



BANCO CENTRAL DO BRASIL

Bali – Indonésia, 11 a 14 de outubro de 2018.

Apontamentos do Presidente do Banco Central do Brasil, Ilan Goldfajn.

IMF - Annual Meeting

G20 - Finance Ministers & Central Bank Governors Meeting

G30 - 33rd International Banking Seminar

Global Outlook

- The global outlook remains challenging, with less risk appetite towards emerging market economies (EMEs).
- The main global risks continue to be associated with:
 - The normalization of interest rates in some advanced economies (AEs).
 - Uncertainties regarding international trade, with possible impacts on global growth.
- The normalization of the US monetary policy brings challenges for emerging market countries.
 - Reallocation of portfolio by global investors have weakened currencies and increased risk premia.
 - Financial markets have become more volatile, reflecting a worsening in international agents' risk perception toward EMEs.
- The global shock affects each economy according to its particular characteristics and fundamentals.
 - Factors such as the external financing needs, level of inflation, de facto autonomy of its central bank, and sensitivity to trade tensions help explain the market reactions.
- EMEs defense starts on the domestic front, with consistent policies and exchange rate flexibility to absorb shocks.
- In addition, buffers, especially in the form of more international reserves and anchored inflation expectations should help to smooth the adjustment path.
- Although this challenging global scenario is currently affecting more intensely EMEs, as the monetary policy normalization process in AEs moves forward, other high-yield assets may also be affected.

Brazil's buffers

- Brazil is well positioned to resist shocks. A robust balance of payments position, a floating exchange rate regime, adequate levels of reserves, low current levels

of inflation and well-anchored inflation expectations uphold the capacity of Brazil to withstand shocks.

- The combination of balanced current account while FDI remained vigorous is an advantage. Inflation continues to behave well.
 - Brazil's balance of payments' position is comfortable.
 - In August 2018, the current account deficit in twelve months reached 0.8% of the GDP;
 - Foreign Direct Investment reached 3.6% of the GDP, more than four times the current account deficit.
 - Twelve-month trade balance accumulated a surplus of US\$ 52.5 billion in August.
 - Brazil has a buffer of international reserves that exceeds US\$380 billion, around 20% of our GDP.
 - Another buffer refers to the low share of nonresident holdings of the general government debt, which is currently around 12 percent of total, below the average observed in the G20 emerging economies (22.7 percent), according to the IMF.
 - Brazil has an environment of low current inflation and anchored inflation expectations, allowing for the accommodation of external shocks.
 - Brazilian financial system is resilient and its funding is mainly based on domestic sources, limiting the impact of global shocks.

Main domestic risks and challenges

- In spite of the progress on the reform agenda in the past couple of years, the decisive step of reforming the pension system is yet to be done.
- The more adverse global financial scenario reinforce the need for the continuation of reforms and adjustments, in order to ensure confidence on fiscal sustainability and engender higher growth.
- There seems to be a rising consensus that reforms and adjustments must continue.

- We emphasize that the approval and implementation of reforms and adjustments — notably those of fiscal nature and the ones enhancing productivity — in the Brazilian economy are crucial for the:
 - Sustainable growth recovery;
 - Sustainability of low and stable inflation in the medium and long run;
 - Lower neutral interest rates in the economy.

Activity and Inflation

- In Brazil, the recovery proceeds in a gradual manner. Growth is expected at around 1.4% this year and 2.4% next year, according to our latest estimate in our September Quarterly Inflation Report
- In the second quarter, the seasonally adjusted GDP grew by 0.8%, in annual terms compared to the previous quarter.
 - It is the sixth positive variation, a behavior not observed since 2011.
- The credit market developments remain favorable: market interest rates and spreads are in a downward trend.
 - Credit growth for households in 12 months stands at 7.3%.
 - The interest rates of the credit operations, as measured by the Cost of Credit Index (ICC), continue to fall.
 - For new credit operations, the average interest rate also decreased 8.9p.p. in comparison to the peak, reached in October 2016.
- Inflation remains well behaved.
 - The 12-month inflation stands now at 4.5% after recent shocks (the target is also 4.5%).
- Various measures of underlying inflation are running at appropriate levels.
 - Including those components most sensitive to the business cycle and to the monetary policy.
- Inflation expectations, for the coming years, remain close to their targets.
 - The Focus survey indicate inflation around 4.4% for 2018, 4.2% for 2019, 4.0% for 2020 and 2021.

- BCB's inflation projections in the scenario with interest rate and exchange rate paths extracted from the Focus survey (exchange rate reaching R\$3,83/US\$ and R\$3,75/US\$ at the end of 2018 and 2019, interest rates raising in 2019 to 8.0%) stand around 4.1% for 2018, and 4.0% for 2019.
- In the scenario with a constant interest rate at 6.50% p.a., and a constant exchange rate at R\$4.15/US\$, inflation projections stand around 4.4% for 2018, and 4.5% for 2019.

Monetary Policy

- The firm conduct of the monetary policy, along with the change of direction in the economic policy in general, was decisive to anchor inflation expectations in the last few years, leading to a falling inflation.
- The Monetary Policy Committee members agreed to maintain the Selic rate at 6.50% p.a. in the last meeting.
- The baseline scenario for inflation encompasses risk factors in both directions, although asymmetric to the upside:
 - Disinflationary risk:
 - The high level of economic slack may lead to a lower-than-expected prospective inflation trajectory.
 - Inflationary risk:
 - Frustration of expectations regarding the continuation of reforms and necessary adjustments in the Brazilian economy may affect risk premia and increase the path for inflation over the relevant horizon for the conduct of monetary policy.
 - The previous risk intensifies in case the global outlook for emerging economies deteriorates.
- Committee members emphasized that:

- the approval and implementation of reforms and adjustments in the Brazilian economy is of crucial importance;
- the perception of continuity in the reform agenda affects expectations and current macroeconomic forecasts;
- economic conditions still prescribe stimulative monetary policy, i.e., interest rates below the structural level; and
- this stimulus will begin to be removed gradually if the outlook for inflation at the relevant horizon for the conduct of monetary policy and/or its balance of risks worsen.

Final Remarks

- The global outlook remains challenging for EMEs, where the main risks continue to be associated to:
 - the normalization of interest rates in some advanced economies (AEs); and
 - uncertainties regarding international trade, with possible impacts on global growth.
- EMEs need buffers against adverse shocks and reinforced efforts to implement structural reforms and improve fundamentals.
- Brazil is prepared to withstand shocks given its robust balance of payments and the environment of anchored inflation expectations.
- Indicators of economic activity point to the recovery of the Brazilian economy, at a gradual pace.
- Inflation expectations remain anchored.
- Brazil must continue its reform agenda to assure the low and stable inflation and sustainable growth.