2024 IMF/World Bank Group Annual Meetings

Washington DC

Banco Central do Brasil

Diogo Guillen – Deputy Governor for Economic Policy

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Where are we?

- The Brazilian economic scenario has been characterized by:

  1. resilience in economic activity,
  2. pressures in the labor market,
  3. positive output gap,
  4. increase in inflation projections,
  5. and deanchored inflation expectations and,

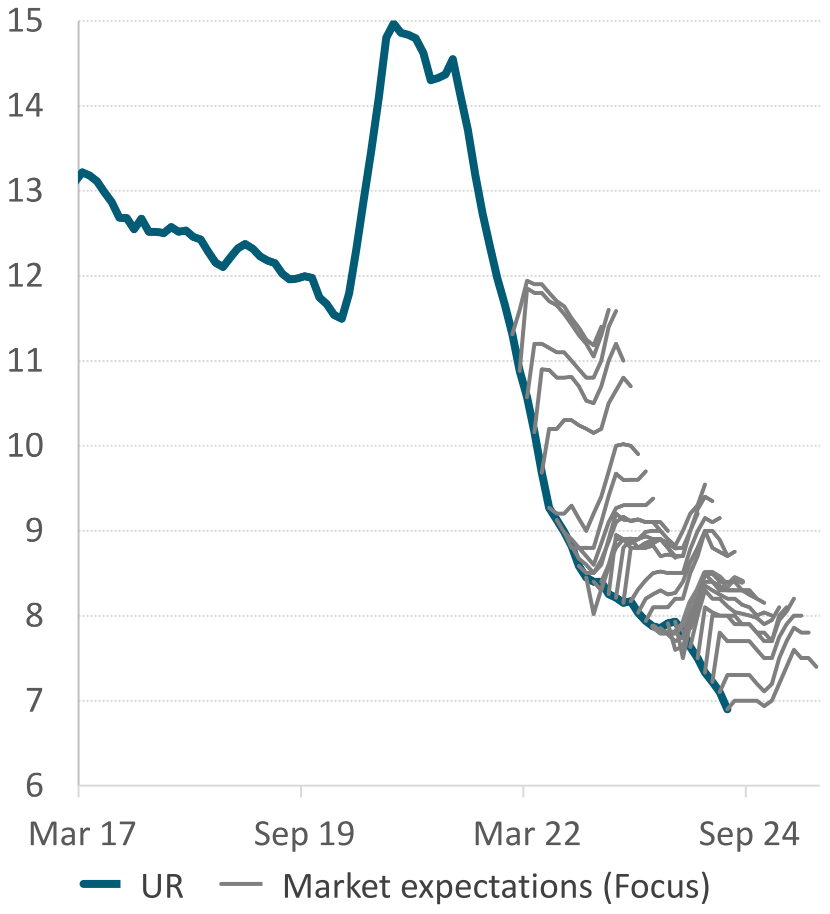
  for this reason, requires a more contractionary monetary policy.

Where are we?

- The pace of future adjustments of the interest rate and the total magnitude of the cycle that has just started will be determined by the firm commitment of reaching the inflation target and will depend on the:
    - inflation dynamics, especially the components that are more sensitive to monetary policy and economic activity;
    - inflation expectations;
    - inflation projections;
    - output gap, and
    - balance of risks.

The current challenges of the disinflationary process: Resilience in economic activity

Unemployment rate (UR) and market expectations (%)



What explains resilience in consumption?

- Fiscal:
  - Real growth in central government spending: 7.8% (Jan-Jul 2024 / Jan-Jul 2023)
- Credit – outstanding credit projected to grow 11.1% in 2024 (BCB IR report September)
- Employment – 12-month change in real households gross disposable national income reached 7.6% in July; unemployment at historically lows

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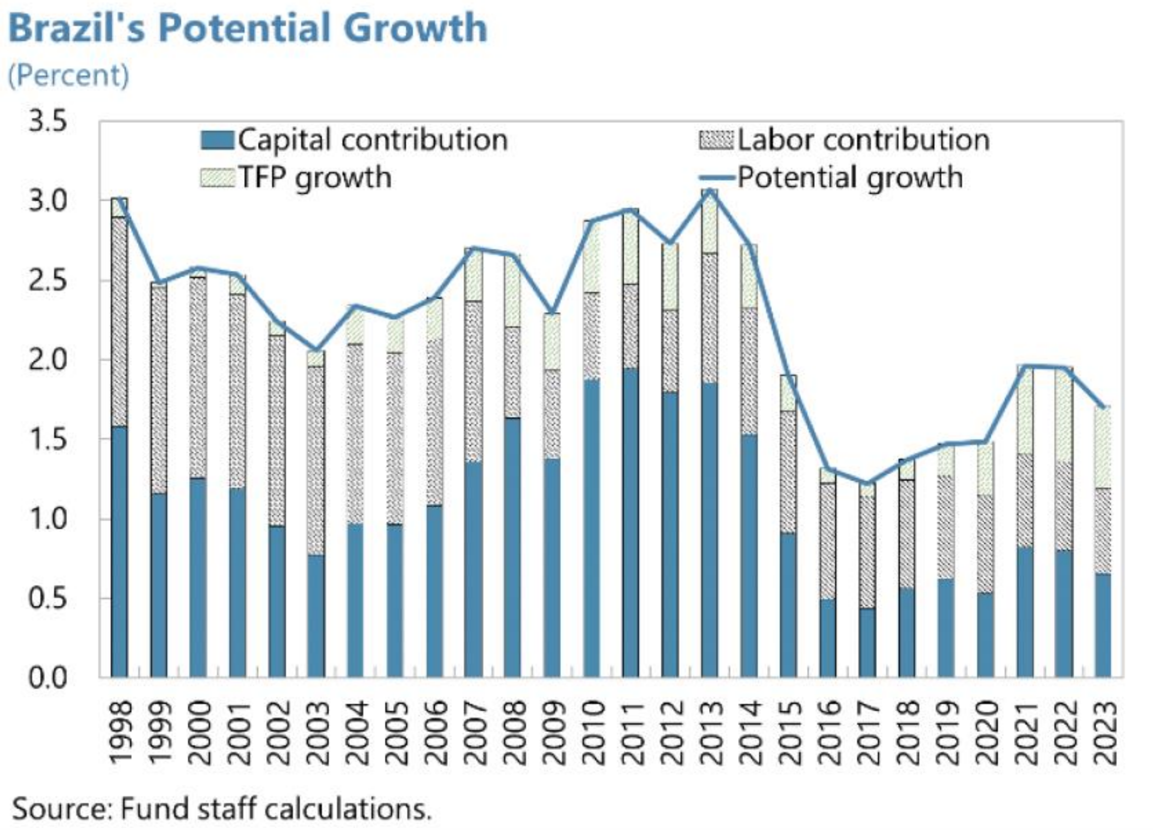
Resilience in economic activity: the positive view



IMF (article IV (July 2024)

Brazil’s potential growth is estimated to have increased in recent years in the context of supply-side reforms […], rising TFP, reflecting catch-up toward the technological frontier and increasing trade integration […]. Labor litigation cases and costs associated with the reform is expected to continue supporting productivity through lower litigation costs, particularly for labor- and trade-intensive firms, and lower barriers for firm growth.

