BANCO CENTRAL DO BRASIL

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Speech by the Deputy Governor for Monetary Policy, Reinaldo Le Grazie, on October 27th, 2016, at the residence of the German Consul General

Mr. Consul General, Axel Zeidler
Dr. Andreas Dombert
Dr. Eike Berner
Dr. Marc Rennert
Ladies and gentlemen

Good evening,

Let me begin by congratulating Dr. Eike Berner on his appointment as Representative of the Deutsche Bundesbank in Brazil. I would also like to convey my best wishes to Dr. Marc Rennert, who has been among us for more than three years now.

It is a pleasure to be here tonight, in such a fine atmosphere, suitable for promoting the dialogue and the exchange of ideas.

As the ties between our central banks grow stronger, the mutual cooperation between Germany and Brazil becomes even more effective and fruitful.

I will now proceed by sharing with you my views on the current economic outlook, as well as on the latest developments in Brazil.

The current global economic environment may be loosely described by a combination of plenty of liquidity with sluggish growth rates among major economies. From the perspective of emerging market economies, this abundant global liquidity has enabled cheaper funding, favoring particularly those countries more dependent on external savings.

However, this favorable scenario will not last for long. As global growth picks up, the return of monetary conditions to a more conventional stance should ease the current search for yield in financial markets and likely reduce capital flows to emerging markets.

This transition of global monetary conditions should be regarded as good news both in the medium and long terms. Indeed, by then, the world economy would be in a growth mode and those countries that had managed to make reforms and to adjust their economies would be ready to benefit from that recovery.

Turning our attention to Brazil, after more than 2 years of a severe downturn in economic activity, the country’s economic performance is now rebounding in a gradual but steady way.

Too much uncertainty during these 2 years inhibited consumption and investments, which fell close to 25%. Labor market slowed down sharply, pushing the unemployment rate up from 6 to almost 12%.

In the meantime, government revenues collapsed and mandatory expenses weakened the fiscal condition further, while additional political and non-economic events heightened the already worrisome lack of confidence.

More recently, though, a comprehensive economic agenda, put together by the new government, is contributing to reduce uncertainty and exerting a positive impact on growth, initially through the confidence channel.

Having said that, the strategy is straightforward and relies on strengthening a policy framework, successful over time, based on fiscal responsibility, inflation targeting and floating exchange rate regime.

Yet, implementation of the intended reforms is key to turning the economy around. For instance, a constitutional amendment establishing a spending cap for government expenditures is currently being appreciated by the Brazilian Congress, and a proposal for social security reform should follow suit.

The aim is to ensure long-term fiscal sustainability, while avoiding unwarranted tax expansion. Other measures include enacting a labor reform in order to raise productivity and to boost competition; lowering trade barriers; improving efficiency in the public sector; and simplifying indirect taxes.

On the monetary policy side, the recent experience, with a prolonged period of high inflation and above-target expectations, may still reinforce inertial mechanisms. There are signs of a recent pause in the disinflation process of IPCA components that are most sensitive to the business cycle and to monetary policy, which might signal slower convergence of inflation to target. In this context, greater inflationary persistence requires greater monetary policy persistence.

Nonetheless, the Monetary Policy Committee analyzes its conditional forecasts for inflation in different scenarios. More recently, taking into account such analysis, the Copom concluded that there is room for a gradual and moderate easing of monetary policy.

Low and stable inflation is required to reinforce confidence, to allow for long-term planning and to reduce uncertainty about investment projects returns, fostering consumption, investment and ultimately growth.

In fact, there are signs that confidence has rebounded, as reflected, for instance, in the consumer, manufacturing and service confidence indices, which have been improving since the 2nd quarter of 2016.

Another positive change is the recent drop in inflation expectations, as shown in our Focus Report survey. The projected inflation for 2017, for instance, fell from 6.0% to 5.0% more recently. And for 2018, inflation projections fell from 5.4% to the target of 4.5%.

The consensus forecast for GDP is a decline of -3.22% this year. Nonetheless, the prospects for 2017 point to a positive performance in excess of 1.0%.

Regarding the external sector, I would like to highlight the positive terms of trade enjoyed by Brazil this year, allowing us to keep the track on exports while imports fell due to the observed recession. Trade performance has been positively affected from both export and import quantum dynamics, resulting in a string of monthly surpluses, which have contributed positively to GDP.

At the same time, the observed reversal of the current account balance, with a shrinking deficit, combined with strong FDI inflows and increasing M&A activities, are contributing to improve the perception of Brazil's sovereign risk, resulting on a substantial decline in credit default swap spreads recently.

That means the floating rate regime has been working well in Brazil, by acting as a proper adjustment mechanism to the aforementioned economic shocks.

Another one of Brazil's strengths rests in its sound banking system. The Central Bank of Brazil embraces a proactive approach with respect to regulation and supervision, so as to mitigate potential threats to the system. The goal is to ensure the Brazilian financial system remains liquid, provisioned and sound throughout any crisis. All financial institutions are supervised in a standardized manner.

Indeed, the Brazilian banking system solvency remains robust. The system continues to operate with capital ratios higher than the regulatory requirements. Likewise, leverage ratios are also better than the level suggested in Basel III.

That brings us to an assessment of the availability of credit lines. Indeed, the amount of Non-Performing Loans (NPL) has risen moderately, along with loss provisions, and Return-On-Equity (ROE) indicators have declined accordingly. As a result, it has been observed a more cautious granting credit policy by banks, in addition to lower demand by borrowers, leading to low growth in loan portfolios.

Nevertheless, the banking system has been resilient and banks remain well capitalized. Therefore, banks are ready to offer the necessary credit lines to both household and companies at the moment the credit demand recovers.

Ladies and gentlemen,

Now I would like to address the new role assigned to the Central Bank of Brazil as a result of the technological evolution which is changing the way we do payments in Brazil. In effect, the new payment instruments and services are challenging banks and traditional payment service providers.

These innovations in retail payments grew in size and are now regulated by a new bill enacted in October 2013, which introduced the concepts of payment schemes and payment institutions into the Brazilian legal framework. It also assigned to the Central Bank the legal mandate to regulate, supervise and oversee payment schemes and payment institutions.

This regulation not only mitigates business risks, but also induces market agents to pursue more competitive, efficient, and inclusive models. Additionally, it grants better conditions to entice investments in new payment services, promoting further innovations.

In sum, I would like to stress that this new business reality brought many benefits for the society as a whole, such as greater competition, cost and price reduction, more convenience for users, better service quality, financial inclusion and innovative solutions, adding value and fulfilling consumer needs in many parts of the payments' value chain.

The Central Bank of Brazil has also given attention to new financial services customers. Indeed, the financial inclusion process has greatly advanced in Brazil. Individuals enjoy now an almost universal access to financial services across the country, but there is still much space for improvement. Therefore, we are constantly working to promote better financial education and protection to the newly included population.

In conclusion, I would like to convey that the Central Bank of Brazil is establishing a comprehensive agenda, comprised of a wide range of actions, as evidence of our firm commitment to restore confidence. The main pillars of this agenda are: (i) reducing the cost of credit, (ii) increasing the efficiency of the financial system, (iii) strengthening financial inclusion, and (iv) revising the legal framework under which the Central Bank operates.

Thank you and I wish you all a pleasant evening.