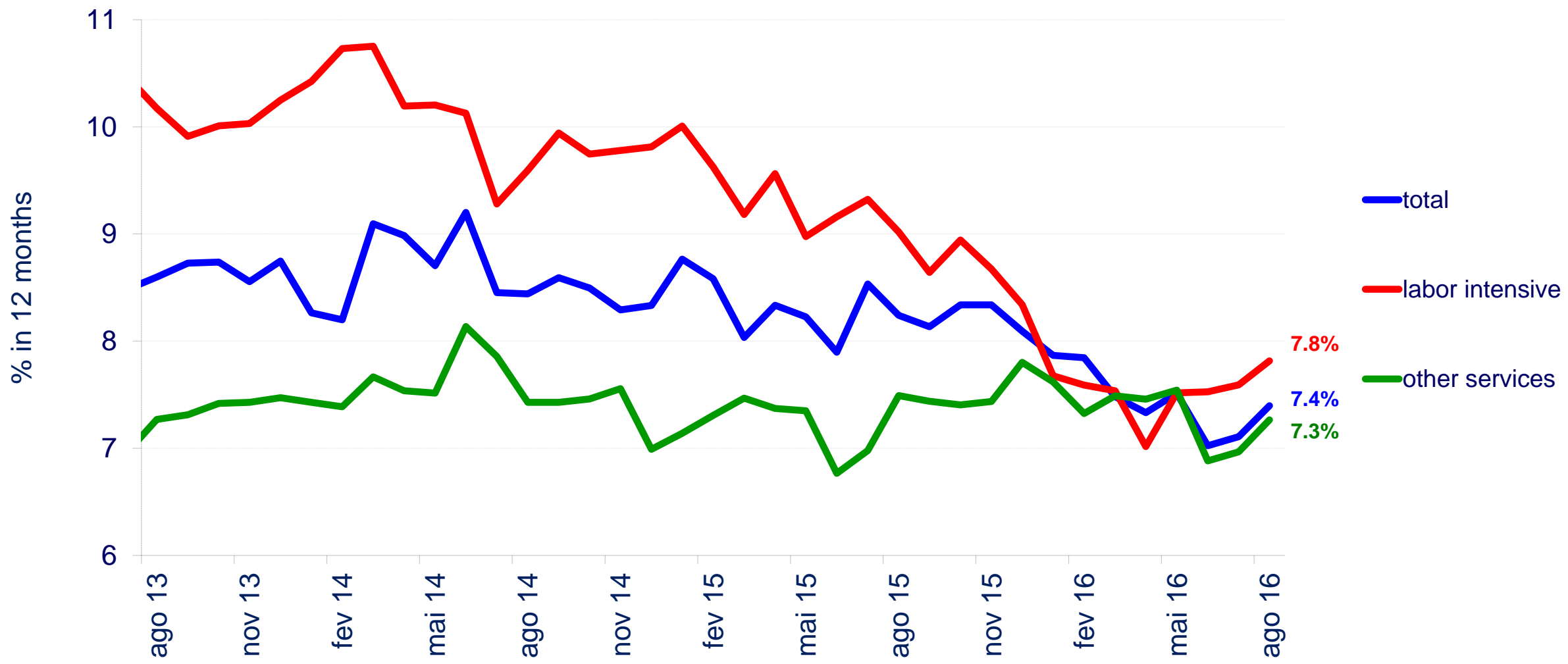
- *Food Prices evolution and secondary effects*
- *Inflation persistence and sensitivity to monetary policy and output gap*
- *Clear progress in implementing fiscal reforms*