According to the IMF, potential growth is expected to rise further over the medium and long term, reflecting structural factors:

- VAT Reform
- Hydrocarbon Production (making Brazil the world’s fourth largest oil producer in 2031)

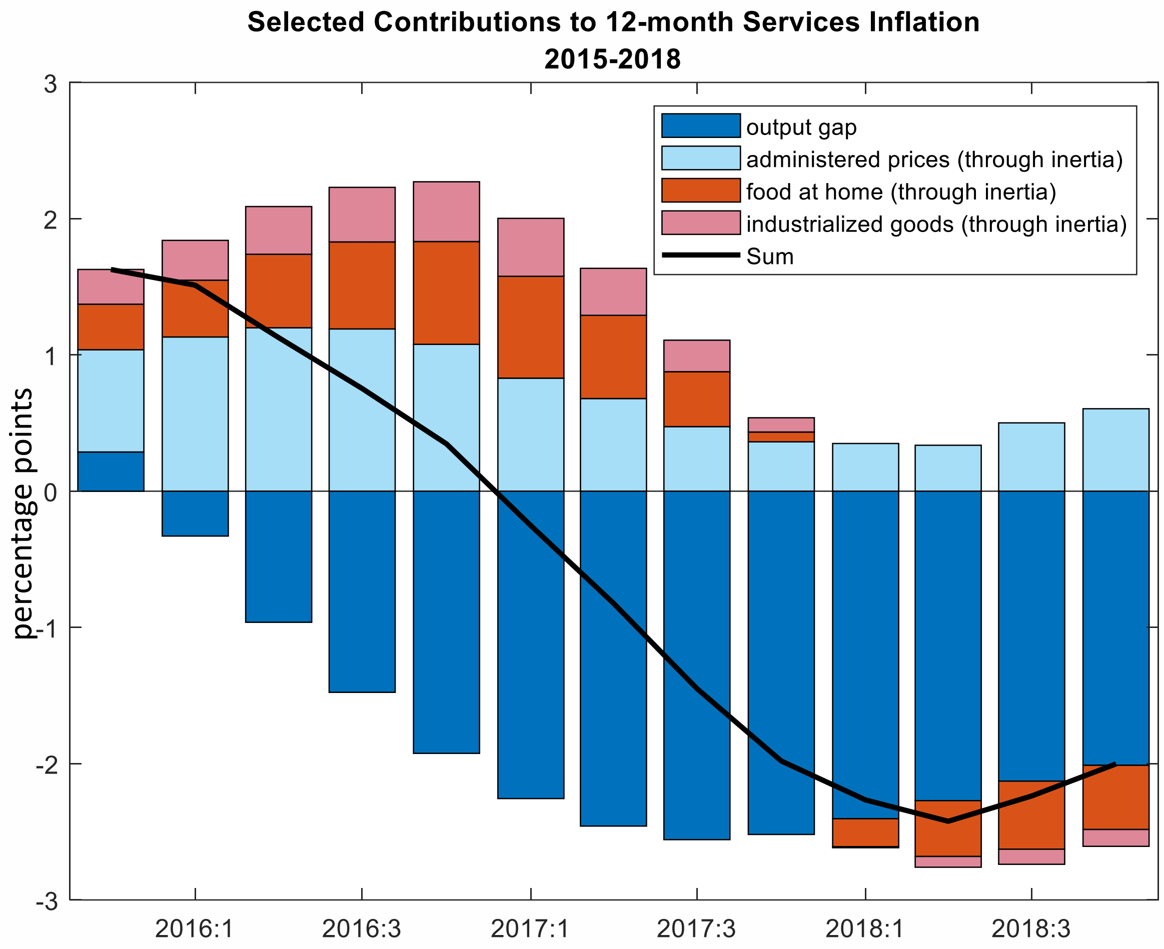
Resilience in economic activity: the negative view

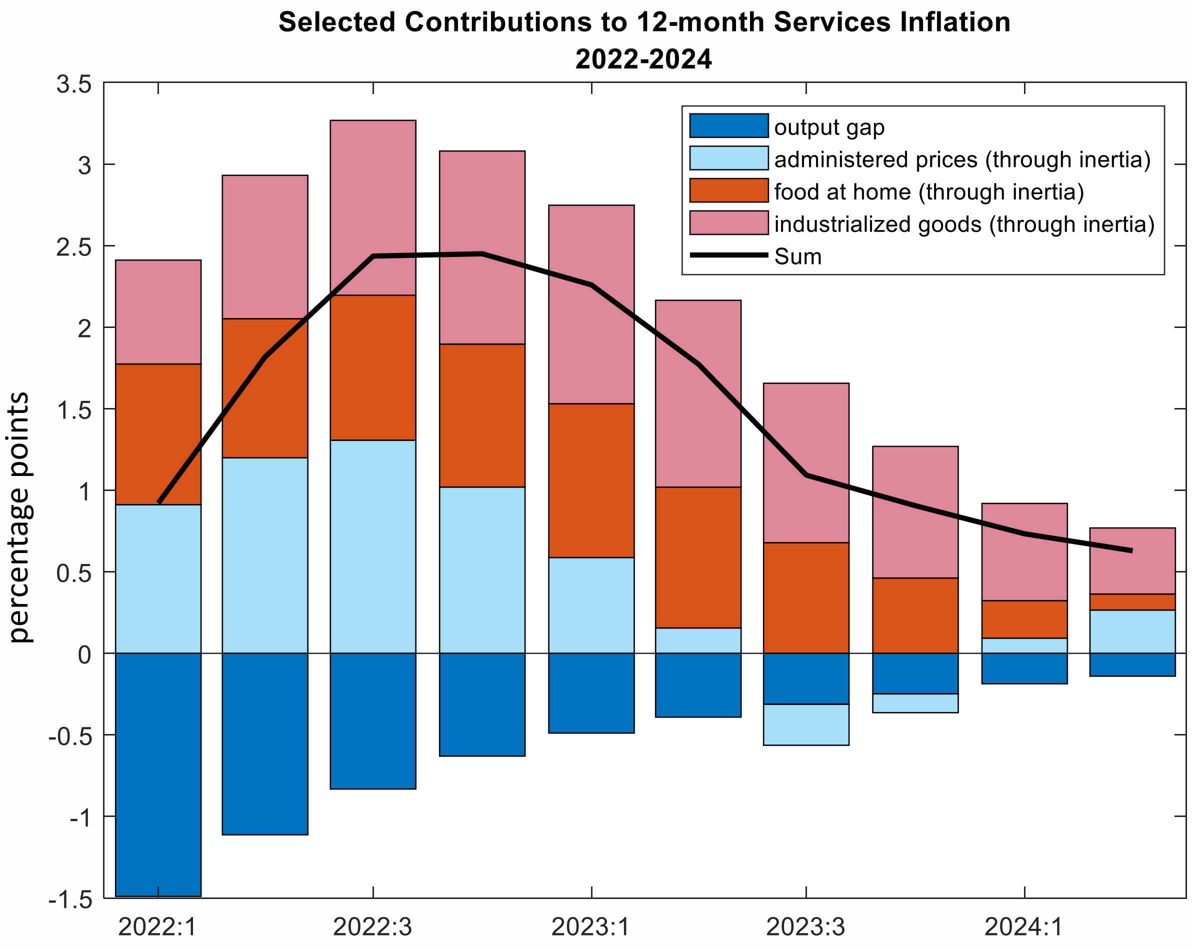
Sectoral growth of labor productivity (% p.y.)

