

**EXECUTIVE  
BOARD  
MEETING**

SM/21/153

Correction 1

September 10, 2021

To: Members of the Executive Board

From: The Secretary

Subject: **Brazil—Staff Report for the 2021 Article IV Consultation**

Board Action: The attached corrections to SM/21/153 (8/24/21) have been provided by the staff:

**Evident Ambiguity** **Pages 5, 15, 63**

**Factual Errors Not Affecting the Presentation of Staff's Analysis or Views** **Pages 35, 39, 42, 43, 45, 60**

**Typographical Errors** **Page 64**

Questions: Ms. Lim, WHD (ext. 37872)



## CONTEXT

**1. New COVID-19 cases are on a downward path following a second wave early this year (Figure 1).** The emergence of a more contagious and lethal variant of the virus, coupled with near pre-pandemic social mobility levels in late-2020, pushed daily infections and fatalities to new highs in April. However, renewed lockdowns and the rollout of vaccination have helped bring down infections since April. New daily cases have declined to 45,000 and daily deaths have more than halved to 1000. Tragically, more than 550,000 Brazilians have died and average life expectancy at birth has fallen by 1.3 years<sup>1</sup>.

**2. Vaccinations are progressing well.** The vaccination campaign, which started in mid-January, has accelerated since March after local production of vaccines was scaled up. As of end July, 50 percent of the population and more than 90 percent of those over 60 had received at least a first dose. The government has procured sufficient doses to inoculate the adult population in 2021, with the most vulnerable populations expected to be fully inoculated by the fall.

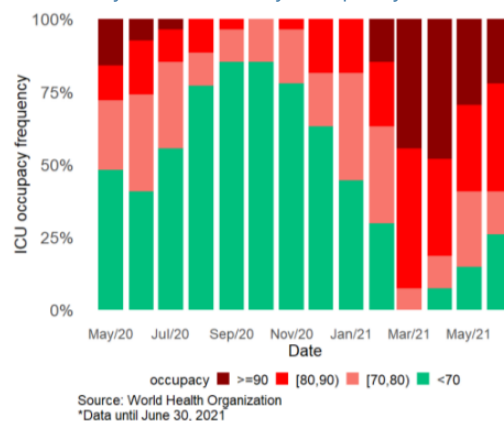
**Confirmed New Daily Cases and Deaths**

(7 Days MA, thousands)



**ICU Occupancy of Brazilian States\***

Monthly distribution by occupancy brackets (%)



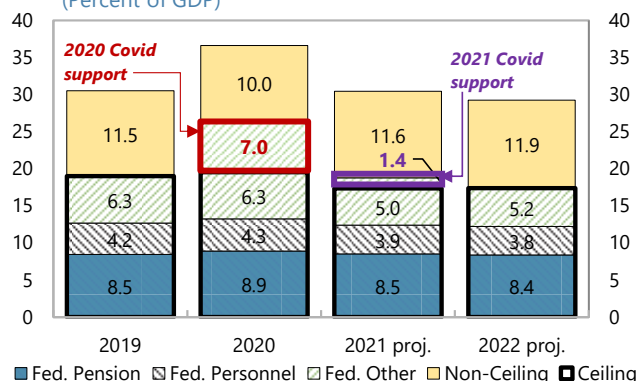
**3. Sustained by strong policy support, the economy withstood well the health crisis.** Real GDP declined by 4.1 percent in 2020, less than in most advanced and emerging economies and the smallest contraction among the major Latin American economies (Box 1). The fall in private consumption was cushioned by about 4 percent of GDP in cash transfers to vulnerable households and informal workers (Box 2). At the same time, substantial liquidity support and capital relief measures ensured the financial system was resilient and banks remained profitable. Private sector credit grew robustly, buoying housing demand and residential construction, while a sharp decline in imports led to a positive contribution to growth from net exports. After contracting by 6.1 percent in H1 2020, the economy returned to its pre-pandemic level by Q1 2021. The recovery has been led by industry and agriculture, with the service sector still struggling (Figure 2).

<sup>1</sup> Castro, M.C., Gurzenda, S., Turra, C.M. *et al.* Reduction in life expectancy in Brazil after COVID-19. *Nat Med* (2021). <https://doi.org/10.1038/s41591-021-01437-z>

expected to bind in the next 3-4 years).<sup>6</sup> The emergency amendment also formalized the “public calamity” clause, authorizing the suspension of fiscal rules in future crises and prohibiting any public wage increases or new mandatory spending while the state of calamity is in effect.

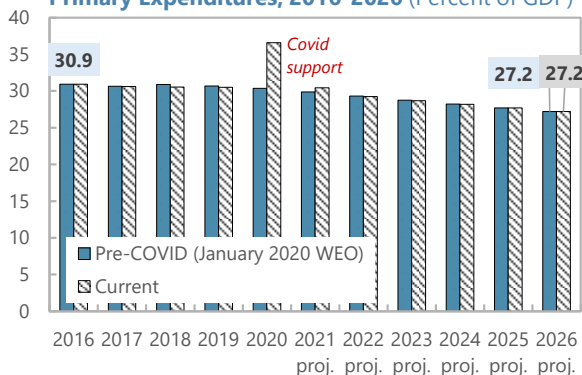
**14. Fiscal consolidation has resumed.** The NFPS primary deficit is expected to narrow substantially from 9.2 percent last year to 1.7 percent of GDP in 2021, due to the expiration of the “war budget”, reduced COVID-19 support, restraints on subnational wage increases, buoyant tax revenues, and the payment of deferred taxes. Fiscal space, though, remains at risk. Adherence to the expenditure ceiling will help rebuild fiscal buffers, with Brazil’s fiscal position improving by around 0.5 percent of GDP per year, reaching a small primary surplus by 2024.