# Consumer Inflation (IPCA) and Food Prices

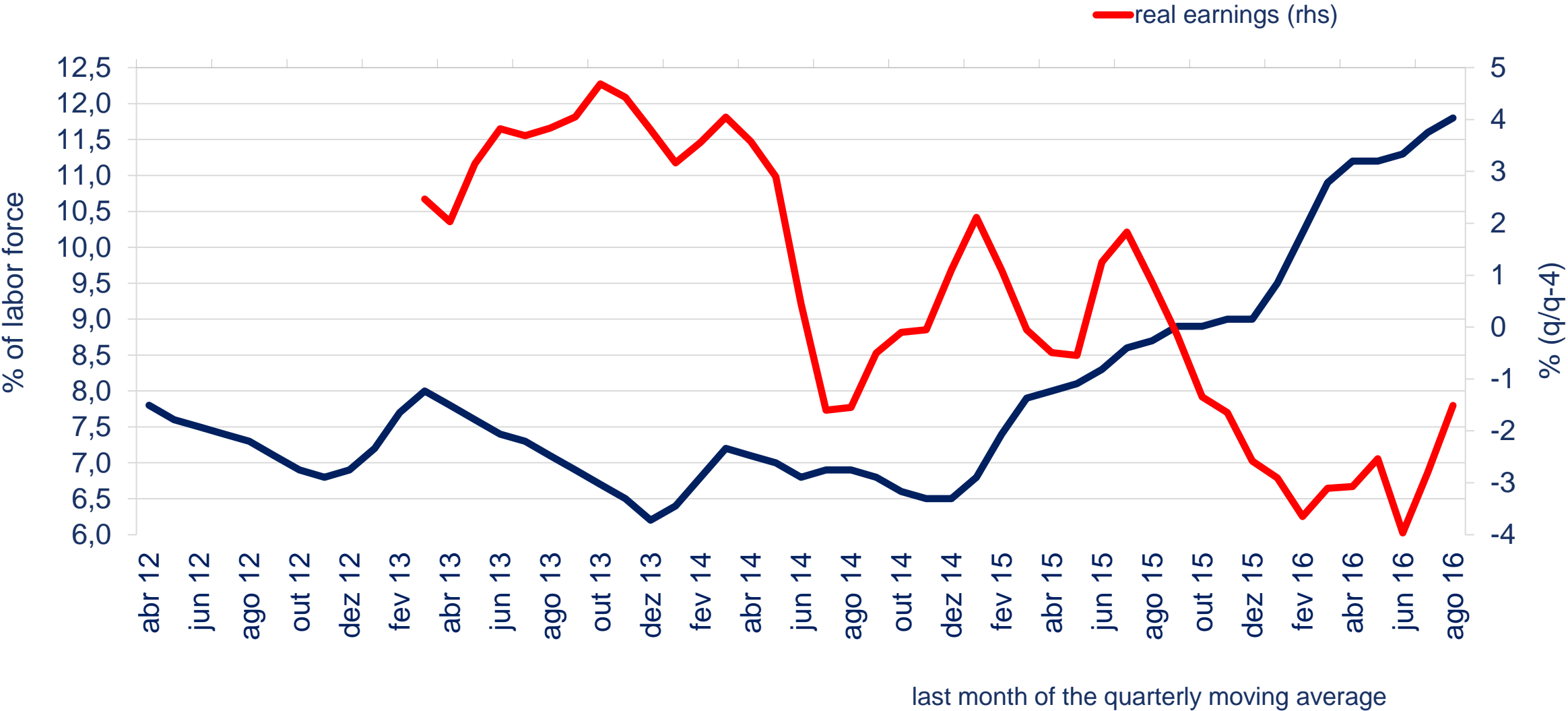


Food weight: 26.1%

# Services Inflation



# Real Wages and Unemployment

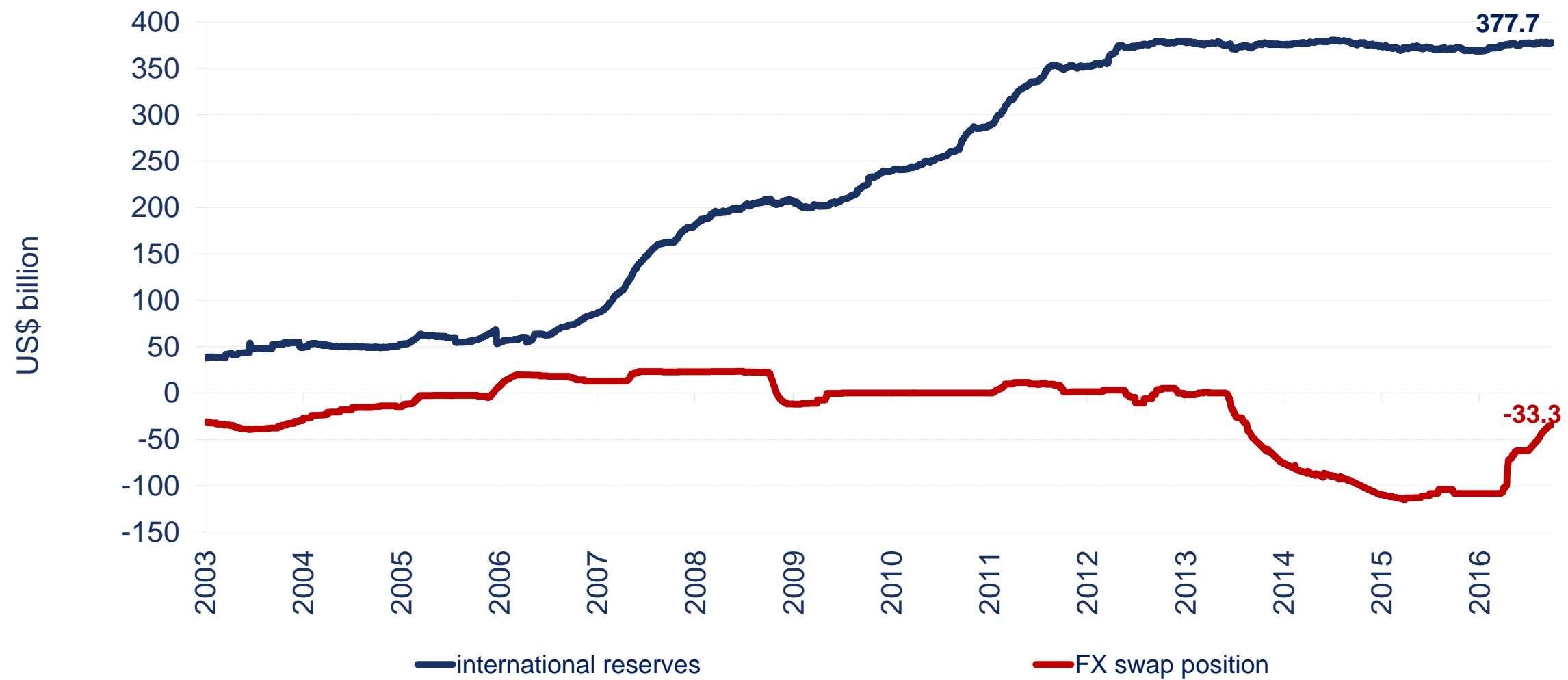


