Brazil: Economic and Monetary Outlook

Tiago Berriel
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1. International Context and External Sector

2. Growth Dynamics: stabilization and signals of recovery

3. Monetary Policy

4. Structural Reforms and Resilience
International Context: uncertainty and mitigating factors for some EMEs

- Positive outlook for global economic activity, despite underlying uncertainty
- US tightening with limited impacts on global yields
- Mitigating factors for some EMEs:
  - Terms of trade and commodity prices, despite recent volatility;
  - Resilient capital flows and asset prices;
  - Growth Stimulus in G4 with low inflationary risks: Europe and Japan
- Risks:
  - Sustainability of current growth momentum.
  - Commodities prices volatility
  - Faster than expected MP tightening in advanced economies
  - Protectionism and global growth
  - Outlook for Chinese economy
US tightening with limited impacts on global yields

**Sovereign Bonds – 2 year (G4)**

**Sovereign Bonds – 10 year (G4)**

Source: Thomson Reuters Datastream
Market Indicators

Skew Index vs VIX

Source: Thomson Reuters Datastream
Emerging Markets and US Corporative Spreads

Source: Thomson Reuters Datastream
EME benefiting from better risk perception

CDS Sovereigns
5 year

Stock Markets – Emerging Economies
01/01/10 = 100

Source: Thomson Reuters Datastream
Brazil in the International Context

• The global outlook coincides with a period of economic stabilization in the Brazilian economy, and improvement in its fundamentals.

• Brazil is now less vulnerable to external shocks.
Brazil: International Reserves vs. FX Swap and Repo Lines or FX Loans

Source: BCB *through April 19th
Brazil: Current Account x FDI

Source: BCB

*Market Expectations – Focus Report, Apr 13th - 2017
Brazil: Exports by Destination

**April 2016 – March 2017**

- Brazil: Exports by Destination

**12m until Feb/17**

<table>
<thead>
<tr>
<th>Exports/GDP</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total exports</td>
<td>10.1%</td>
</tr>
<tr>
<td>Latin America and the Caribbean</td>
<td>1.8%</td>
</tr>
<tr>
<td>European Union</td>
<td>1.8%</td>
</tr>
<tr>
<td>Asia (ex-ME and China)</td>
<td>1.3%</td>
</tr>
<tr>
<td>USA</td>
<td>1.3%</td>
</tr>
<tr>
<td>China</td>
<td>2.0%</td>
</tr>
<tr>
<td>others</td>
<td>1.8%</td>
</tr>
</tbody>
</table>

**Mar/16 – Feb/17:** US$191.0 billion  
**Apr/16 – Mar/17:** US$195.1 billion

Source: BCB
Reduction of External Vulnerability

External Vulnerability Indicators (% of GDP)

<table>
<thead>
<tr>
<th>Year</th>
<th>Net External Debt</th>
<th>Total External Debt</th>
<th>International Reserves</th>
<th>Current Transactions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1974</td>
<td>12.3</td>
<td>18.1</td>
<td>4.8</td>
<td>-6.8</td>
</tr>
<tr>
<td>1982</td>
<td>29.3</td>
<td>31.5</td>
<td>1.5</td>
<td>6.0</td>
</tr>
<tr>
<td>1987</td>
<td>37.7</td>
<td>42.9</td>
<td>2.6</td>
<td>-0.5</td>
</tr>
<tr>
<td>1998</td>
<td>21.6</td>
<td>28.6</td>
<td>6.0</td>
<td>-3.9</td>
</tr>
<tr>
<td>2008</td>
<td>12.0</td>
<td>11.4</td>
<td>5.2</td>
<td>-1.7</td>
</tr>
<tr>
<td>2016</td>
<td>17.7</td>
<td>20.6</td>
<td>11.4</td>
<td>-1.3</td>
</tr>
</tbody>
</table>

Source: BCB, National Treasury Secretariat
Financial Soundness Indicators

**Capital Adequacy Ratio**
- Germany: 18.0%
- UK: 17.9%
- France: 17.1%
- Brazil: 16.2%
- Turkey: 15.6%
- Japan: 15.5%
- Italy: 14.8%
- Mexico: 14.5%
- Spain: 14.3%
- Korea: 14.2%
- USA: 14.1%
- South Africa: 13.9%
- Canada: 13.8%
- Australia: 13.8%
- India: 12.7%
- Russia: 12.4%