**Brazil: NFPS Primary Expenditures, 2019-2022**  
(Percent of GDP)

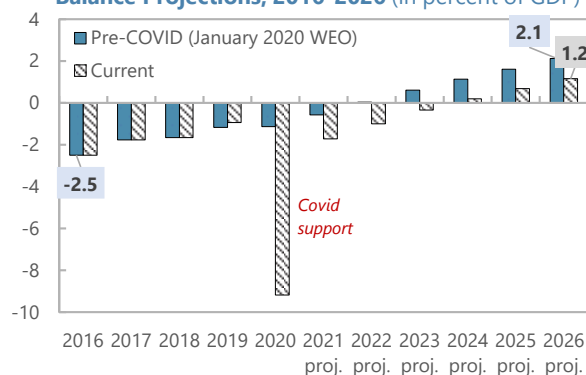


**15. Gross public debt remains high, but the medium-term risk of sovereign stress is assessed as moderate** (Box 6 and Annex IV). With a favorable interest-growth differential<sup>7</sup> as well as BNDES debt repayments, NFPS gross debt will fall by 7 percentage points to 92 percent of GDP (IMF definition) in 2021. Over the medium-term, though, public debt is expected to level off around 92 percent of GDP and gross financing needs will remain high (around 20 percent of GDP), with the debt-GDP path sensitive to shifts in the outlook for interest rates, growth, and the primary balance. The federal government also faces risks from implicit and explicit legal<sup>8</sup> and subnational contingent liabilities.

**Brazil: Impact of Expenditure Ceiling on NFPS Primary Expenditures, 2016-2026**  
(Percent of GDP)



**Brazil: Pre- and Post-Pandemic NFPS Primary Balance Projections, 2016-2026**  
(in percent of GDP)



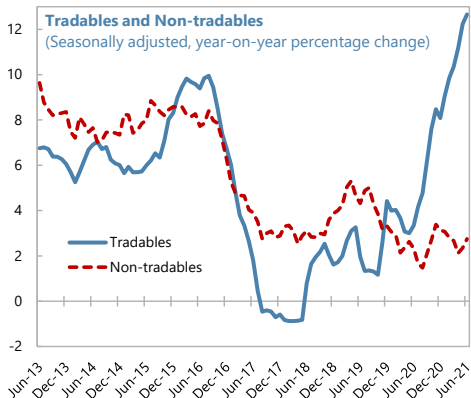
<sup>6</sup> This mechanism applies to the Federal Government. A similar provision was added to facilitate fiscal consolidation at the subnational level. Albeit not compulsory, it is required if subnational governments wish to obtain Federal guarantees in credit operations. The provision is thus expected to bind for several states.

<sup>7</sup> The boost to nominal GDP is significant from the sharp increase in the terms of trade.

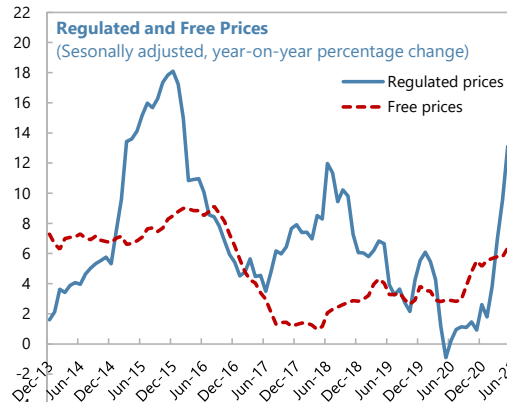
<sup>8</sup> The Supreme Court ruled that the base of the PIS/COFINS (federal tax) on the value of goods and services should not include the ICMS (state tax) and ordered the government to repay taxpayers the disputed amount as tax credits. The decision could reduce revenues by around 0.7 percent of GDP over the medium term.

**Figure 4. Brazil: Monetary Sector Developments**

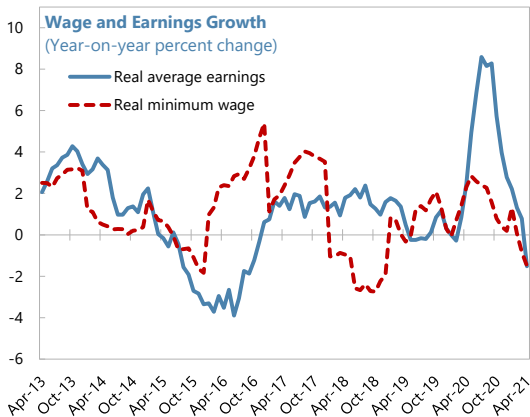
Tradable inflation has increased steadily since mid-2020, driven by commodity prices and the BRL depreciation....



