BANCO CENTRAL DO BRASIL

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Keynote Address by Alexandre Tombini Governor, Banco Central do Brasil

Your Excellencies, Miladies, Milords, Ladies and Gentlemen

Good evening. It is a pleasure to speak to you tonight.

I'd like to thank the President of the Brazilian Chamber of Commerce in Great Britain, Mr. Jaime Gornsztejn, for the kind words of introduction.

I appreciate the opportunity to share with the business community tonight our views on the international economic outlook.

I will also discuss the impact of the normalization of international monetary conditions on emerging markets and, in particular, on Brazil.

Lastly, I will refer to the economic transition underway in my country, marked by a wide-ranging structural reform agenda that is already and will result in a more productive and competitive economy in the coming years.

The relationship between Brazil and the United Kingdom has a long history of mutual development and joint achievements. Two hundred and six years ago the opening of Brazilian ports to free trade with friendly nations represented the beginning of commercial relations between our two nations. Since then, a constant partnership that has greatly influenced the Brazilian economy has developed.

Throughout the nineteenth century, the UK was our number one commercial partner; it is still an important destination for Brazilian exports.[1]

The UK was also for a long time the main foreign investor in Brazil.

Among the legacies of that period we may highlight the investments made by British companies on Brazil's first railroads and ports, as well as the implementation of several public utility services in the growing urban areas, such as public lighting, gas and sanitation.

But possibly the most visible influence the relationship between our two countries has brought about, was that of a young Brazilian named Charles Miller, son of a Scotsman, that back in the eighteen hundreds came to England to study and, a few years later, returned home bringing in his luggage two footballs and the passion for the game.

[1] The UK was the 7th most important Brazilian export destination in the 2009-2013 period.

He promoted the first ever football match in Brazil in April 1895, which opposed employees from two British companies: the São Paulo Railway Company, where Charles worked, and the São Paulo Gas Company.

What followed is history... History that is about to gain a glorious new chapter, as you all know, starting next month.

As Chancellor Osborne pointed out when he visited us a few weeks ago, football is the one British legacy to Brazil he regrets.

Ladies and gentlemen

The global economy is in transition, with some strengthening of economic growth prospects.

This transition has been led by the economic recovery in the United States, which is supported by improved economic fundamentals, in particular in the housing market and progress in private sector deleveraging.

But there are also signs of stronger growth in the Eurozone and in other important advanced economies, in particular the United Kingdom.

In the case of the Eurozone, the recovery is still modest, heterogeneous and subject to potential risks and vulnerabilities.

Although projected economic growth is just over 1% in 2014, this is a significant improvement over last year, when economic activity contracted.

In the emerging market economies, China is choosing to consolidate its pace of economic growth at a 7% to 7.5% per year range. It is lower than its average growth over the last fourteen or so years, but this level represents a larger contribution to the overall global economy for a simple reason: China's economy today is three and a half times larger than at the beginning of the century.

In Latin America, most economies continue to display good growth prospects, despite the deceleration relative to the last few years, and should benefit from the recovery in the U.S. Some countries in our region have been marginally affected by the slowdown in China.

Even so, terms of trade are still high relative to historical levels. But the most significant change in Latin America today is that most countries have built robust economic and financial fundamentals that allowed us to sail safely through the global financial crisis and make us well equipped to maintain stability going forward.

In sum, my view is that the central fact today about the global economy is that it is finally recovering from the lingering effects of the global financial crisis.

And as a consequence, we are entering the beginning of a process of normalization of international monetary conditions, a process that is already underway in the United States.

Obviously, for advanced and emerging economies alike, it is essential that monetary authorities approach this process with caution and flexibility, and are prepared to make adjustments if necessary.

As I have noted and said publicly before, the normalization of monetary conditions in the United States is a net positive for emerging and advanced economies, since it reflects the recovery in the world's largest economy.

Normalization has a clear implication in the long run: a realignment of asset prices, including exchange rates. This is a natural and, to a certain extent, predictable process, that was set off in May 2013 by the beginning of the discussion about tapering the large asset purchases programs of advanced economies after several years of highly expansionary policies.

However, normalization can also bring in the short run, as a consequence, greater volatility in international financial markets. This is typical of transition periods, which are marked by uncertainty about the size and pace of adjustment. Clear communication and predictable policies by central banks can help reduce uncertainty to some extent, and that has been the case, but some volatility remains inevitable.

This realignment of asset prices should not be confused with vulnerability. There was an early and precipitous view that associated "tapering-related" exchange rate depreciation with an inevitable, looming, emerging market external payments crises.

The central bank of Brazil was among the first to reject this simplistic view of the global adjustment process. By making this point, and by accompanying it with an adequate policy reaction, we believe to have helped dispel the false thesis of generalized vulnerability or fragility of emerging economies.