	Total 2001-2022	1st period 2001-2006	2nd period 2007-2013	3rd period 2014-2019	4th period 2020-2022
Total of the economy	0.5	0.3	2.2	-0.8	-0.6
Agriculture and livestock	4.4	4.1	7.1	3.0	1.7
Extractive industry	1.2	3.5	-2.3	7.4	-6.7
Manufacturing	-1.1	-0.7	-0.6	-0.9	-3.5
Public utilities	0.6	-0.2	0.2	2.0	0.0
Construction	-0.5	-1.4	1.9	-3.3	1.4
Trade	0.0	-0.9	2.9	-1.5	-1.5
Transportation and storage	-0.9	-1.0	1.7	-3.1	-2.2
Information services	0.6	-1.1	2.2	0.5	0.4
Financial and related services	0.3	1.5	5.9	-4.4	-4.7
Real estate	0.2	3.4	1.3	-2.1	-3.6
Other services	-0.1	-0.8	1.4	-1.9	1.7
Public admin., health and educati	-0.4	-0.0	-1.2	0.4	-1.2
Memo: aggregate EDP	-0.3	0.1	0.9	-0.9	-1.9

IBGE, BCB estimates

Cyclical challenges – 1st stage of disinflation: The costless period

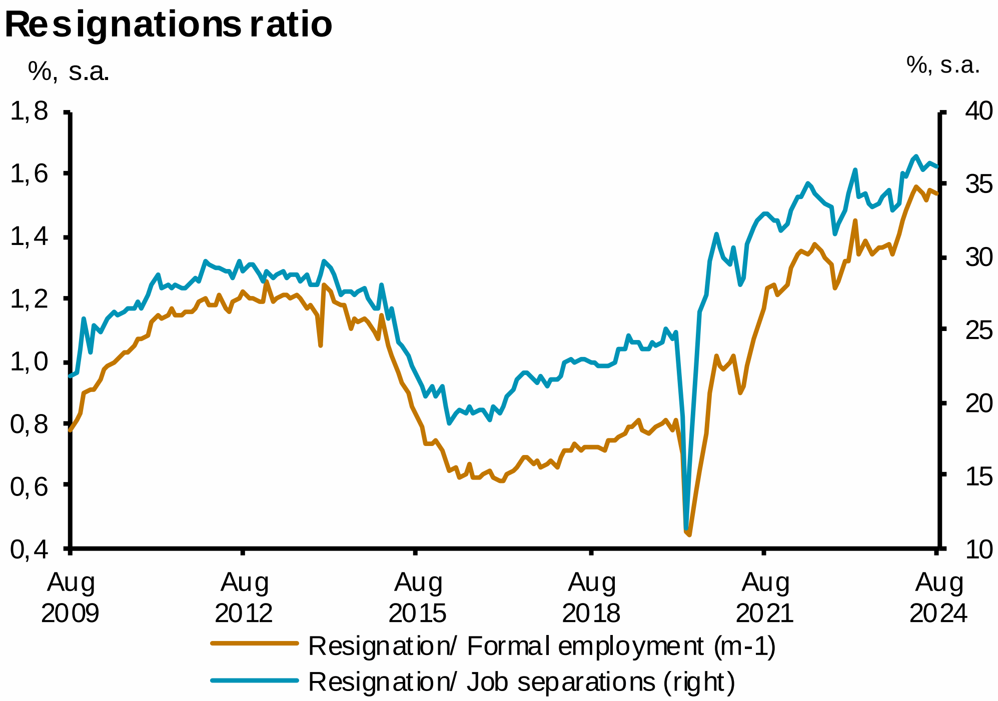




Note: the decomposition is based on a small-scale semi-structural model.

The current challenges of the disinflationary process: labor market

Source: Ministry of Labor and Employment



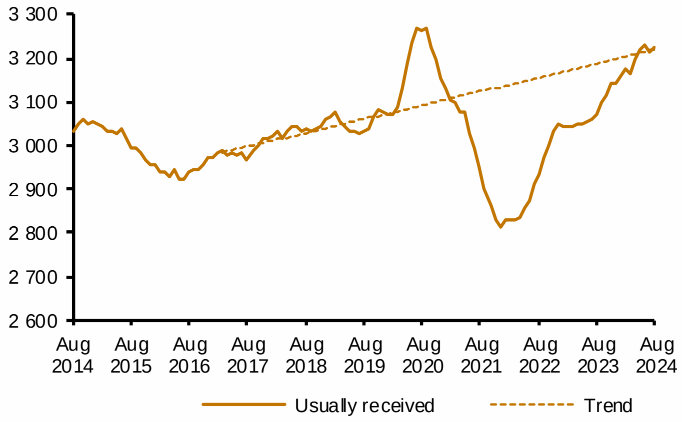
Source: Ministry of Labor and Employment

The current challenges of the disinflationary process: labor market

Average labor income measured by the PNAD Continuous continued to rise consistently, although slowing down. Other salary indicators, which have shown lower real growth than the PNAD throughout 2023, have not slowed down.

Real average labor income

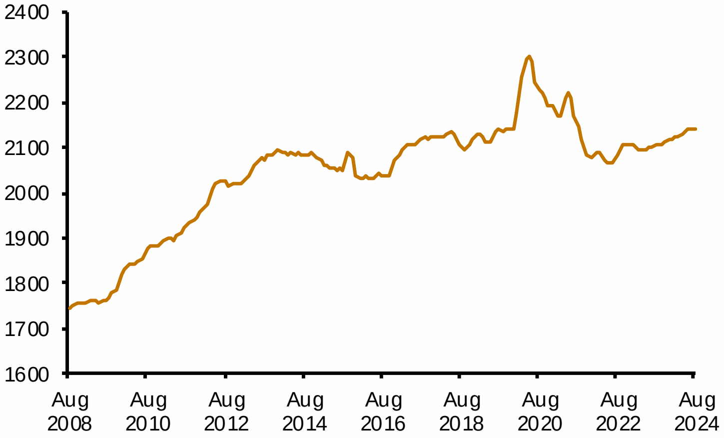
Jun-Aug 2024 BRL, 3mma, s.a.