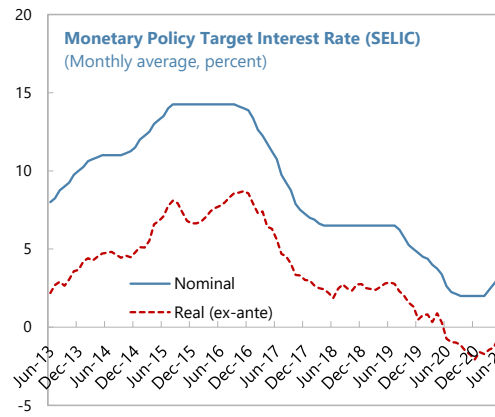
...resulting in higher regulated and free prices, and lifted headline inflation above target since November 2020.



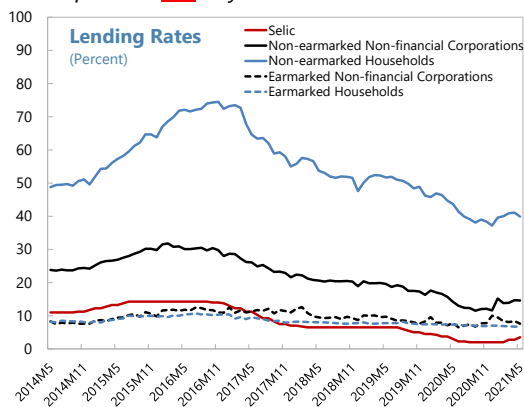
Real average earnings and the real minimum wage fell accordingly.



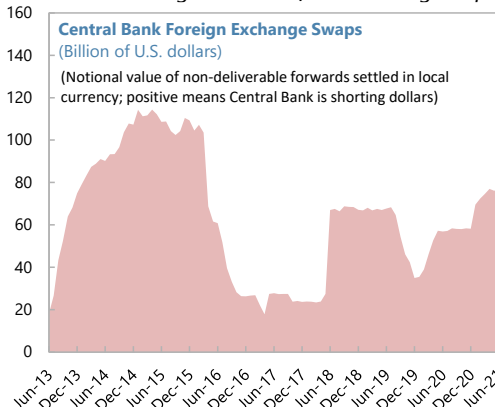
The BCB has raised the policy rate by 325 basis points but the real rate remains negative.



Lending rates have been decreasing since mid-2017 but ticked up in Feb/January.



To contain BRL volatility, the BCB has intervened in the FX market, increasing the stock of outstanding swaps.



Sources: Haver Analytics, IBGE, BCB, and Fund Staff calculations.

**Table 2. Brazil: Balance of Payments**  
(in billions of U.S. dollars, unless otherwise indicated)

	2017	2018	2019	2020	Proj.					
					2021	2022	2023	2024	2025	2026
<b>Current Account</b>	<b>-22.0</b>	<b>-51.5</b>	<b>-65.0</b>	<b>-25.9</b>	<b>7.1</b>	<b>-19.1</b>	<b>-38.3</b>	<b>-54.1</b>	<b>-64.5</b>	<b>-74.2</b>
Trade balance	57.3	43.4	26.5	32.4	76.1	63.4	55.9	49.7	50.0	50.8
Exports (fob)	218.0	239.5	225.8	210.7	281.2	280.4	279.9	283.6	294.0	304.4
Imports (fob)	160.7	196.1	199.3	178.3	205.2	217.0	224.1	234.0	244.0	253.6
Income, net	-41.0	-58.8	-56.1	-37.4	-48.6	-56.2	-62.6	-67.1	-73.1	-78.6
<b>Capital and Financial Account</b>	<b>17.5</b>	<b>52.8</b>	<b>64.7</b>	<b>22.8</b>	<b>-7.1</b>	<b>19.1</b>	<b>38.3</b>	<b>54.1</b>	<b>64.5</b>	<b>74.2</b>
Capital account	0.4	0.4	0.4	4.1	0.3	0.3	0.3	0.3	0.3	0.3
Financial account 1/	17.1	52.3	64.4	18.6	-7.3	18.8	38.0	53.8	64.3	73.9
Direct investment, net	47.5	76.1	46.4	48.1	57.9	64.8	69.5	72.8	75.9	74.3
Assets	21.3	2.0	22.8	-3.5	-3.2	-3.1	-2.6	-1.9	-0.9	-0.4
Liabilities	68.9	78.2	69.2	44.7	54.7	61.7	66.9	70.9	75.0	73.9
Portfolio investment, net	-17.7	-6.9	-19.2	-13.6	-13.5	-14.3	-13.0	-11.5	-9.7	-7.8
Financial Derivatives, net	-0.7	-2.8	-1.7	-5.4	-5.5	-5.8	-6.1	-6.4	-6.6	-7.3
Other investment, net	-6.9	-11.3	12.8	-24.7	-27.3	-25.8	-12.4	-1.2	4.7	14.6
Change in Reserve Assets, net	-5.1	-2.9	26.1	14.2	-19.0	0.0	0.0	0.0	0.0	0.0
<b>Errors and Omissions</b>	<b>4.6</b>	<b>-1.3</b>	<b>0.3</b>	<b>3.1</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Memorandum Items:</b>										
Gross reserves (eop) 1/										
In billions of U.S. dollars	374.0	374.7	356.9	355.6	353.4	353.4	353.4	353.4	353.4	353.4
Current account (in percent of GDP)	-1.1	-2.7	-3.5	-1.8	0.4	-1.0	-1.8	-2.3	-2.6	-2.8
Trade balance (in percent of GDP)	2.8	2.3	1.4	2.2	4.6	3.3	2.6	2.2	2.0	1.9
Merchandise exports (in percent of GDP)	10.6	12.5	12.0	14.6	16.9	14.4	13.2	12.3	11.8	11.5
Merchandise imports (in percent of GDP)	7.8	10.2	10.6	12.3	12.3	11.2	10.6	10.1	9.8	9.6
Export volume (yoy change, in percent)	5.4	3.5	-1.6	-1.2	4.1	4.7	2.2	1.7	3.5	3.4
Import volume (yoy change, in percent)	10.2	6.6	5.3	-7.7	4.2	7.9	5.1	4.2	4.0	3.8
Export price index (yoy change, in percent)	10.1	5.2	-3.9	-6.8	28.8	-3.6	-1.6	-0.1	0.3	0.3
Import price index (yoy change, in percent)	4.0	7.4	-4.5	-8.2	11.8	0.3	0.0	1.2	1.4	1.2
Terms of trade (yoy change, in percent)	15.6	-2.2	0.6	-7.0	15.1	-3.9	-1.6	-1.3	-1.1	-0.9
Oil price (Brent blend; US\$ per barrel)	52.8	68.3	61.4	41.3	58.5	54.8	52.5	51.3	50.7	50.5
Nominal exchange rate (R\$/US\$, annual average)	3.19	3.65	3.9	5.2	5.1	4.8	4.6	4.5	4.4	4.4
REER (annual average in percent; appreciation +)	8.5	-10.4	-1.8	-20.6	...	...	...	...	...	...
GDP in billions of U.S. dollars	2,064	1,917	1,878	1,445	1,666	1,943	2,116	2,309	2,488	2,649