**Liquid Assets to Short Term Liabilities**
- Brazil: 195.2%
- Germany: 153.1%
- Russia: 121.8%
- Korea: 118.4%
- Italy: 93.1%
- USA: 91.2%
- Turkey: 69.6%
- Canada: 47.7%
- Mexico: 44.5%
- Australia: 39.3%
- Japan: 38.7%
- UK: 36.8%
- South Africa: 33.4%
- India: 24.6%

**Provisions – NPL / Capital**
- Germany: 17.0%
- India: 14.3%
- Russia: 12.0%
- Brazil: 4.6%
- Mexico: -3.8%
- Turkey: -3.9%
- UK: -4.5%
- Canada: -5.8%
- USA: -7.2%
- Australia: -8.3%
- South Africa: -18.0%
- Japan: -24.0%
- Spain: -32.3%

Source: FMI (FSI) – latest available data
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Stabilization and signs of gradual recovery

• Recovery in businessmen confidence indexes

• Monetary Policy easing cycle

• Deleveraging process well advanced

• Strong growth in agricultural sector

• Infrastructure Concessions. Asset Sales and Privatization Agenda. Concessions to the Private Sector: Logistics Investment Program (PIL) and Infrastructure Works with regulatory stability

• Business Climate improvement and efficiency and productivity gains

• Structural Reforms (government expenditure cap, social security, tax and labor reforms)
Industrial Production and IBC-BR Index

Source: IBGE
Agents’ Confidence - Businessmen

Obs.: proportion of favorable answers – proportion of unfavorable answers + 100

Source: FGV
Grains, Production and Cropped Area

Production (1991-2016)
Growth: 222% = 4.8% / year

Cropped Area (1991-2016)
Growth: 54% = 1.7% / year

Source: Conab
*average estimate in Apr 17
Deleveraging Process (I)

Household Debt

% of income

Source: BCB
Deleveraging Process (II)

Debt Service

% of income

Source: BCB
Selic Rate

Source: BCB
Admissions and Dismissals vs. Salaries

Sources: MTPS (CAGED) / IBGE (INPC)
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Monetary Policy Outlook: Inflation and current easing cycle

- Consolidation of a disinflation for inflation components that are most sensitive to the economic cycle and to monetary policy justified a moderate intensification of the monetary easing process. The Committee judged the pace of 100bps adequate.

- IPCA diffusion indexes exhibited a relatively large drop in recent months

- Favorable inflation dynamics, with widespread disinflation, lower persistence and expectations well anchored in longer horizons.
Consumer Price Inflation (IPCA)

Source: BCB, Focus

Focus: expectations as of Apr 13th

Mar 17
4.57%

% in 12 months


IPCA  Focus

target (4.5%)

2018
Market, Regulated and Food Prices

**IPCA Regulated Prices (%)**
- 2015: 18.07
- 2016: 5.50
- mkt expectations 2017*: 5.50

**IPCA Market Prices (%)**
- 2015: 8.51
- 2016: 6.54
- mkt expectations 2017*: 3.60

Sources: BCB, IBGE

*as of April 13th
IPCA – Headline, Cores and Diffusion Index

IPCA

Diffusion Index

Source: IBGE
Services Prices Path (CPI-IPCA): Underlying Component (moving average)

12M Inflation – Underlying Services(*)

Source: BCB

(*) Overall services excluding domestic services, courses, communication and tourism.
Conditional Inflation Forecasts

Scenario with Focus Selic and Exchange Rates

% in 12 months

Source: BCB
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Business Environment Improvement

Microeconomic Measures

- Measures to support the reduction of margin on bank loans
  - Streamline credit worthiness list (Cadastro Positivo)
  - System for Electronic Receivables
  - Creation of Central Bank work force to investigate spread reduction

- Real-estate market
  - Enhance the credit market with creation a mortgage-back security (LIG)

- Cut time to open new companies

- New BNDES Policy
  - Working capital credit line (BRL 5 bn to direct operations and BRL 8 bn ton indirect ones)
  - SME classification change: from BRL 90 to BRL 300 mi in gross operating revenue/year
  - Incentives to integrate different industries
  - Monitoring and evaluation of results