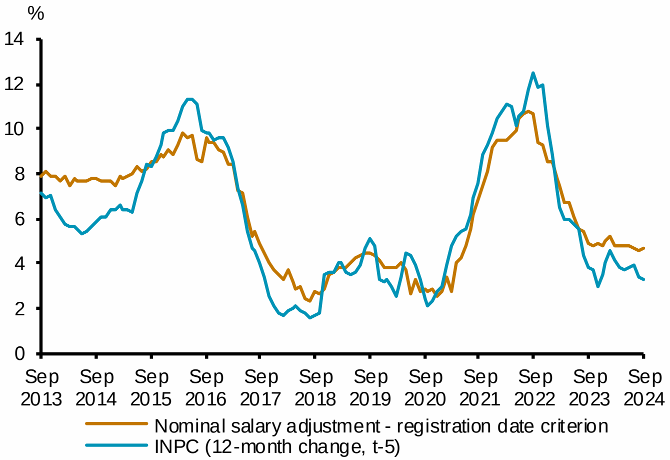
Source: IBGE

Hiring salary

Aug 2024 BRL, 3mma, s.a.



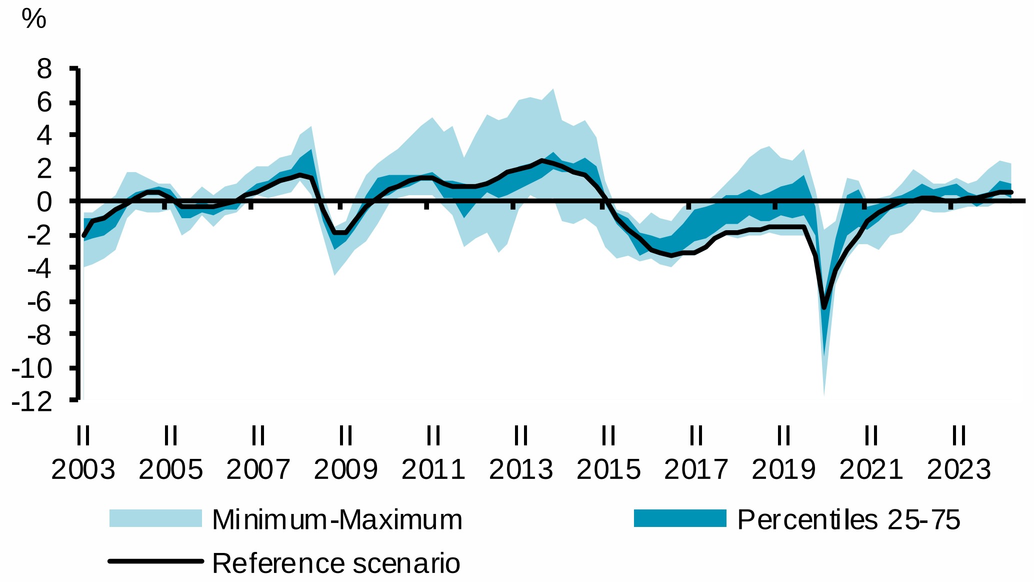
Collective bargaining agreements



Sources: IBGE, MLE and BCB

The current challenges of the disinflationary process: positive output gap

Output Gap: estimates and dispersion

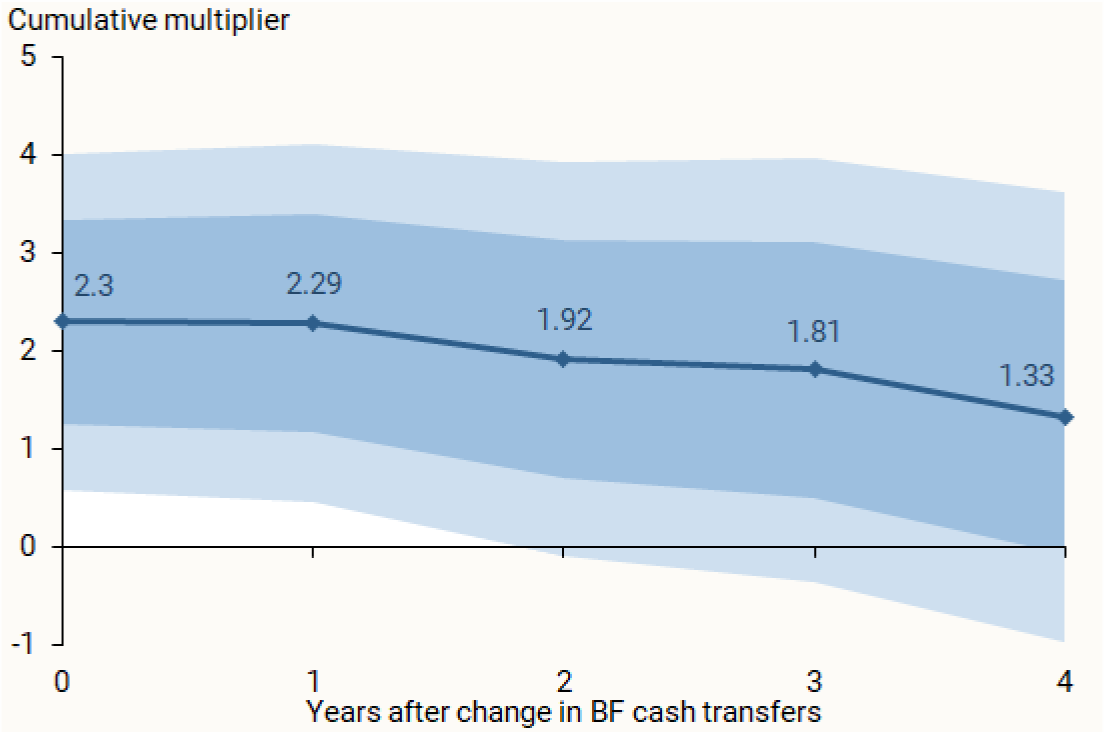


Note: Dispersion measures were constructed using a set of output gap measures. See the box "Output gap measures in Brazil", in the June 2024 Report, for a presentation of various methodologies. Chart data: 2003Q2–2024Q3.