Sources: Central Bank of Brazil; and Fund staff estimates and projections.

1/ Historical numbers include valuation changes.

Table 5. Brazil: Medium-Term Macroeconomic Framework

	2017	2018	2019	2020	Proj.					
					2021	2022	2023	2024	2025	2026
<b>MACROECONOMIC FRAMEWORK</b>										
(Percent of GDP, unless otherwise specified)										
GDP growth at constant prices (percent)	1.3	1.8	1.4	-4.1	5.3	1.9	2.0	2.1	2.1	2.1
Consumer prices (IPCA, end of period, percent)	2.9	3.7	4.3	4.5	5.8	3.7	3.3	3.0	3.0	3.0
Gross domestic investment	14.6	15.1	15.4	15.4	16.5	16.9	17.4	18.0	18.4	18.8
Private sector	12.3	13.0	13.3	12.7	14.5	14.6	15.1	15.8	16.2	16.6
Public sector	2.3	2.1	2.1	2.7	2.0	2.3	2.3	2.2	2.2	2.2
Gross domestic savings	13.6	12.7	12.5	15.0	16.9	15.9	15.6	15.7	15.8	16.0
Private sector	20.1	18.6	17.2	26.6	22.1	21.5	20.6	20.1	19.7	19.6
Public sector	-6.5	-5.9	-4.7	-11.6	-5.2	-5.6	-5.0	-4.5	-4.0	-3.6
External current account balance	-1.1	-2.7	-3.5	-1.8	0.4	-1.0	-1.8	-2.3	-2.6	-2.8
Central government primary balance	-1.8	-1.7	-0.9	-9.2	-1.7	-1.0	-0.3	0.2	0.7	1.2
Consolidated non-financial public sector										
Primary balance	-1.8	-1.7	-0.9	-9.2	-1.7	-1.0	-0.3	0.2	0.7	1.2
Overall balance	-7.9	-7.1	-5.9	-13.4	-6.3	-6.9	-6.2	-5.7	-5.2	-4.8
Public sector net debt 1/	51.4	52.8	54.6	62.7	63.9	66.4	69.4	71.8	72.6	74.6
General government gross debt, Authorities' definition	73.7	75.3	74.3	88.8	82.6	81.8	83.2	84.0	83.6	84.5
NFPS gross debt 2/	83.6	85.6	87.7	98.9	91.6	90.9	91.7	92.0	92.1	92.0
<b>EXTERNAL DEBT 3/ 4/</b>										
(Billions of U.S. dollars)										
<b>Total external debt</b>	<b>667.1</b>	<b>665.8</b>	<b>675.8</b>	<b>639.3</b>	<b>627.5</b>	<b>617.9</b>	<b>621.0</b>	<b>634.8</b>	<b>654.4</b>	<b>683.6</b>
Medium- and long-term	615.8	598.9	596.6	570.3	559.7	551.2	554.0	566.3	583.8	609.9
Nonfinancial public sector	197.7	181.7	184.5	173.4	170.2	167.6	168.4	172.1	177.5	185.4
Public sector banks	60.0	38.1	43.8	41.4	40.6	40.0	40.2	41.1	42.3	44.2
Private sector	409.4	446.0	447.5	424.6	438.1	456.6	482.1	512.9	547.7	587.8
Short-term	51.3	66.8	79.2	69.0	67.7	66.7	67.0	68.5	70.6	73.8
<b>Medium- and long-term external debt service</b>	<b>113.6</b>	<b>116.4</b>	<b>109.0</b>	<b>119.0</b>	<b>104.4</b>	<b>96.3</b>	<b>94.3</b>	<b>91.5</b>	<b>90.9</b>	<b>92.3</b>
Amortization	93.1	93.8	86.3	98.4	85.7	78.7	77.0	74.5	73.7	74.7
Interest	20.5	22.6	22.7	20.6	18.7	17.7	17.3	17.1	17.2	17.5
(Percent of GDP)										
<b>Total external debt</b>	<b>32.3</b>	<b>34.7</b>	<b>36.0</b>	<b>44.3</b>	<b>37.7</b>	<b>31.8</b>	<b>29.3</b>	<b>27.5</b>	<b>26.3</b>	<b>25.8</b>
Medium- and long-term	29.8	31.2	31.8	39.5	33.6	28.4	26.2	24.5	23.5	23.0
Nonfinancial public sector	9.6	9.5	9.8	12.0	10.2	8.6	8.0	7.5	7.1	7.0
Public sector banks	2.9	2.0	2.3	2.9	2.4	2.1	1.9	1.8	1.7	1.7
Private sector	19.8	23.3	23.8	29.4	26.3	23.5	22.8	22.2	22.0	22.2
Short-term	2.5	3.5	4.2	4.8	4.1	3.4	3.2	3.0	2.8	2.8
(Percent of gross international reserves)										
<b>Medium- and long-term external debt service</b>	<b>30.4</b>	<b>31.1</b>	<b>30.5</b>	<b>33.5</b>	<b>29.5</b>	<b>27.3</b>	<b>26.7</b>	<b>25.9</b>	<b>25.7</b>	<b>26.1</b>
Amortization	24.9	25.0	24.2	27.7	24.3	22.3	21.8	21.1	20.8	21.1
Interest	5.5	6.0	6.4	5.8	5.3	5.0	4.9	4.8	4.9	5.0
<b>Short-term debt</b>	<b>13.7</b>	<b>17.8</b>	<b>22.2</b>	<b>19.4</b>	<b>19.2</b>	<b>18.9</b>	<b>19.0</b>	<b>19.4</b>	<b>20.0</b>	<b>20.9</b>
<b>MEMORANDUM ITEMS:</b>										
Gross reserves (eop) 4/										
In billions of U.S. dollars	374.0	374.7	356.9	355.6	353.4	353.4	353.4	353.4	353.4	353.4
In percent of external short-term debt (maturity basis)	729.2	560.6	450.7	515.5	522.0	530.1	527.4	516.0	500.5	479.1
In months of prospective GNFS imports	16.8	16.7	18.4	14.9	14.8	14.1	13.4	12.7	12.7	12.1
In percent of external short-term debt (residual maturity)	257.7	244.7	200.9	229.8	241.5	246.0	249.8	248.6	243.2	235.9
Short-term debt in percent of total external debt	7.7	10.0	11.7	10.8	10.8	10.8	10.8	10.8	10.8	10.8
Intercompany debt (in billions of U.S. dollars)	227.8	238.6	250.7	244.1	260.9	282.2	306.8	333.7	363.0	394.8
In percent of GDP	11.0	12.4	13.3	16.9	15.7	14.5	14.5	14.4	14.6	14.9
GDP (billion US\$)	2,064	1,917	1,878	1,445	1,666	1,943	2,116	2,309	2,488	2,649