Source: IBGE (Continuous PNAD)

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# Resilience factors

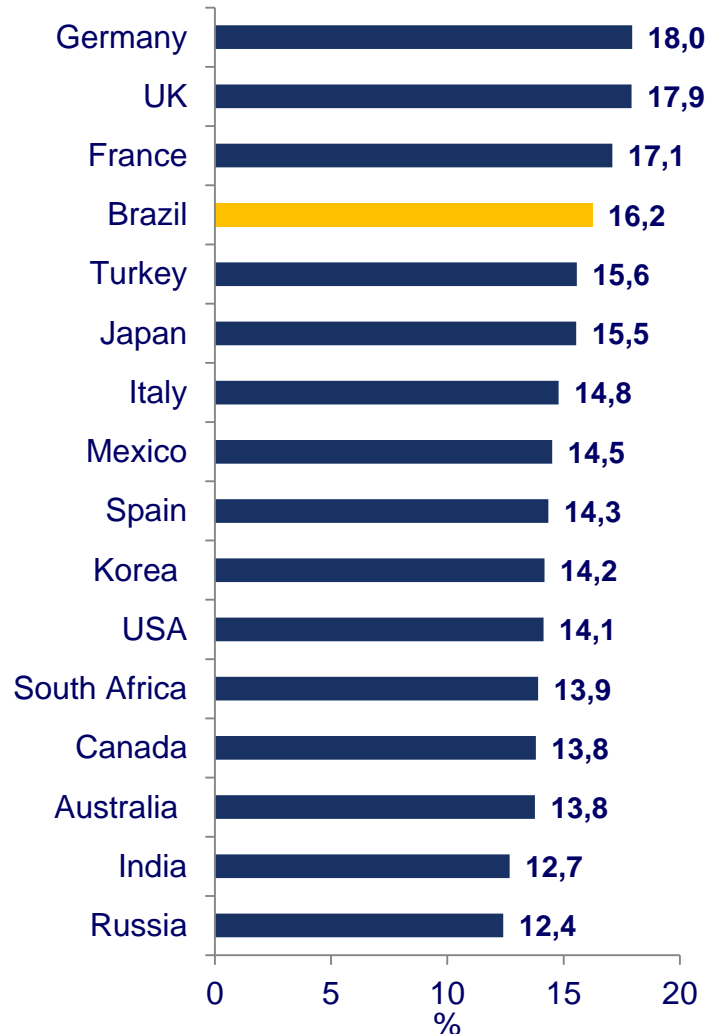
# Reduced CB Vulnerability: FX Repos and Reserves Cushion