And we had reasons to be adamant because we prepared ourselves for this moment. We always thought there was an excessive exuberance at some point vis-à-vis Brazil that would turn into its opposite, as it did. So Brazil built, in particular, robust economic and financial fundamentals, patiently in our good years. As a result, Brazil is now much more resilient to external shocks, has effective policy tools and large buffers.

Our financial system has remained and is Basel III compliant, well-capitalized, well-provisioned, liquid and lucrative. We have nearly US$380 billion in international reserves and are net external creditors. Foreign debt is low, and short-term debt especially so. Although there are no restrictions, the non-resident share of domestic public debt is just 17%.

Brazil has responded in a classic and robust manner to the challenges presented by this phase of the GFC and the new global outlook. Our response today combines austere macroeconomic policies, a flexible exchange rate and the use of the buffers accumulated over time to smooth asset price changes and continue to ensure financial stability in our jurisdiction.

Brazil is prepared for the normalization of global financial conditions and fully capable of managing this transition safely. In fact, the strong capital inflows we have received over the last few months, including to equities, is a sign of confidence in the quality of the policies in place.

Ladies and gentlemen,

Looking ahead, we know in Brazil that we need to combine the maintenance of our macro-financial stability with a deepening of our reform agenda. We need to continue enhancing labor force skills and expanding and updating our infrastructure. Those two together will build more physical and human capital, contribute to higher investment and enhance productivity.

Over the last decade, Brazil has followed an inclusive growth and development model in which unemployment and informal employment shrank as 18 million jobs in the formal economy were created; in which inequality fell and the share of poor households was reduced by more than half; and in which 40 million people joined the middle class.

Currently, we are near full employment. The unemployment rate in 2013 was the lowest in the country's recent history.

Therefore, it is quite straightforward that in order for our country to produce a faster pace of growth, we need to put more capital to be used by our (almost) fully employed labor force and to increase productivity. More capital and more skills combined will yield higher total factor productivity and strengthen the sources of inclusive growth. It is a win-win strategy, creating more room for non-inflationary domestic absorption.

Therefore, Brazil is implementing a wide-ranging structural reform agenda in order to increase investment and productivity. We have challenges that we are addressing in this area, many through a dialogue with domestic and foreign investors. The good news is that there are a number of "low hanging fruits" available in Brazil, i.e. bankable, profitable investment projects with relatively low costs and high returns.

A good example amongst many of a Brazilian "low hanging fruit" being caught is the potential cost reduction impact of the expansion and improvements to the BR 163 highway, which will connect grain-producing areas in the mid-western states of Brazil to ports in the north and northeast of the country.

According to private-sector estimates, the improvements to this major road may decrease shipping time to Europe by 3 to 5 days, which means significantly lower costs, besides helping reduce congestion in southern ports. According to one large soybean producer, changing their transportation logistics, from South to North and from mainly road trucks to mainly river ships, with a mere $350 million project has already brought them a 30% return.

Promoting private infrastructure investment is a central part of the G20 agenda this year. G20 member countries are working together to find ways to facilitate private sector involvement and channel global savings to long-term infrastructure projects.

Increasing investment in general is a challenge for almost all countries. According to estimates from multilateral agencies, overall investment in the G20 is still eighteen percent below the pre-crisis trend.[2]

Foreign investment has been present and can naturally help to meet Brazil's infrastructure and investment needs, both through the provision of finance and by helping to disseminate state-of-the-art methods and technologies.

[2] IMF (2014). Macroeconomic and Reform Priorities. Prepared by IMF Staff with inputs from the OECD and the World Bank (www.g20.org)

In this context, the United Kingdom can play a significant role. The UK has historically been, and continues to be, a major investor in Brazil; measured by stock of FDI, the UK is currently the fourth largest investor in Brazil.

But as Chancellor Osborne reminded us in its recent trip to Brazil, we do have room and resources to increase our partnership, promoting greater bilateral trade and investment between the UK and Brazil. In our successful economic and diplomatic history we have a strong basis to further strengthen a relationship based on shared values.

Ladies and gentlemen,

In conclusion, the world is undergoing a transition generating greater volatility in financial markets. Asset price changes in emerging markets in general and in Brazil in particular should not be confused with vulnerability. Brazil knew that the GFC would produce ups and downs. We prepared ourselves by building strong and resilient fundamentals. We are much better positioned today to face this transition than in the past and take advantage of the recovery.

The outlook for the global economy in the coming years is of stronger growth; we have to ensure that the recovery also increases international trade, which is positive for all countries. However, in order to reap the full benefits of this improving global economic outlook, all countries will have to revisit their growth and development models.

In Brazil, it is clear to us that we need to address mainly our well-identified supply constraints, our bottlenecks to grow faster. Brazil has an on-going ambitious agenda of structural reforms under implementation, focusing on human capital and on infrastructure investment, which will allow the economy to produce a stronger growth path while maintaining macro and financial stability and its socially-inclusive and environmentally- responsible development model.

Thank you.