Sources: Central Bank of Brazil; and Fund staff estimates and projections.

1/ Includes assets, which mainly comprise international reserves, outstanding liabilities of public financial institutions to the Treasury, financial assets of public enterprises, and assets of the federal labor fund (FAT).

2/ Gross non financial public sector debt consolidates debt of public enterprises with that of general government.

Unlike the authorities' definition, gross general government debt comprises treasury bills at the central bank's balance sheet not used under repurchase agreements.

3/ Includes intercompany debt.

4/ Historical numbers include valuation changes.

**Table 6. Brazil: External Vulnerability**  
(in billions of U.S. dollars, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	Proj. 2021
<b>Trade</b>							
Exports of GNFS (12-month percent change, US\$)	-15.2	-2.8	16.1	8.9	-5.4	-8.0	34.1
Imports of GNFS (12-month percent change, US\$)	-23.7	-16.3	14.7	14.6	0.6	-15.3	16.5
Terms of trade (12-month percent change)	-11.0	3.0	15.6	-2.2	0.6	-7.0	15.1
<b>Current account</b>							
Current account	-54.8	-24.5	-22.0	-51.5	-65.0	-25.9	7.1
In percent of GDP	-3.0	-1.4	-1.1	-2.7	-3.5	-1.8	0.4
<b>Capital and financial account</b>							
Capital Account	57.1	16.4	17.5	52.8	64.7	22.8	-7.1
Financial Account	0.5	0.3	0.4	0.4	0.4	4.1	0.3
Portfolio investment (net)	56.6	16.1	17.1	52.3	64.4	18.6	-7.3
Foreign direct investment (net)	17.8	-20.0	-17.7	-6.9	-19.2	-13.6	-13.5
Of which: intercompany loans (net)	61.6	59.6	47.5	76.1	46.4	48.1	57.9
Short-term external liabilities of commercial banks	23.7	25.7	4.8	16.5	3.5	2.8	15.4
External debt	42.7	46.8	42.1	45.6	60.0	51.5	50.5
Total external debt 1/	664.4	675.8	667.1	665.8	675.8	639.3	627.5
In percent of gross reserves	186.4	185.2	178.4	177.7	189.4	179.8	177.5
Amortization of external MLT debt (in percent of GNFS exports)	51.2	52.2	42.7	39.2	38.2	46.7	30.5
External interest payments (in percent of GNFS exports)	9.8	10.3	9.4	9.4	10.1	9.8	6.6
<b>Reserves</b>							
Gross reserves	356.5	365.0	374.0	374.7	356.9	355.6	353.4
In months of prospective GNFS imports	21.0	18.8	16.8	16.7	18.4	14.9	14.8
In percent of broad money (M2)	28.9	21.9	21.8	23.7	21.6	23.4	19.1
In percent of short-term external debt (maturity basis)	241.8	244.2	257.7	244.7	200.9	229.8	...
In percent of IMF metric	192.2	167.0	160.8	167.8	157.7	...	...
<b>Exchange rate</b>							
Exchange rate (R\$/US\$, period average)	3.33	3.49	3.19	3.65	3.94	5.16	5.14
REER (annual average in percent; appreciation +)	-17.7	4.9	8.5	-10.4	-1.8	-20.6	...

