Central Bank Measures Aimed at Expanding Liquidity in National Currency

Restrictive liquidity conditions on international financial markets coupled with obstruction of the credit flows used by national banks to grant advances on exports have provoked interbank market contraction.

With the aim of ensuring adequate liquidity conditions in the system, the Central Bank adopted measures targeted at generating liquidity in foreign currency (see box International Financial Crisis – Brazilian Government Measures to Strengthen Liquidity in Foreign Currency, page 98) and in national currency. These measures are summarized in Table 1 of this box. The principal initiatives taken to provide national currency liquidity took the form of alterations in the rules governing reserve requirements maintained at the Central Bank by financial institutions. These rules are considered a traditional monetary policy instrument and play a fundamental role in stabilizing short-term liquidity in the economy.

Reserve requirements are calculated by applying rates to the principal deposit modalities: demand deposits, savings deposits and time deposits and, as of January 2008, to interbank deposits contracted with leasing companies. These resources, which also encompass additional reserves on demand resources, time deposits and savings deposits are deposited in cash or maintained in the form of federal public bonds in the Special System of Settlement and Custody (Selic). The Brazilian model divides reserve requirements maintained at the Central Bank into those bearing earnings and those that do not bear earnings, thus making it possible to adjust liquidity through alterations in the opportunity costs of financial institutions.

The recent alterations introduced by the Central Bank and National Monetary Council (CMN) consisted of reductions in rates, increases in the amounts to be deducted from callable reserves, changes in earnings on reserve requirements, together with discounts on amounts to be deposited as an incentive to negotiation of assets among financial institutions. Viewed as a whole, these alterations resulted in effective release of R$93.9 billion out of the total balance of these deposits in the period extending from September 24 to December 2.

The first alteration in that period occurred on September 24 with issue of Circular n. 3,405. This instrument postponed the schedule for raising reserve requirement rates on interbank deposits contracted with leasing companies. Circular n. 3,412, dated October 13, permitted deduction of the amounts of foreign currency acquisitions with Central Bank buyback commitments from callable reserves on interbank deposits. This measure resulted in release of as much as R$18.6 billion into the banking system, as of the date of its publication. Of this amount, R$8 billion were released by December 2.

Circular n. 3,405 also raised the value to be deducted from additional reserves on demand deposits, time resources and savings deposits from R$100 million to R$300 million, resulting in additional releases of R$5.3 billion as of September 29. The deduction limit was raised once again, this time to R$1 billion by Circular n. 3,410, dated October 13, resulting in injection of approximately R$8.1 billion. With issue of Circular n. 3419 on November 13, as of December 1 deposits related to additional requirements were no longer made in cash with earnings at the Selic rate, but rather by setting aside federal public bonds in Selic.

Acquisitions of the assets of small and medium financial institutions were stimulated by the provision in Circular n. 3,407, dated October 2, later altered by Circulars n. 3,411, dated October 13, and 3,414, dated October 15, which allowed institutions that acquire assets from banks with base capital of up to R$7 billion, to deduct the value of acquisitions of credit operations, bonds and fixed yield securities from investment fund portfolios, credit rights originating in leasing operations or FIDC quotas from Credit Rights Investment Fund (FIDC) portfolios and investments in interbank deposits guarantied by credit and leasing operations or fixed yield securities, up to a limit of 70% of reserve requirements on time resources. This measure made it possible to release an amount of up to R$29.5 billion in reserve requirements to financial institutions. The incentive to interbank acquisitions of financial assets was further reinforced by Circular n. 3,417, dated October 30, which included interbank deposits of institutions not related one to another among the assets apt for deduction and determined that 70% of deposits related to time resources must be maintained in cash without earnings – up to that time, compliance was limited exclusively to bonds. The new rule on the composition of these requirements went into effect on November 14. Circular n. 3,421, dated November 25, excluded BNDES from the base capital limitation, allowing banks to deduct acquisitions and investments with that institution from reserve requirements on time resources. In effective terms, the release of resources resulting from interbank acquisitions of assets totaled R$27.1 billion through December 2.

