

The contents of this document are preliminary and subject to change.

GRAY/21/2543

September 8, 2021

**Statement by Mr. Mozhin, Mr. Palei, and Mr. Biriukov on Brazil
(Preliminary)
Executive Board Meeting
September 10, 2021**

1. We thank staff for the informative set of reports and Mr. Bevilaqua for his comprehensive and convincing comments provided in the Buff statement. **We broadly concur with the thrust of the staff appraisal and offer the following remarks for emphasis.**
2. **We commend the Brazilian authorities for their decisive policy response to the pandemic, which prevented a much more severe recession.** Broad and proactive policy response augmented the well-established strength of institutional frameworks in Brazil. The latter include the inflation targeting regime with flexible exchange rate and deeply rooted culture of mitigating exchange rate and other risks; transparent and time-tested fiscal framework evolving in line with fiscal and broader economic challenges; and the authorities' comprehensive agenda of structural reforms. GDP declined by less than 4 percent in 2020, a commendable outcome when compared to many advanced and emerging market economies and to staff's prior expectations. Strong cyclical recovery allowed the economy to return to its pre-pandemic level already in early 2021, again, an enviable performance. *However, the output unexpectedly fell by 0.1 percent in Q2. What does it imply for staff's baseline economic outlook?*
3. On a more general note, we recall that, at the times of our previous discussions, the Brazilian authorities had been concerned about staff's overly pessimistic projections and provided a broad range of well-articulated arguments to support their differing views. In several other prominent country cases we observed similar divergences in views between staff and the authorities. While we certainly appreciate the challenges associated with developing projections during this very unusual crisis, we also note that under extreme

uncertainty the authorities' views deserve closer attention and that their positions could be better presented in the reports. This experience deserves close attention from staff.

4. **There have been significant differences in policy responses to the pandemic across Latin American countries.** Brazil is among those countries that provided the largest financial support to the economy and population during the pandemic. Yet, the increase in debt-to-GDP ratio in Brazil was similar to that in quite a few other Latin American countries, which spent much less, due to smaller economic downturn and earlier and faster recovery in Brazil.

5. **We want to commend staff for an excellent analysis of the impact of vaccination on mobility on the basis of an extended SEIRD model.** It clearly shows how costly any delay in vaccination could be for the economy. A faster pace of vaccination should allow Brazil to achieve a robust economic growth this year.

6. **The amended fiscal rule should become one of the anchors of Brazil's institutional strength.** Sticking to the fiscal rule requires a reduction in primary spending next year. We note that, from a historical perspective, primary spending has hardly ever fallen on election years in Brazil. At the same time, we note from the report and from the Buff that this time it will be different. We would certainly encourage the authorities to maintain firm commitment to the fiscal rule. *Could staff, please, elaborate on the 2022 budget proposal recently submitted to Congress?*

7. **While the tax reform is anticipated to be revenue neutral in the near term, it could bring substantial fiscal gains over the medium term through improved business climate, boosting competition and productivity.** The taxpayers and investors consider the tax system overhaul to be critical not only because of the existing tax burden, but also because of the risks associated with the number of taxes, rules, regimes, and exceptions imposed by the very complex Brazilian tax system. According to the World Bank, a mid-sized Brazilian firm typically spends 1,500 hours a year dealing with tax compliance, compared with 175 hours for a similar firm in the U.S. Hence, the authorities' continuous efforts to streamline and simplify the tax system and associated procedures are very important.

8. **Headline inflation flirting with double-digits and underlying inflation also running high justify timely initiation and even acceleration of the tightening cycle.** Policy rate should remain the primary instrument to control inflation while FX interventions remain limited to countering disorderly market conditions. We hope that the de jure central bank independence will enhance the transmission of monetary policy.

9. **We encourage the Fund to reflect on the past monetary policy advice given to many EMEs facing mounting inflationary pressures.** Mr. Bevilaqua in his Buff

appropriately pointed to a U-turn in staff's recommendation to the BCB versus the previous Article IV consultation in November. It is an important observation not just for the case of Brazil, as earlier this year the Central Bank of Russia also did not agree with similar policy recommendations, which turned out to be off the mark. In our opinion, in both cases staff rather forcefully opposed the views of the respective monetary authorities and could have paid more attention to emerging evidence of rising inflationary pressures. Any perceptions of "intrinsic limitations of the top-down approach to policy recommendations" in the Fund call for a close additional analysis.

10. **We take a positive note that the banking system in Brazil remains resilient to adverse shocks.** Thus, the BCB could go ahead with gradual phasing out of crisis-related financial support. *Could staff, please, elaborate on implications of the current tax reform for banks? As we understand, the proposed changes include a reduction in corporate taxation, but also the elimination of the Interest on Own Capital tax deduction, which has been heavily used by banks to reduce their overall tax rate.*

11. **The next Article IV consultation could benefit from a broader discussion of the new ESG regulation from the BCB.** Back in 2014, the BCB was a pioneer in launching new rules in this area. As a new stage in the development of the associated regulatory frameworks, the financial regulator decided to further improve regulation to address new challenges from the ongoing climate change.

12. The authorities are developing multiple policies to promote environmentally responsible activities. **Yet, the "program for the sustainable use of national mineral coal" seems to be at odds with international calls to phase out the most polluting of fossil fuels.** It also seems to question the push by the Italian G20 presidency and the UK Cop26 host to get the group of nations, of which Brazil is a member, to agree to exit coal. A major report by the Intergovernmental Panel on Climate Change (IPCC) found that temperatures in South America are expected to increase at a greater rate than the global average and anticipated an increasing frequency of extreme heat waves in the Amazon. *Staff comments are welcome.*

13. **The Brazilian authorities have accelerated structural reform efforts even despite the pandemic, with several important institutional reforms already completed and quite a few remaining in the pipeline.** The current supply side agenda, based on three main pillars, looks ambitious. We note the authorities' estimates that full implementation of their reform package would allow to achieve a 4-8 percent higher real GDP level over the next 10 years. *Did staff have a chance to review the authorities' estimates?*

With these comments, we wish the Brazilian authorities every success in their future endeavors.