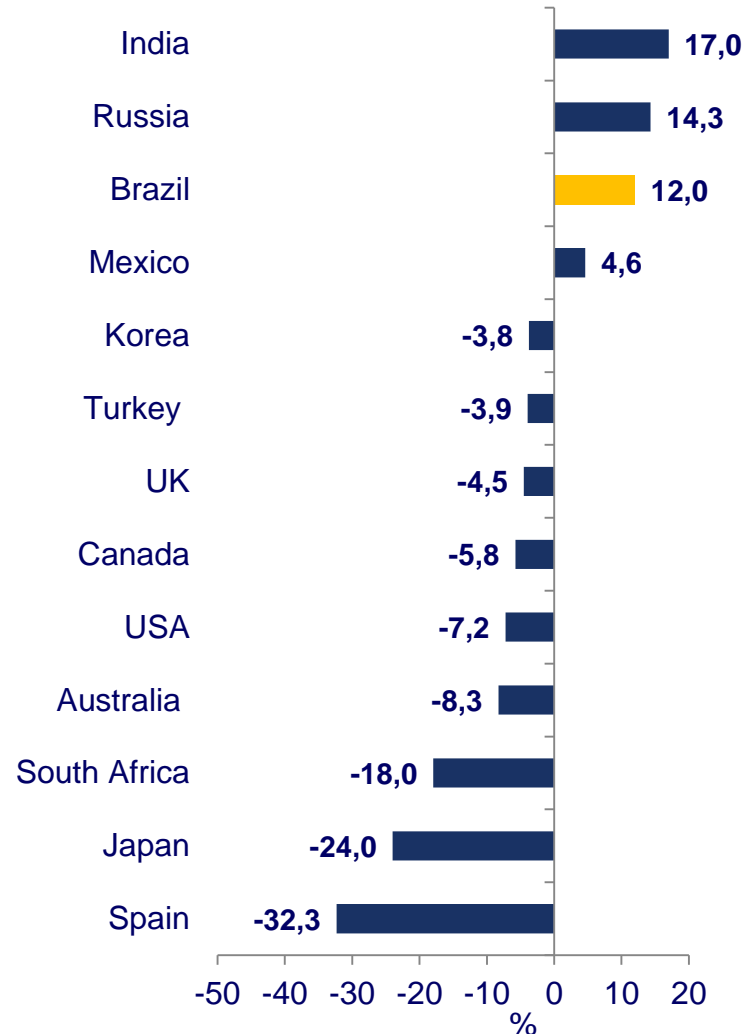
\*data until September 29<sup>th</sup>

# Brazil: Comparative Financial Soundness Indicators\*

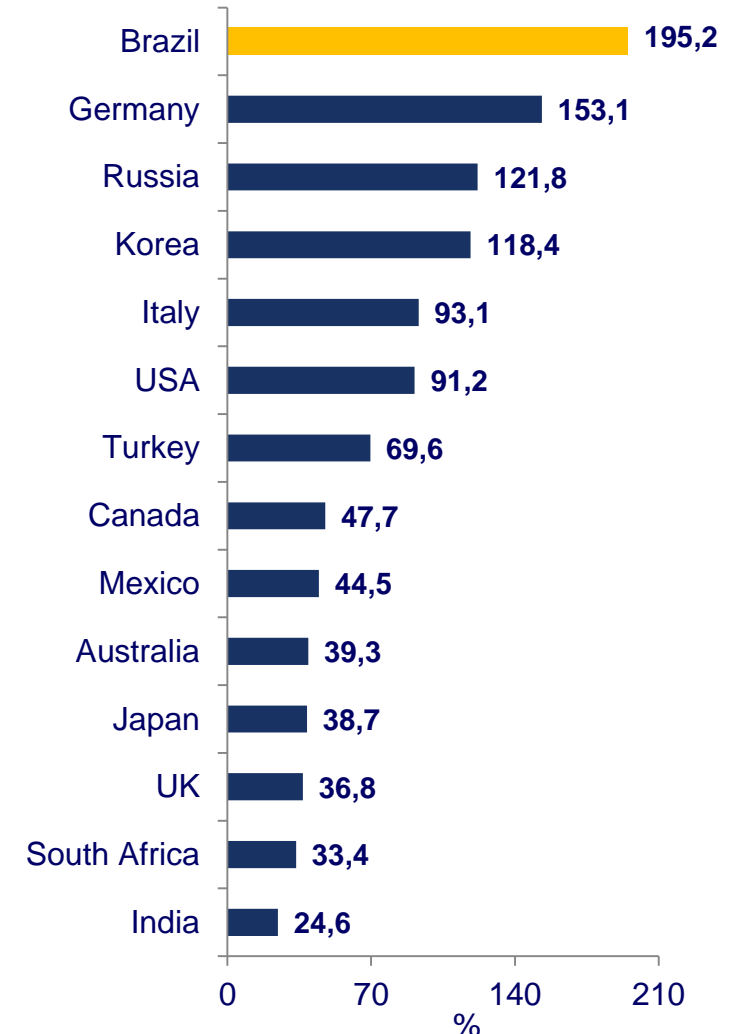
Capital Adequacy Ratio



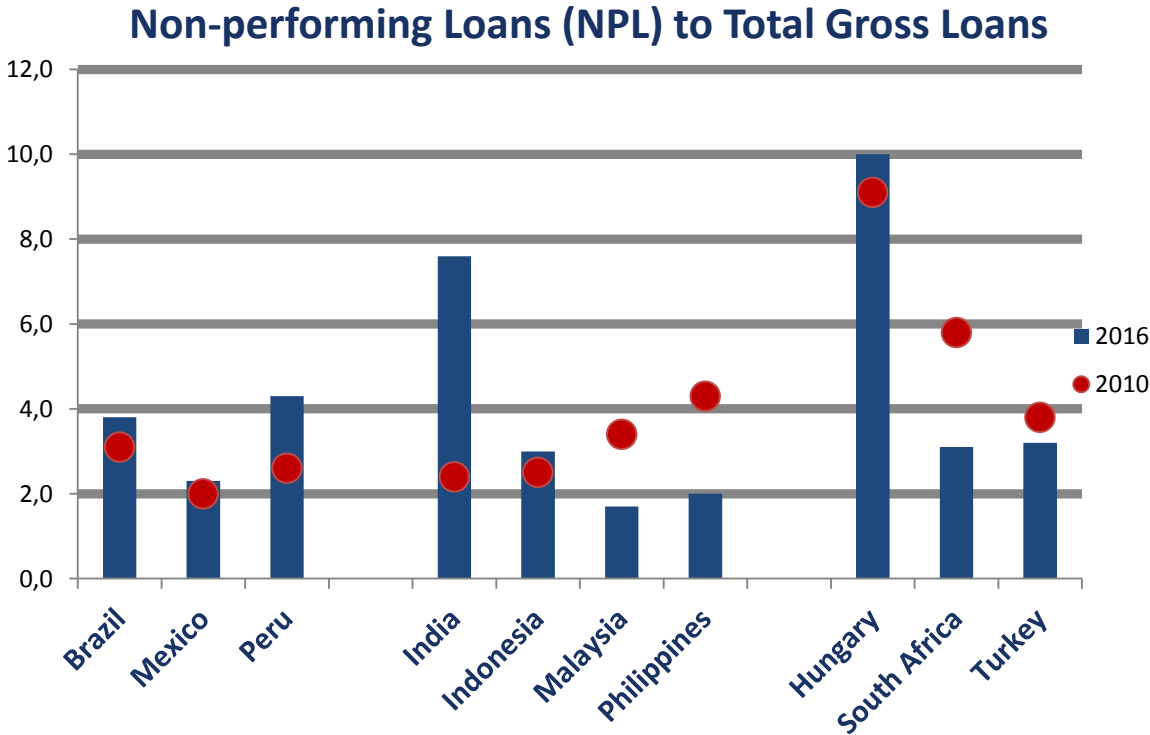
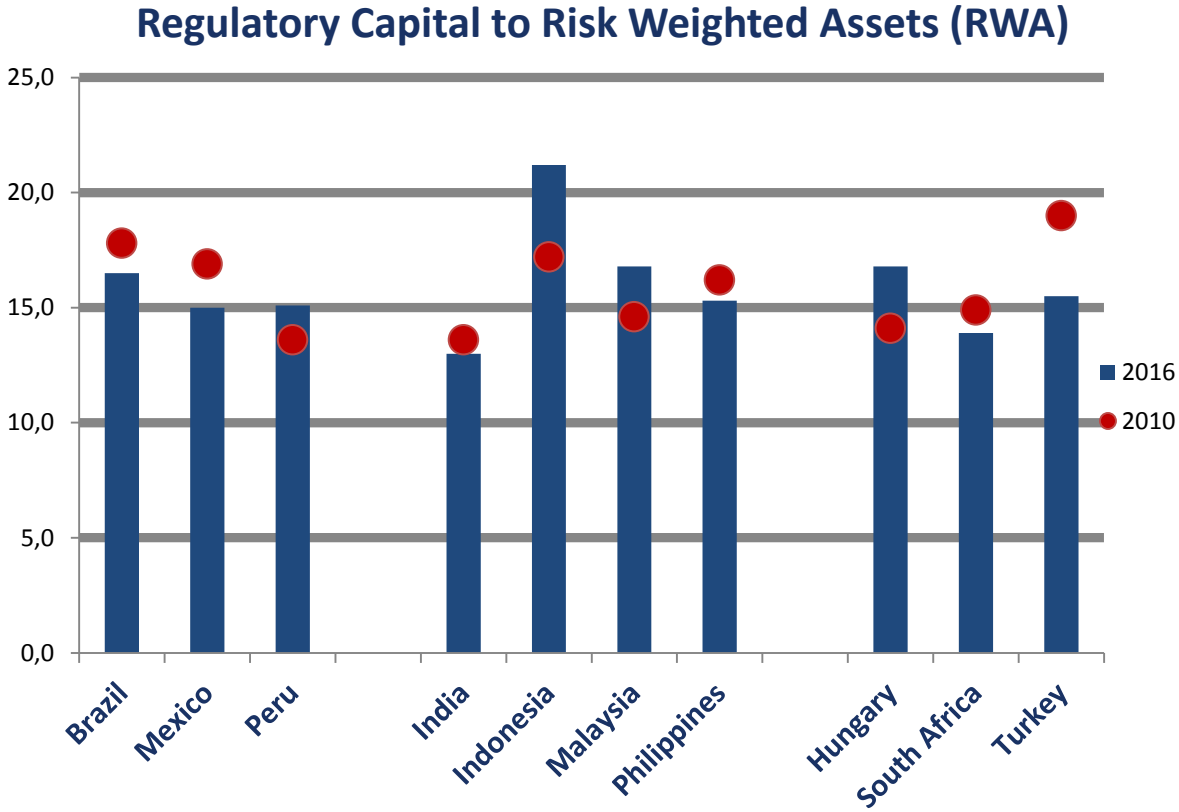
(Provisions – NPL) / Capital



Liquid Assets to Short Term Liabilities



# EM and Brazil: Banking sector in an stronger position



Source: IMF (FSI).



# Outlook: Resilience Factors amid a Virtuous Transition

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- Low exposure to forex liabilities and sound current account financing assure resilience to (negative) headwinds from the international economy and limit contagion from external volatility
- Financial system with solid capital structure and limited leverage open room for consumer, investment and housing financing

# Outlook: Conclusions

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- Brazil can withstand external headwinds
- There is a firm commitment to new comprehensive policy agenda.
- Despite transitional risks, Brazil can show gradual but firm progress addressing domestic challenges
- Final goal is to recover sound fiscal dynamics, converge to inflation target and achieve sustainable growth



# ***Thank You!***

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October 7<sup>th</sup> 2016