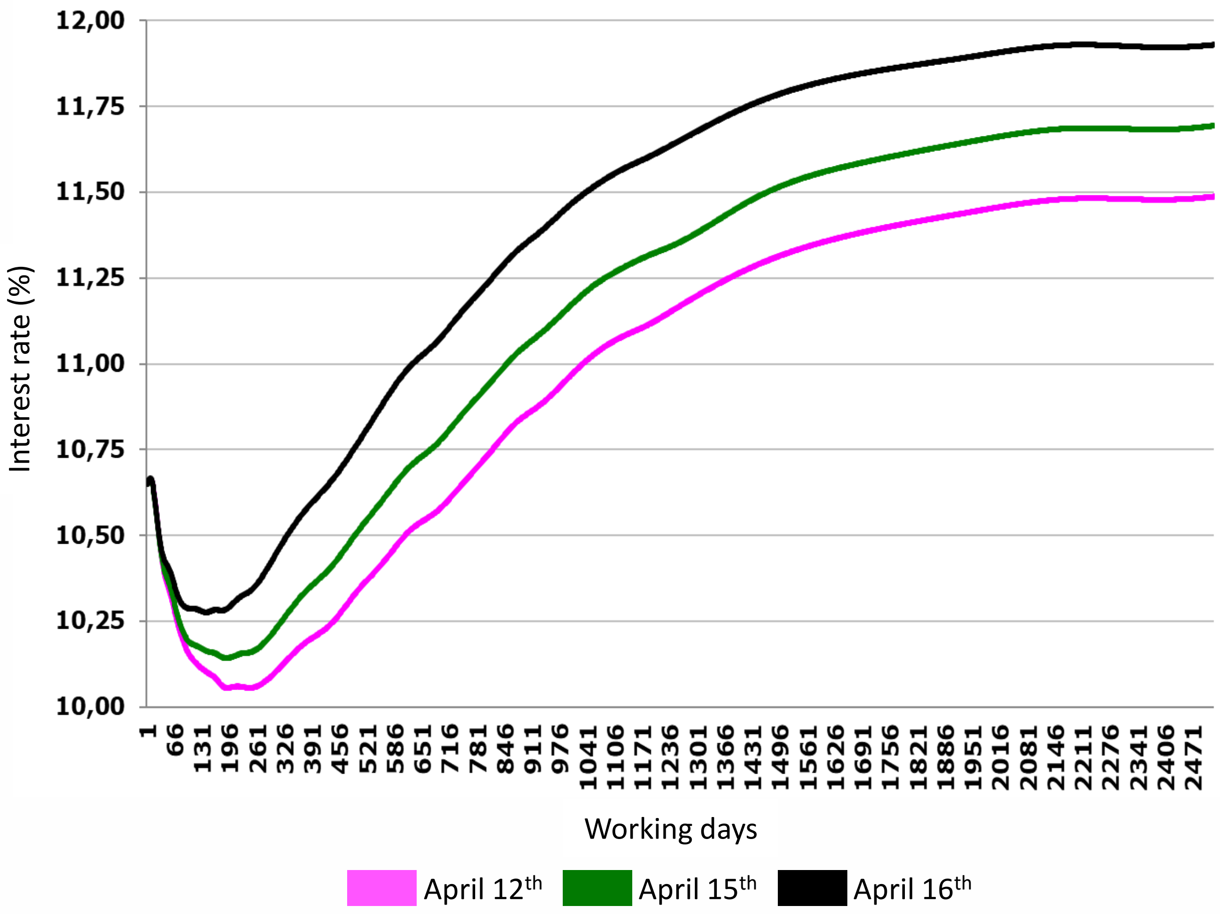
- The estimated output gap for 2024Q3 and 2024Q4 are 0.5% and 0.3%, respectively.
- The projected output gap for 2026Q1 is -0.3%.

The current challenges of the disinflationary process: fiscal policy

Cumulative effects of cash transfers on relative GDP



Yield curve (derivative DI futuro)



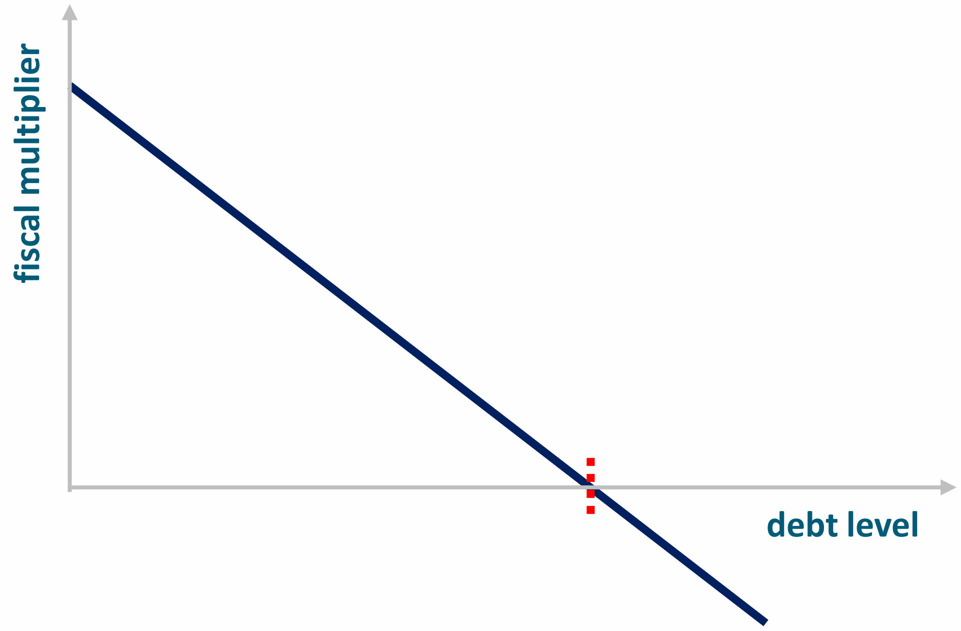
Fiscal authorities announced revision on fiscal targets on April 15th

Source: https://www.frbsf.org/research-and-insights/publications/economic-letter/2024/09/macroeconomic-impact-of-cash-transfers-in-brazil/

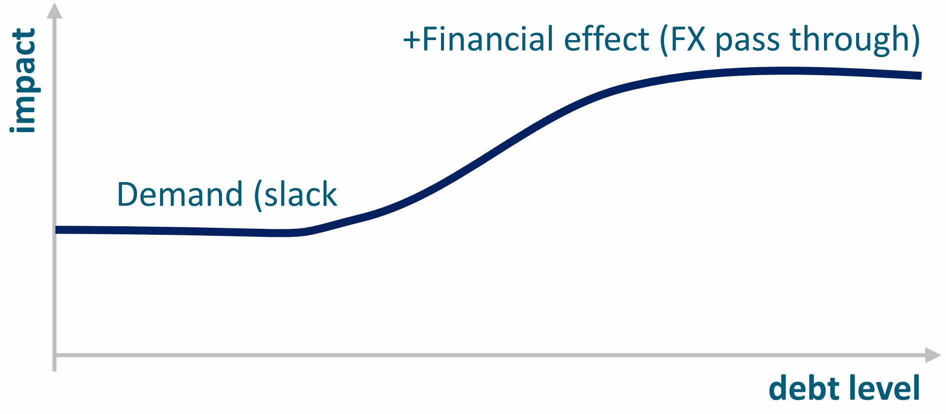
The current challenges of the disinflationary process: fiscal policy