- Government Severance Indemnity Fund for Employees - FGTS
  - FGTS investment fund new selection rule based on strict project finance
  - Withdrawal authorization for inactive employees’ accountant: estimate of BRL 30 bn

Source: Ministry of Finance
Business Environment Improvement


- Collective Agreements will prevail over Law Provisions (relative to 13 points)
- Temporary work contracts maximum period will go from 3 to 8 months
- Improvements in the Job Protection Program (PPE), renamed Job Insurance Program (PSE)
  - New admission criteria
  - Maximum annual cost
  - Fines and punitive measures in case of fraud and noncompliance with the program rules

Tax Reform: Simplify Tax System

- Expected to be submitted to Congress still in 2017
- Focus: PIS and Cofins (federal), ICMS (state)
- Announced measures in the subject includes a series of system to reduce red-tape costs
The main goal is to pursue a more efficient financial system, with more free market credit, contributing to increase the power of monetary policy.

Based on four Pillars:

I. Increase financial citizenship
II. Increase financial system efficiency
III. Improve legal framework
IV. Reduce cost of credit
Directed Credit, Quasi-Fiscal Impulses and Long Term Rates

• New economic policy involved a significant decrease in expansionary quasi-fiscal impulses

• From the monetary policy standpoint, a more efficient financial system, with more free market credit, contributes to increase the power of monetary policy.

• **Structural measures (Agenda BC+)** aim to reach a sustainable reduction in overall cost of credit, increasing economic efficiency and productivity, thereby helping monetary policy effectiveness.

• **New methodology for TLP** (parameter for the remuneration system of directed credit) aligned with market rates favors monetary policy effectiveness.
Earmarked Credit

Source: BCB
new methodology since Mar 07
*Feb/17
Structural Fiscal Reform Agenda and Monetary Policy Effectiveness

• Persistent growth in expenditures caused a **fiscal deterioration that eroded confidence**.

• **Structural Fiscal Reform Agenda is critical** to bring fiscal equilibrium back, assuring public debt sustainability through a recovery in primary surpluses' horizon;

• **Intertemporal consistency in fiscal policy is critical for monetary policy effectiveness**, definitively removing uncertainty for longer horizons.

• **Spending Ceiling** - *Constitutional Amendment was approved in October 2016*.

• **Social Security Reform** is under sound debate in the society, and in advanced consideration in the Chamber, with expected examination in the floor by mid-May.
Spending Cap will anchor fiscal policy opening room for primary surpluses

Projection of Primary Expenditures with and without Expenditures Cap (% GDP)

Source: National Treasury Secretariat
Social Security Reform - Key Features and Positive Impacts

Evolution of RGPS Expenses (% GDP)

Source: National Treasury Secretariat
Outlook for the Brazilian Economy: Conclusions (I)

• **Positive outlook for global economic activity, but relevant global uncertainty and risks for EME** (faster tightening in US, protectionism, Europe’s politics, Protectionism and global growth, and Outlook for Chinese economy)

• **Brazil is resilient to external volatility and risks.** Sound current account financing through FDI; Low overall exposure to forex liabilities including corporates; diversified trade ties (global trader) and financial system with solid capital structure and limited leverage.

• Monetary Policy easing, microeconomic reform agenda, and structural sound growth in agriculture favor a **gradual growth recovery along 2017.**

• **Real and nominal interest rates are falling in Brazil.** The policy rate (Selic) fell during the past few months and it is expected to fall further. The real interest rate have also receded.
Outlook for the Brazilian Economy: Conclusions (II)

• Favorable inflation dynamics, with widespread disinflation, lower persistence and expectations well anchored for longer horizons

• Consolidation of a disinflation for inflation components that are most sensitive to the economic cycle and to monetary policy justified a moderate intensification of the monetary easing process. The Committee judged the pace of 100bps adequate.

• Structural Fiscal Reform Agenda is critical to assure public debt sustainability, definitively removing uncertainty for longer horizons. Spending Ceiling was approved in Oct/16, and the Social Security Reform is under advanced consideration in Congress.
Thank You!

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and Corporate Risk Management