Sources: Central Bank of Brazil; Bloomberg; and Fund staff estimates.

1/ Includes intercompany loans.

## Annex I. External Sector Assessment

<p><b>Overall Assessment:</b> <i>The external position in 2020 was broadly in line with the level implied by medium-term fundamentals and desirable policies.</i> In the wake of the COVID-19 shock, the current account deficit contracted due the large currency depreciation and improvements in the service and income balances. The trend is expected to persist in 2021.</p> <p><b>Potential Policy Responses:</b> Policies that would help keep the current account in line with its norm include desirable fiscal consolidation, accompanied by measures to support public and private investment, including supply side reforms to support a more competitive economy</p>							
<b>Foreign Asset and Liability Position and Trajectory</b>	<p><b>Background.</b> Brazil's NIIP was -38.3 percent of GDP at end-2020, moderately stronger than at end-2019 (-42 percent of GDP) mainly due to valuation effects associated with the currency depreciation (assets are predominantly denominated in FX while liabilities are more concentrated in local currency). At end-2020, external debt declined by about 5 percent in nominal terms compared to 2019, accounting for about 44.3 percent of GDP and 303 percent of exports, against a value of 36 percent of GDP and 299 percent of exports in 2019, with the large increase in the external debt to GDP ratio in 2020 driven by the significant output contraction when measured in USD.</p> <p><b>Assessment.</b> Brazil's NIIP has been negative since 2001. Short-term gross external financing needs are significant, at around 11 percent of projected 2021 GDP, with capital flows and the exchange rate particularly sensitive to global financing conditions.</p>						
2020 (% GDP)	NIIP: -38.5	Gross Assets: 63.5	Res. Assets: 25.0	Gross Liab.: 102.0	Debt Liab.: 44.6		
<b>Current Account</b>	<p><b>Background.</b> The CA deficit contracted from -3.5 percent of GDP in 2019 to -1.7 in 2020 due to improvements in the trade, service, and income balances, supported, respectively, by the currency depreciation, the contraction in tourism and transport service imports and lower distribution of profits and dividends. In 2021, the trade balance is expected to continue improving on the back of a recovery in economic activity in trading partners that would boost exports, more than offsetting the rebound in imports. Overall, staff projects a CA balance of about -0.4 percent of GDP for 2021.</p> <p><b>Assessment.</b> In 2020, the cyclically adjusted CA deficit was -1.8 percent of GDP. EBA estimates suggest a CA norm in 2020 of -2.4 percent of GDP. Staff assesses a CA norm between -1.9 and -2.9 percent of GDP. Thus, after adjusting for the transitory impacts of the COVID-19 crisis on the oil, travel services, including tourism, and medical goods sectors (resulting in an impact on the CA balance of 0.3 percent, -0.3 percent and 0.1 percent of GDP, respectively), the staff CA gap is assessed at 0.7 percent of GDP. The medium-term outlook for the CA is still difficult to assess given the unfolding COVID-19 crisis and related policy response.</p>						
2020 (% GDP)	CA: -1.7	Cycl. Adj. CA: -1.8	EBA Norm: -2.4	EBA Gap: 0.6	COVID-19 Adj.: 0.1	Other Adj.: 0	Staff Gap: 0.7
<b>Real Exchange Rate</b>	<p><b>Background.</b> After remaining broadly stable in 2019 (-1.9 percent), the REER depreciated sharply in 2020 (-20.6 percent), driven by large capital outflows in the first half of the year. Depreciation pressures have subsided since mid-May 2020.</p> <p><b>Assessment.</b> The staff CA gap implies a REER gap of -5.4 percent in 2020 (applying an estimated elasticity of 0.13). The REER index (-36.5 percent) and level (-21.2 percent) methodologies point to some possible overshooting of the nominal exchange rate. Overall, staff assesses the REER gap at end-2020 to be closer to the REER gap implied by the staff CA gap. Therefore, considering the CA norm standard deviation of 0.8 percent, staff assesses the REER gap to be in the range of -11.4 to 0.6 percent, with a mid-point of -5.4 percent (undervaluation).</p>						
<b>Capital and Financial Accounts: Flows</b>	<p><b>Background.</b> Net FDI has fully financed CA deficits since 2015 (averaging 3.2 percent of GDP during 2015-20, while CA deficits averaged -2.2 percent), despite net portfolio outflows (0.6 percent of GDP on average during 2015-20). In 2020, net FDI stood at 3.5 percent of GDP, against a CA deficit of 1.7 percent. Net portfolio outflows accelerated sharply in the first half of the year before easing in the third quarter and then partly recovering in the fourth quarter, recording a balance of -0.9 percent of GDP over the year (-1 percent of GDP in 2019). Net FDI was stronger than in 2019, due to divestment abroad that more than compensated lower FDI inflows.</p> <p><b>Assessment.</b> The composition of capital flows is expected to remain favorable over the medium-term with positive net FDI inflows outweighing negative portfolio outflows which started in 2016 following the sovereign's downgrade below investment grade. Nevertheless, the high degree of uncertainty about the scarring effects of COVID-19 on the global economy make it challenging to assess the medium-term prospects for capital flows. A renewed spike in international risk aversion, potentially linked to a second wave of COVID-19, or a sudden tightening of global financing conditions could trigger a new bout of capital market volatility.</p>						
<b>FX Intervention and Reserves Level</b>	<p><b>Background.</b> Brazil has a floating exchange rate. To dampen exchange rate volatility associated with the COVID-19 shock, in 2020 the Central Bank sold USD 21.2bn in the spot and repo markets and increased the stock of outstanding FX swaps by USD 23.3bn (the latter does not directly affect the level of reserves given they are settled in local currency). Nevertheless, reserves remain high at US\$334 billion at end-2020.</p> <p><b>Assessment.</b> The flexible exchange rate has been an important shock absorber. Reserves are adequate relative to various criteria including the IMF's reserve adequacy metric (161 percent as of end-2020) and serve as insurance against external shocks. The authorities should retain strong external buffers, with intervention limited to addressing dysfunctional conditions in FX markets.</p>						