A framework for fiscal impacts under large debt and high rates: policy trade-off

Growth impact



Inflationary impact



	Growth	Inflation
Demand side	+	+
FCI side	–	+

Methodological issues

Estimating fiscal policy channels in Brazil

SVAR model for Brazil

A. Fiscal variables (Transfers, Expenditure ex-transfers, Primary balance)
B. Financial variables (yield curve, exchange rate)
C. Expectations and macro variables (Focus, Output gap, Inflation, Selic rate)

Estimation

- Sample 2008Q1-2024Q2 (start of public bond yield curve data)
- Litterman priors, assumptions about the unconditional mean and restrictions on the number of variable lags
- Generalized Least Squares
- Weights in the covariance matrix reduce the relevance of outliers (GFC and Covid)

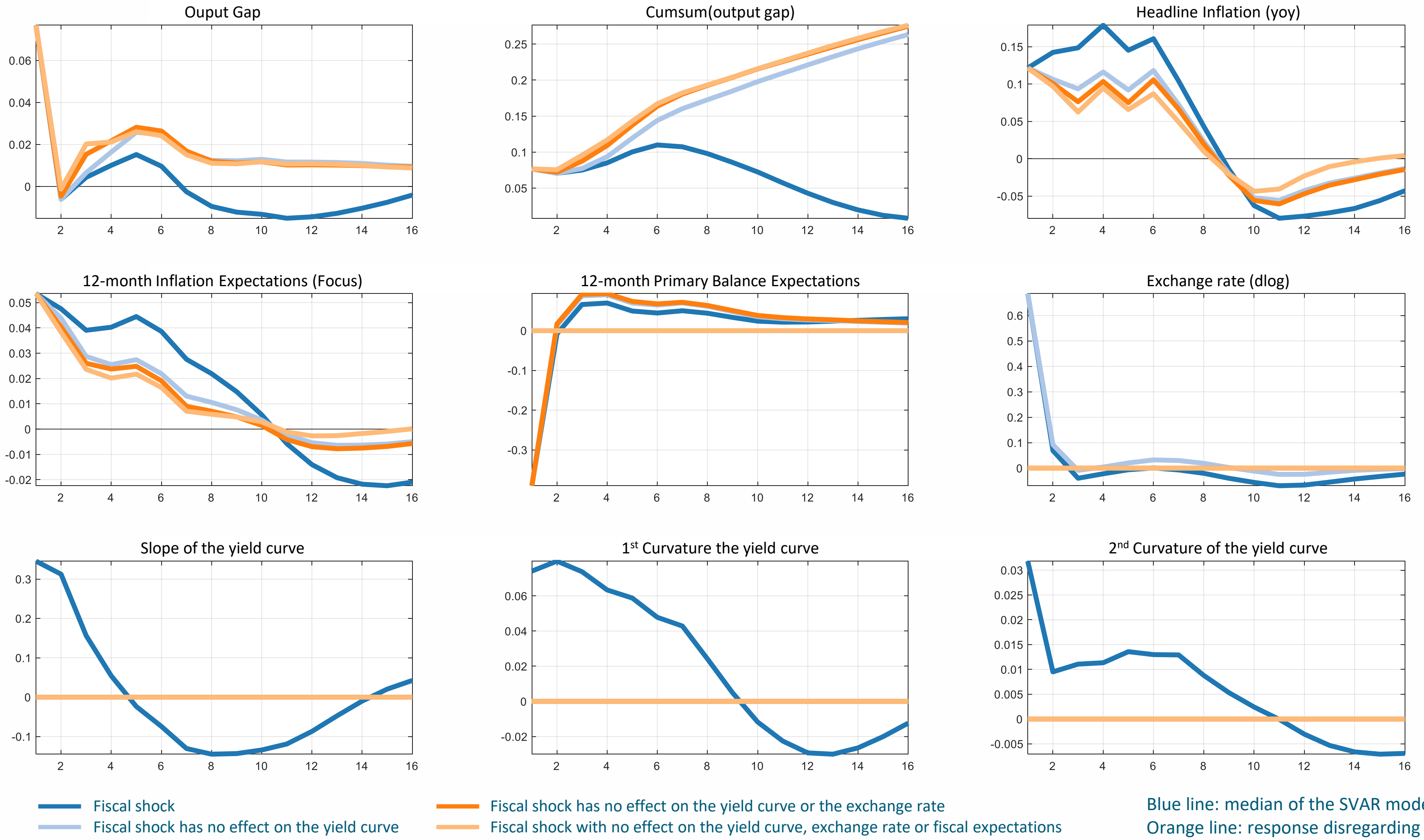
Structural identification

- Combined strategy of identification by exclusion and by signs
- Main exclusions: fiscal variables (A) are not contemporaneously affected by financial variables (B) and Selic rate
- Main sign restrictions on the short-run impact matrix:
    - Keynesian effect: fiscal expansion increases activity and puts pressure on inflation
    - Financial conditions effect: fiscal expansion deteriorates the exchange rate, yield curve and expectations
    - More pressured yield curve contributes negatively to activity

The current challenges of the disinflationary process: fiscal policy

Breakdown of channels: Transfers Shock equivalent to +1 p.p. of GDP

Preliminary results



Blue line: median of the SVAR models, sorted by fiscal impact on the gap
Orange line: response disregarding the yield curve reaction

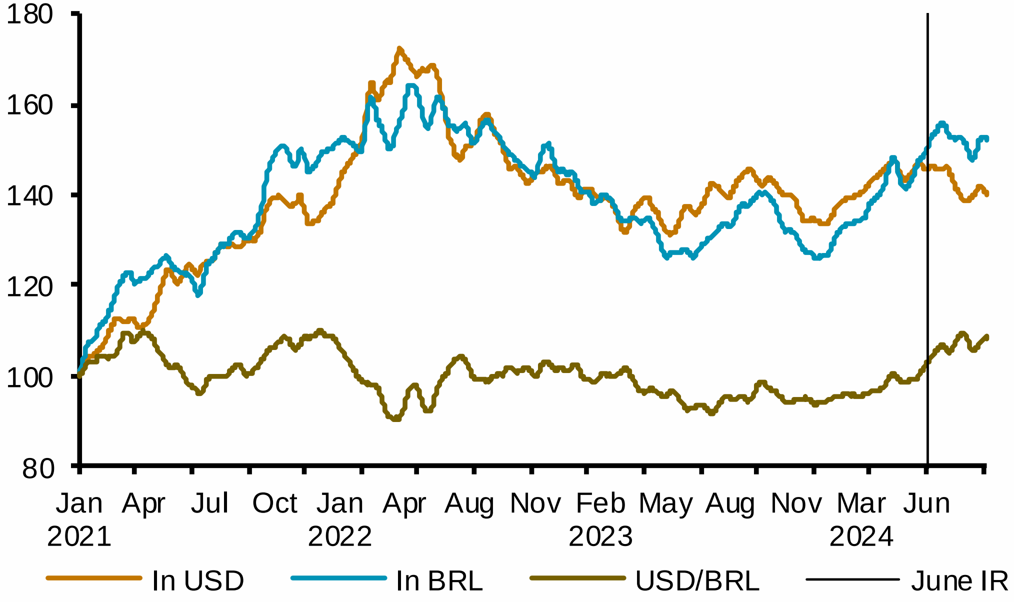
The current challenges of the disinflationary process: imported inflation

