GRAY/20/3470

November 23, 2020

Statement by Mr. Ronicle and Mr. Chrimes on Brazil
(Preliminary)
Executive Board Meeting
November 25, 2020

Thank you to staff for the useful paper and to Mr. Bevilaqua for his informative buff statement.

While we are pleased that Brazil's growth performance in 2020 seems to be better than staff previously feared, the drop in output is substantial and the recovery is projected to be gradual. Neither the challenges associated with COVID-19 nor the underlying factors which have held back the economy in recent years should be taken lightly. Policies to address pandemic-related problems and begin the recovery will need to be both responsible and responsive, adapting as the situation evolves, while not losing sight of Brazil's pre-COVID structural issues or the authorities' reform efforts.

We share staff's view that the authorities' package of economic support during the COVID-19 outbreak amounted to a "rapid and effective response". The system of cash transfers to informal workers and poorer households was a notable success. Liquidity support and capital relief measures also seem to have been well-targeted and effective. Monetary policy has been loosened, but inflation still remains below target. Taken together, the measures have helped soften the negative economic impact of the disease.

Nonetheless, in staff's assessment there is a large negative output gap that will take four years to close on current policies. We think staff's message on this could have been more proactive: there are obvious advantages to closing the output gap more quickly. While there are clear trade-offs, articulated by both staff and the authorities, around looser fiscal policy, parallel arguments for monetary policy are not really substantiated in the report. Policy space exists in the form of conventional policy rates, forward guidance and asset purchases; inflation and inflation expectations are at the lower boundary of the target range. Closing the output gap sooner through further monetary easing would strengthen the public finances, help people return to work and reduce the extent of scarring. The report's message could have been much clearer on near-term support if it was more consistent in advocating using monetary policy as the preferred marginal instrument for supporting demand, with fiscal policy reserved as a backstop if needed. We understand there are other considerations associated with more supportive monetary policy, but the paper does not elaborate on these. *We note that the BCB see trade-offs in easing monetary policy; could staff comment further on these concerns, which make the BCB wary of further interest rate cuts?*

Striking the right balance on fiscal support in the coming months is a difficult and important judgment. How the health and economic situation evolve should inform policy. While we applaud the authorities' intentions to remain within the expenditure ceiling in 2021, staff point out that the virus has not yet been brought under control; protecting lives and livelihoods should remain an overarching priority. Within the expenditure ceiling, that points to prioritizing health and social safety net spending, and refining the efficiency and targeting of that support.

Structural reforms to put medium-to-long term growth on a higher trajectory will also be an important objective, and the authorities have made some significant progress. We support those efforts, including the historic pensions reform, as well as tax and administration initiatives and the Federative Pact. At the same time, we recognize the legislative and capacity constraints facing the authorities in Brazil, in common with many other countries. We agree that the social safety net should be strengthened further, and that this need not necessarily add to costs. We encourage further trade and investment liberalization, and welcome plans to join the WTO's Government Procurement Agreement; like staff, we hope for an ambitious market access proposal. We concur that addressing corruption should remain a focus. We are also supportive of efforts to bolster the BCB's independence, including through security of tenure for the Governor: such measures will help cement the strong record of independence demonstrated in recent years.

We urge the authorities to ensure the recovery helps to lock in greener and more sustainable growth. We understand that deforestation last year was at its highest rate in over a decade; this is likely to have a negative impact on Brazil's economic objectives through several channels. Notably, in addition to the many livelihoods directly dependent on the sustainability of the Amazon, international investors are increasingly concerned about the ecological credentials of their supply chains. We strongly welcome the BCB's new sustainability pillar, an important step towards future financial systems properly incorporating climate risks, as well as supporting markets to identify green investments in Brazil through the sustainable finance agenda. A roadmap for meeting the ambitious timetable for mandatory climate-related financial disclosures would be a helpful next step. We encourage staff to consider more detailed reporting on climate and environmental issues in future Brazil Article IVs: preserving the country's unique ecological advantages and promoting low carbon growth are critical for Brazil's domestic economy as well as for the world as a whole.