## Annex V. Implementation of Key FSAP Recommendations<sup>1</sup>

Brazil: Key FSAP Recommendations		
Recommendations	Time	Authorities' Actions
<b>Microprudential and macroprudential institutional arrangements</b>		
Establish a multi-agency high-level committee, with an explicit mandate for macroprudential policy and the power to issue policy recommendations on a comply-or-explain basis.	ST (Short Term)	The BCB has—in agreement with CVM, Previc and SUSEP – finalized a draft bill named the “Financial Stability Coordination Law”, which is now being <del>discussed with</del> <del>analyzed by</del> the <del>Ministry Office</del> of <del>the President’s Chief of Staff (Casa Civil)</del> <u>Economy</u> .
Strengthen the crisis management institutional arrangements for inter-agency cooperation and exchange of information, including for contingency planning.	MT (Medium Term)	This proposal is directly related to the above-mentioned “Financial Stability Coordination Law”. According to the draft bill proposed by BCB, the “Financial Stability National Committee” would have authority over macroprudential policy and crisis management (including contingency plans/crisis management). The BCB’s Contingency Plan has already been implemented.
Strengthen legal protection of all supervisors (BCB, SUSEP) through clear rules, including fixed term, condition of dismissal, public disclosure of reasons for dismissal and qualification criteria for appointments. Strengthen the independence of the BCB.	ST	<p>Two bills of law that tackle BCB autonomy are currently under discussion in Congress. One bill has been approved by the Senate, which addresses the Central Bank mandate, including the criteria for the appointment and the dismissal of Governors, and sets four-year tenures (with one renewal) for the Board of Governors. Their tenures do not match the presidential term to avoid a wholesale change whenever a President is elected.</p> <p>This bill has moved to the lower house. The second bill, submitted to the lower house, is broader and proposes legal protection of BCB staff, defines aspects of operational autonomy, addresses the delegation of decisions about other monetary policy and macroprudential tools from CMN to BCB, and enhances policy transparency, such as through the publication of inflation and financial stability reports. This bill has stalled due to COVID and has yet to be evaluated in the specialized committees before a plenary vote.</p> <p>The Bank Resolution bill – submitted to the lower house and currently being discussed by a special congressional committee – also provides for protection of public agents. As it stands, this bill includes both a provision for legal protection of public agents and for legal defense by the General Counsel on BCB expenses.</p> <p>The insurance supervisor (SUSEP) Board has drafted a bill to merge SUSEP with the pension funds supervisor (Previc), addressing, among other issues, the structure of the new authority. This draft bill has not yet been approved by Congress. However, it is worth noticing that the Decree n° 9.727/2019 has established qualification criteria for appointments to strategic positions in the Administration.</p>
Increase resources of CVM and SUSEP.	ST	The CVM budget was reduced to R\$ 22 million during 2019 from R\$ 30.5 million at the beginning of the year. The total discretionary budget for 2020 was R\$ 27.7 million, <del>and the expected</del> budget for 2021 <u>currently amounts to was</u> R\$ <del>2631.3</del> million.

<sup>1</sup> The description of authorities' actions in this table was compiled by the Brazilian authorities.