USDBRL Exchange rate

Reais per US Dollar

IC-Br and foreign exchange rate

10-day moving average; Dec/31 2020 = 100



Sources: Bloomberg and BCB

The current challenges of the disinflationary process: credit concessions

- *Nominal growth projection for the SFN credit balance in 2024 increased from 10.8% to 11.1%, driven by greater growth in non-earmarked credit portfolios, reflecting higher economic growth and a heated job market.*
- *For 2025, nominal growth is expected to decrease slightly to 10.3%.*

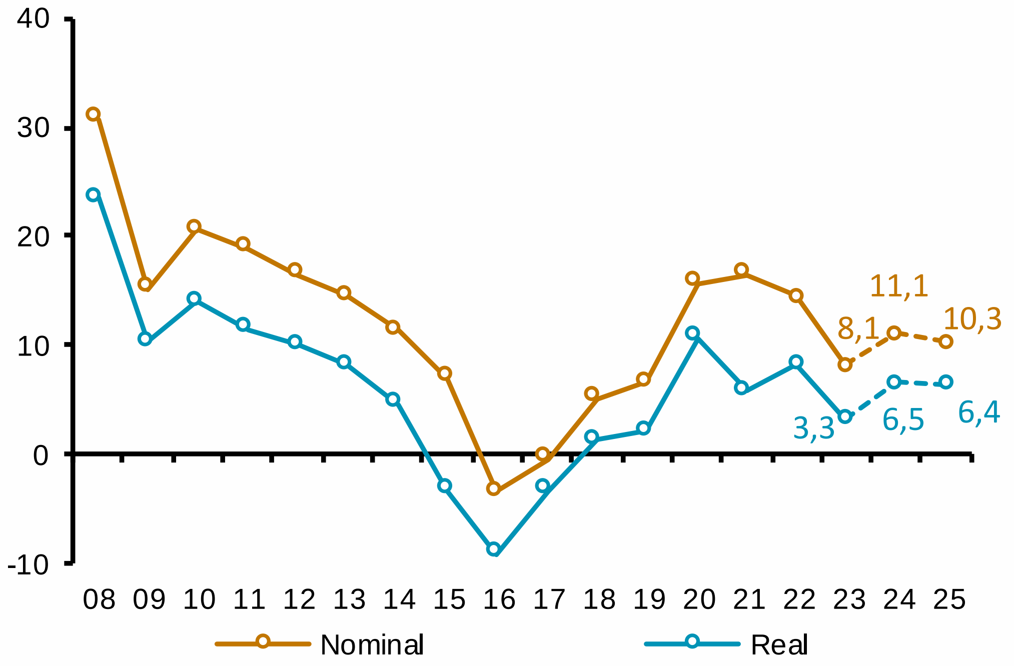
Credit balance

12-month % change

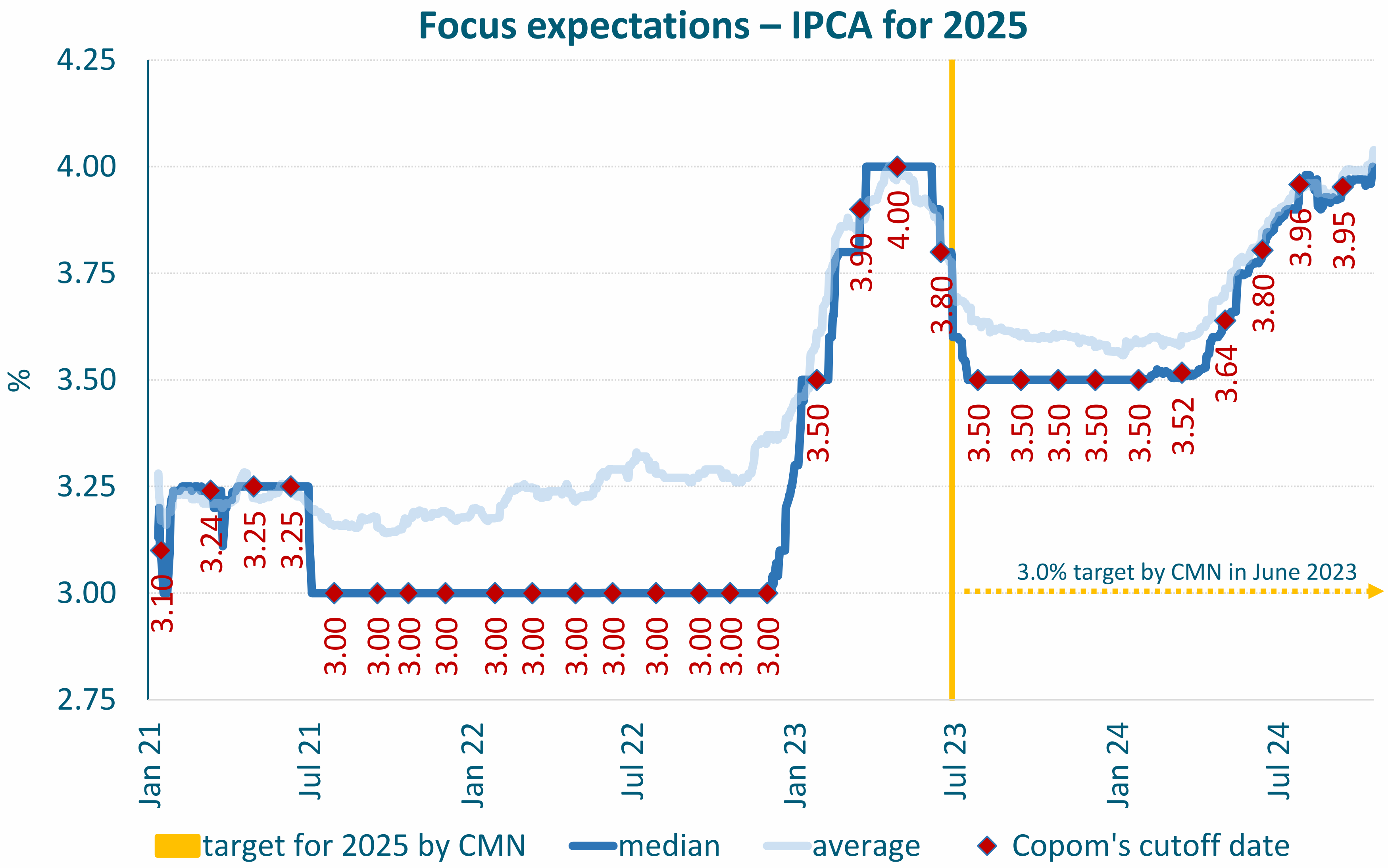
	Occurred			Proj. 2024		Proj. 2025
	2022	2023	Jul 2024	Previous	Current	Current
Total	14.5	8.1	10.3	10.8	11.1	10.3
Non-earmarke	14.9	5.5	8.6	10.0	10.5	10.2
Households	17.5	8.2	10.6	11.5	12.0	11.0
Corporations	11.9	2.1	6.1	8.0	8.5	9.0
Earmarked	14.0	11.9	12.7	12.0	12.0	10.5
Households	18.0	13.1	13.5	10.5	12.0	10.5
Corporations	6.9	9.6	11.1	15.0	12.0	10.5
Total Househ	17.7	10.4	11.9	11.0	12.0	10.8
Total Corpora	10.1	4.7	7.8	10.5	9.7	9.5

