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November 23, 2020

**Statement by Ms. Grant, Ms. Johnson, and Mr. Yoo on Brazil
(Preliminary)
Executive Board Meeting
November 25, 2020**

We thank staff for their comprehensive report and Mr. Bevilaqua for his helpful Buff statement. The Brazilian economy has been sluggish since the 2015-16 recession and has been severely affected by the pandemic, with a sharp contraction in GDP and significant job losses. We commend the authorities for the swift and sizeable measures to support the economy and protect the vulnerable but note that risks from the pandemic remain high for Brazil. We agree that policy priorities include safeguarding lives and livelihoods and implementing structural reforms to ensure a robust and inclusive economic recovery.

Given the sizeable economic support measures, the authorities should carefully frame the transition and plan an exit strategy towards recovery, informed by economic outcomes. We welcome authorities' commitment to maintain the expenditure ceiling, but note that the implementation of structural reforms including by reducing mandatory spending and budget rigidities, rationalizing social protection programs, reforming subnational pensions, and introducing medium-term fiscal and budget frameworks will also help to secure medium-term fiscal sustainability. We welcome the authorities' willingness to consider providing additional fiscal support if the economic recovery is weaker than expected. As the recovery is subject to considerable risks and uncertainty, continued close engagement by staff and collaboration with the authorities seems warranted, taking into account Brazil's specific circumstances. While there is the potential risk from the fiscal cliff when the emergency fiscal support measures such as the Emergency Aid (EA) and the employment retention schemes are unwound, accumulated private savings may buffer the negative effect by helping to sustain private consumption. *Staff's view on the macroeconomic effect of Brazil's fiscal support measures during the crisis and their expiration is welcome.*

Structural reforms should be prioritized to improve the competitiveness and productivity of the Brazilian economy. Longstanding vulnerabilities such as low potential

growth and income inequality have constrained Brazil's growth performance. But the political realities, size and difficulty of such reforms should not be underestimated. Tax reform and labor market reforms are notoriously difficult. Prioritizing reforms that are achievable in the current uncertain environment and considering Brazil's fiscal position - such as finalizing trade agreements, targeting of civil service payroll, pension reforms, strengthening governance and safeguards to corruption - will help build credibility and maintain market confidence. Strengthening governance and combating corruption is a priority, including preparations for the upcoming FATF/GAFILAT AML/CFT assessment and strengthening the framework for asset disclosures.

Monetary policy is appropriately accommodative and progress is being made on financial sector reforms. The Central Bank of Brazil has room to cut the policy rate further, continues to use forward guidance and has the power to conduct asset purchases for financial stability purposes. We agree that monetary policy will be an important support to the economy when fiscal stimulus is withdrawn in 2021. De jure Central Bank independence would further strengthen the integrity of the monetary policy framework and we urge the authorities to secure approval of the Central Bank Independence Bill in the Lower House as soon as possible. We also welcome the progress made so far in implementing financial sector reforms recommended in the 2018 FSAP and look forward to further progress in the areas listed in Annex I and X.

The external sector has recovered but capital outflows should be carefully monitored. The flexible exchange rate remains a key shock absorber while the authorities have intervened in FX spot and derivative markets in disorderly conditions. While FX reserves are sufficient to preserve financial stability, it is noted that the banking sector is sensitive to large depreciations given banks' open FX positions. *What is staff's view on the potential disruption from this sensitivity? What measures would staff recommend to prevent disruptive capital outflows and reduce excessive pressure on the currency in the context of the Integrated Policy Framework?*