## Brazil: Key FSAP Recommendations (Concluded)

Recommendations	Time	Authorities' Actions
<b>Financial integrity</b>		
Complete the national AML/CFT risk assessment and introduce a risk-based approach specific to AML/CFT supervision.	ST	The coordination of the activities related to the National AML/CFT Risk Assessment is attributed to the Brazilian Intelligence Unit (Coaf). The decree to establish the Strategic Committee for the National AML/CFT Risk Assessment was issued on March 6, 2020.
<b>Financial intermediation efficiency</b>		
Foster competition through client mobility and financial product cost transparency and comparability.	ST	<p>The National Monetary Council issued Resolution 4,639/2018 to enhance the portability of salaries' accounts.</p> <p>The Credit Registry Law, Lei do Cadastro Positivo, in effect since 2011, was amended by Lei Complementar 166/2019, and regulated by Resolution 4,737/2019, to adopt the opt-out model instead of the opt-in model.</p> <p>Resolution 4,734/2019 and Circular 3,952/2019 set rules for registering and blocking credit and debit card receivables pledged as collateral in credit operations. With these measures, the volume of blocked receivables cannot exceed the outstanding balance of the transaction, which precludes a previous practice of totally blocking the receivables. Moreover, it allows retailers to discount their receivables at any financial or accrediting institution of their choice.</p> <p>The set of credit modalities eligible for portability between institutions now comprises credit granted to individual microentrepreneurs (before restricted to individuals). Resolution 4,762/2019 already allows credit portability for legal entities, but it depends on enacting a specific rule (Circular). Additionally, different credit modalities can be the destination of ported credit, providing a larger menu of options to financial customers. This allows, for instance, the portability of revolving credit operations into personal credit lines, with a fixed number of installments. It might foster the contribution of new entrants and incumbent institutions that do not operate with the original credit modality to a greater competition in the Brazilian credit market.</p>
<b>Reform of public banks</b>		
Change product offering of BNDES under new strategy with focus on catalyzing private sector finance and developing the financial sector.	ST	<p>In December 2019, BNDES launched a new planning and communication tool for strategic agendas and deliveries: the 2020-2022 <del>Triennial</del><u>three-year</u> Pplan. This is based on three main pillars: financial sustainability, focus on social development and divestments of the equity portfolio.</p> <p>In terms of financial sustainability, with the Long-Term Rate (TLP) in force and its market convergence from 2023 forward, and a deleveraging policy of continued prepayments of the loans from the National Treasury, the bank has been structured to seek new funding alternatives. This policy also includes developing strategies for syndication of transactions, bringing in more players to fund the projects alongside BNDES, as well as adjusting its loan agreements in order to allow securitization in the future.</p> <p>BNDES started divestments in 2019, in a very cautious manner in order to reduce its risk limit by 90% up to December 2022. In 2020 from January to September, BNDES has divested around R\$33.7 billion in equity positions including, Petrobras (R\$ 22 billion) and Vale (R\$ 8.1 billion).</p>

Brazil: Key FSAP Recommendations (Continued)		
Recommendations	Time	Authorities' Actions
		<p>Regarding FAEP, the provisional act has lapsed without approval of Congress. Nevertheless, BNDES is still focused and committed to support the States and Municipalities in their privatization efforts, providing project preparation services in all modalities, including concessions, public-private partnerships (PPP) and privatizations, and sharing knowledge with the public sector. As of September 2020, there were 74 projects being structured by BNDES in its portfolio: 31 federal, 30 state and 13 at municipal level in several sectors such as water and sanitation, ports, highways, street lighting, power distribution among others. A successful auction has occurred in the sanitation sector, with the participation of many private players in the bidding process, and the major part of the portfolio is expected to be auctioned by 2022.</p> <p>Strategic guidelines for this topic include contributions to the financial sustainability of the entities <a href="#">in the</a> Federation, promoting regulatory security for leverage investments and competitive auctions, and supporting the public sector in structuring long-term partnerships to make feasible private investments in projects of public interest. The bank is also stimulating the opening of the Brazilian infrastructure market, promoting the entry of new national and international players, including operators and financial investors.</p> <p>Regarding the capital markets initiatives, in the second semester of 2019 Fund Manager for the Infrastructure Bonds Special Purpose Vehicle (FDIC Debêntures de Infraestrutura) was selected. However, due to the interest rate curve structure in 2020, the fund is currently not active.</p> <p>(ii) On the other hand, the Sustainable Energy Fund, launched in 2016 and implemented in 2018, with assets under management of R\$500 million in infrastructure projects private bonds related to a low-carbon economy, is currently in its investment phase. Since it was launched over 50 primary investment opportunities for the Fund's portfolio have been analyzed, resulting in the subscription of 12 different project debentures. The annualized return (last 12 months) was 19.4% per year and the annualized volatility (last 12 months) was 3.95% per year. The fund's annualized return, from Sep / 2018 to Dec / 2019, was 18.85% per year.</p> <p>(iii) A new and relevant initiative in the Brazilian Capital Markets was launched in May 2020: an RFP process for the selection of FDICs for SMEs as one of the emergency measures to support SMEs during the COVID crisis. The Bank pre-selected 12 FDICs, of which 10 will receive funds up to R\$5 billion to offer credit for small businesses, helping to diversify the fund sources and improve access to credit.</p>
Focus Caixa on core activities, improve governance, and invite a strategic investor.		<p><b>Focus Caixa on core activities:</b></p> <p>CAIXA is repositioning its credit operations, prioritizing the granting of loans to the segments linked to microenterprises, to the promotion of housing loans, maintaining its operations in "Minha Casa Minha Vida" and expanding operations to the middle class through resources from savings and increase in the payroll loans portfolio.</p> <p><b>Improve governance:</b></p> <p>CAIXA continues to improve its corporate governance practices, seeking to become a reference in the adoption of good management strategies, in line</p>