



BANCO CENTRAL DO BRASIL

Santiago, 11 de novembro de 2016.

**Apontamentos do Presidente do Banco Central, Ilan Goldfajn,
na 20ª Conferência Anual do Banco Central do Chile.**

The situation in Brazil

- Brazil is experiencing the most severe recession of its history. GDP fell 7% in the last year and a half. Unemployment has reached 12%.
- Inflation reached 11% by the end of 2015 and is now expected to end 2016 slightly below 7%.
- It was equivalent to a supply shock. Global deceleration was magnified by distorted domestic policies.
- The main problem was a confidence crisis due to fiscal problems. Fiscal primary surplus declined over time from 3-4% of GDP to -2.5%.
- Political and non-economic events aggravated the crisis.
- Doubts about debt dynamics. Gross debt reached 70% and was expected to reach 80-90% of GDP.

The global economy is in transition to a new steady state

- **From the perspective of EMEs, abundant liquidity and slow growth recovery among major economies characterize a “benign period”.**
 - Benign: abundant global liquidity has enabled cheaper funding, favoring especially EMEs. **And the fear of new global recession has abated.**
 - Transitory: it is not likely to last long, as changes in AEs occur.
- **EMEs should seize the opportunity to reform and adjust their economies.**
 - The normalization of monetary conditions in advanced economies should end the capital "flight from zero interest rates" to EMEs. Needed reforms will, then, become more costly.
 - Normalization of global monetary condition should not be interpreted as bad news in the medium and long terms.
 - But bouts of volatility are possible.
 - Reforms are urgent.

Brazil's strategy and domestic economic outlook

- **The policy strategy is:**
 - Strengthening the policy framework based on: fiscal responsibility, inflation targeting and flexible exchange rate regime.
 - Two main fiscal reforms: spending cap (approved in the Lower House) and social security reform.
 - Beyond fiscal policy, advance on a broad agenda of structural reforms to boost productivity and long-term economic growth: infrastructure, privatization, tax reform, trade agreements.
 - Initiatives are important to recover growth and deliver low and stable inflation.
- **As a result, less uncertainty and lower risks.**
- **Baseline scenario.**
 - Signs of economic stabilization in the short run
 - Economic activity ran slightly below expectations in the short run, probably due to fluctuations that usually occur at the current stage of the business cycle.
 - Possible gradual recovery in economic activity over the next quarters
 - High level of economic slack.
 - Disinflationary process is underway.
 - We expect recovery through increase confidence, investment should lead (especially infrastructure).

Monetary Policy

- Recent inflation releases were more favorable than expected.
- Inflation expectations for 2017 fell to around 4.9%. Expectations for 2018 and longer horizons are already at 4.5%.

- Under the reference scenario (constant interest and exchange rates), the forecast for 2017 inflation fell to approximately 4.3%, whereas the forecast for 2018 sits around 3.9%.
- The convergence of inflation to the 2017 and 2018 target is compatible with a moderate and gradual easing of monetary conditions.
- The Copom will assess the pace and magnitude of monetary easing over time, in order to assure convergence of inflation to the 4.5% target.

Floating exchange rate regime.

- The floating exchange rate regime is an important tool.
- The BCB only reduces its stock of FX swaps when markets conditions permit.

Why does the financial system in Brazil remain solid in spite of the crisis?

- Financial institutions are not immune to domestic economic downturn.
 - Profitability decrease – return on equity fell from 15.5% in the end of 2015 to 13.4% in the latest figure.
 - Non-performing loans increase – delinquency rate increased from 2.7% in December 2014 to 3.7% in the latest figure.
- But there are reasons why the system remains sound – preemptive reaction and buffers.
 - Banks prepared themselves for the crisis, as it did not come as a surprise.
 - Private banks reacted preemptively: set stricter underwriting standards, shifted their portfolio to less risky assets and increased non-credit income.
 - The annual growth of outstanding credit reduced steadily from 18.8% in 2011 to -1.7% in September 2016.
 - The delinquency rate of the entire system is still manageable at 3.7%.

➤ Buffers.

○ Capitalization:

- ✓ The capital adequacy ratio is now at 16.6%, even greater than 16.3% that prevailed at the end of 2011.

○ Liquidity:

- ✓ The short-term liquidity ratio moved from 1.6 in January 2012 to 2.1 in June 2016.
- ✓ In the long run, no liquidity shortage is expected long-term assets remain fully supported by stable funding.

○ Provisioning:

- ✓ The coverage ratio (provisions to delinquency) has been 1.7 on average, one of the highest when compared to G20 countries.

○ Profitability:

- ✓ The return on equity has floated between 13% and 16% since 2013.
- ✓ It has decreased in the first half of 2016 because of increased loan loss provisions.
- ✓ Other income sources were raised and operational costs were reduced.

- Capital stress tests show that these buffers provide adequate capacity to financial institutions withstand shocks stemming from rigorous adverse macroeconomic scenarios.

Prudential policy guidelines

- BCB's regulation and supervision goals is to maintain the Brazilian financial system solid, liquid and provisioned throughout the crisis.
- Prudential and regulatory processes treat equally public and private banks.

Final remarks

- **EMEs should seize the opportunity created by the benign interregnum in the global scenario to implement the necessary adjustments.**
- **For Brazil, it is important to approve reforms (spending cap and social security reform) to restore confidence and create conditions for the economic recovery, with low and stable inflation.**
- **BCB is committed to bring inflation back to target and keep it stable. This will help the economy to regain confidence and recover growth.**