Reserve requirements on time resources were also altered by Circulars n. 3,408, dated October 8, and n. 3,410, dated October 13, which raised the value to be deducted from these requirements in two stages from R$300 million to R$2 billion. The resulting release added up to R$18.6 billion.

The rate on demand resources was cut from 45% to 42% by Circular n. 3,413, dated October 14, resulting in release of R$3.6 billion as of the 29th day of that month. Aside from this, Circular n. 3,416, dated October 24, determined that the value of voluntary anticipated payments to the Credit Guaranty Fund (FGC) could be deducted from reserve requirements, in an amount corresponding to 60 times the value of the ordinary contribution for the month of August 2008. These voluntary anticipations added up to R$5.4 billion.

Compulsory reserve on savings deposits in the framework of the SBPE remained subject to the 20% rate. Parallel to this, Resolution n. 3,625, dated October 30, reduced the rate on rural savings to 15%, representing an additional release of resources totaling approximately R$2.6 billion as of November 10.

Aside from alterations in the reserve requirement rules, measures were adopted with the aim of channeling credit to specific sectors of economic activity. In this context, targeting of demand deposit and rural savings resources to farm credits was increased from approximately 25% to 30%, by Resolution n. 3,623, dated October 14, and from 65% to 70%, by Resolution n. 3,625, dated October 30. In both cases, the alterations will remain in effect from November 2008 to June 2009.

In another initiative aimed at expanding banking system access to liquidity, Resolution n. 3,622, dated October 9, defined criteria and special conditions for Central Bank evaluation and acceptance of assets in discount window operations in national currency. These operations can be carried out in the form of asset sales with buyback commitments by the financial institutions.

Table 1 –Timetable of Alterations

Norms	Assets	Adjustment (as of)	Alteration
Circular n. 3,413, 10.14.2008	Demand deposits	10.29.2008	Lowers the rate from 45% to 42%.
Circular n. 3,416, 10.24.2008		10.24.2008	Deducts the voluntarily anticipated instalments of the ordinary contribution to the FGC.
Resolution n.3,623, 10.14.2008		10.14.2008	Increases the rural credit channeling from 25% to 30%.
Circular n. 3,407, 10.2.2008	Time deposits	10.10.2008	Deducts from the payment on time resources in purchases of credit portfolios from financial institutions.
Circular n.3,408, 10.8.2008		10.10.2008	Raises the instalment to be deducted from payments on time resources from R$300 million to R$700 million.
Circular n. 3,410, 10.13.2008		10.17.2008	Raises from R$700 million to R$2 billion the value of the instalment to be deducted from payments on time resources.
Circular n. 3,411,10.13.2008		10.17.2008	Alters Circular n.3,407 (assets and eligible institutions).
Circular n. 3,414,10.15.2008		10.15.2008	Alters Circular n. 3,407 (included interbank deposits, advances and other credits among eligible assets.)
Circular n. 3,417, 10.30.2008		11.14.2008	Compliance with the requirements for payments shall be 30% in federal public securities and 70% in cash.
Circular n. 3,421, 11.25.2008		11.25.2008	Alteration of Circular n. 3,407 (BNDES assets included among those eligible)
Circular n. 3,405, 9.24.2008	Additional requirements	9.29.2008	Raises the instalment to be deducted from payments of additional requirements from R$100 million to R$300 million.
Circular n. 3,408, de 10.8.2008		10.13.2008	Lowers the rate of the additional requirement on demand and time resources from 8% to 5%.
Circular n. 3,410, 10.13.2008		10.13.2008	Increase from R$300 million to R$1 billion in the amount to be deducted from payments referring to additional claims.
Circular n. 3,419, 11.13.2008 and Resolution n. 3,634,		12.1.2008	Complying with the additional requirements shall be in federal public securities.
Circular n. 3,405, 9.24.2008	Interbank deposits	1.16.2009 and 3.13.2009	Alters the timetable for a gradual rate increase.
Circular n. 3,412, 10.13.2008		10.13.2008	Allows to reduce the amount of foreign currency acquisition with resale commitment from payments.
Resolution n. 3,625, 30.10.2008	Rural savings	11.10.2008	Raises the channeling of resources to the rural credit from 65% to 70% and reduces the rate of payments from 20% to 15%.