Total credit outstanding

% year change



The current challenges of the disinflationary process: unanchored expectations



The current challenges of the disinflationary process: inflation projections

Inflation projections – Reference scenario

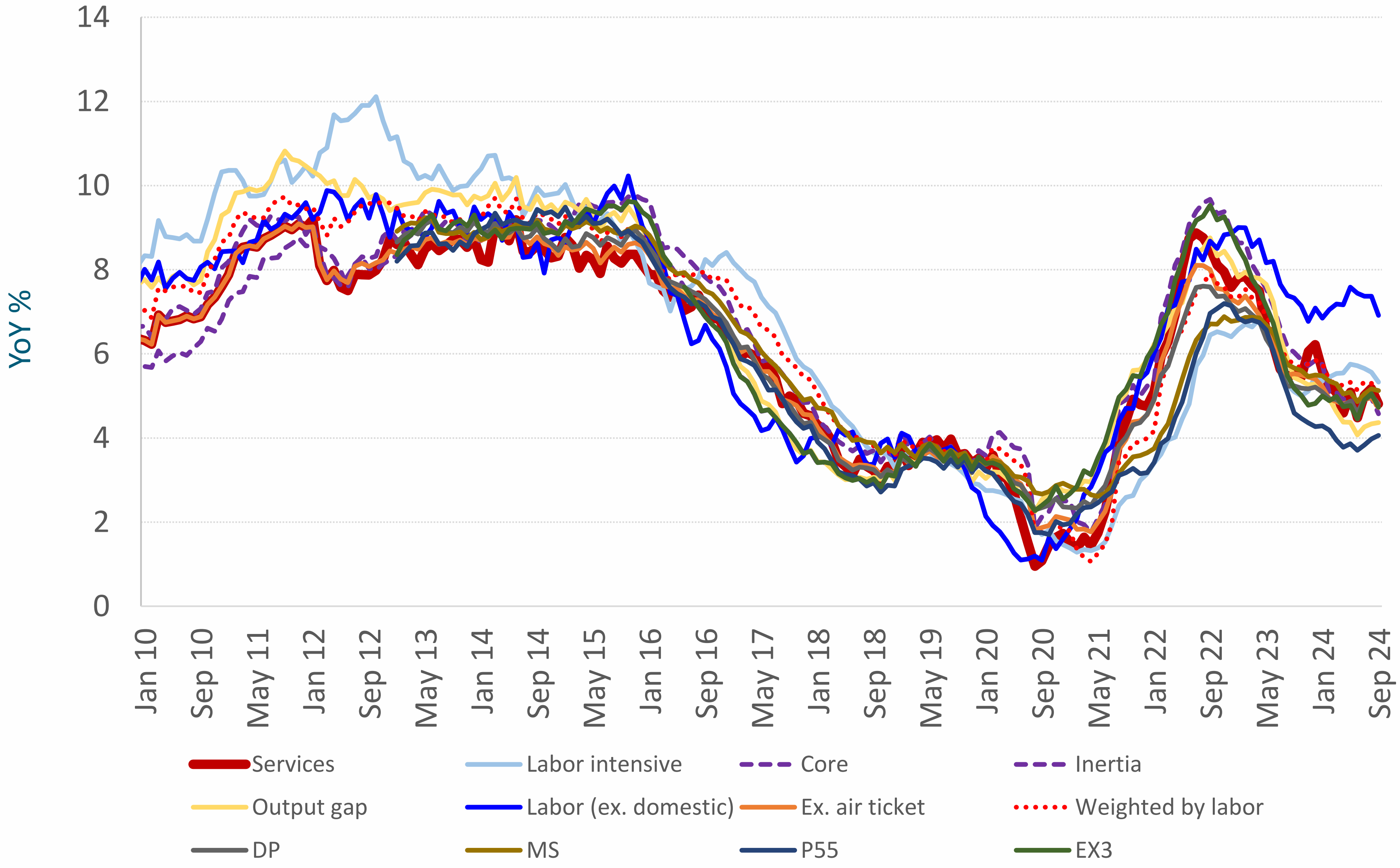
YoY IPCA inflation

%

	2023		2024				2025				2026				2027
Price index	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
IPCA	5.2	4.6	3.9	4.2	4.6	4.3	4.0	3.8	3.5	3.7	3.5	3.5	3.4	3.3	3.2
Previous IR difference (p.p.)	[0.0]	[0.0]	[0.0]	[-0.2]	[0.5]	[0.3]	[0.2]	[0.5]	[0.1]	[0.3]	[0.2]	[0.3]	[0.2]	[0.1]	-
Market prices	3.5	3.1	3.1	3.5	4.3	4.4	4.3	4.1	3.8	3.6	3.4	3.3	3.2	3.1	3.1
Previous IR difference (p.p.)	[0.0]	[0.0]	[0.0]	[-0.2]	[0.2]	[0.5]	[0.7]	[1.0]	[0.7]	[0.4]	[0.2]	[0.2]	[0.1]	[0.0]	-
Administered prices	10.2	9.1	6.4	6.4	5.3	4.2	3.3	2.8	2.5	4.0	3.9	4.1	3.8	3.8	3.6
Previous IR difference (p.p.)	[0.0]	[0.0]	[0.0]	[0.2]	[1.2]	[-0.2]	[-0.8]	[-1.3]	[-1.6]	[0.0]	[0.2]	[0.6]	[0.3]	[0.3]	-

Note: Shaded areas indicate projections. The values presented are rounded; therefore, the aggregated values may not match the combination of the rounded disaggregated values. The difference with respect to the previous Report is calculated using the rounded values.

Services prices



Conclusion

- Challenging inflation outlook
- Unanchored inflation expectations
- Higher inflation projections
- Positive output gap

THANK YOU

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