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Statement by Mr. Andrianarivelo, Mr. N'Sonde, and Mr. Sidi Bouna on Brazil (Preliminary)
Executive Board Meeting
November 25, 2020

We thank staff for an insightful set of reports and Mr. Bevilaqua for his informative Buff statement.

The pandemic continues to have a severe impact on Brazil amid elevated uncertainty. The economy is forecast to contract sharply in 2020 causing inflation to drop well below the central bank target, and unemployment to rise. At the same time, the primary fiscal deficit has widened significantly, pushing the country's debt ratios substantially higher. We commend the authorities for their rapid and robust response to the crisis. While the economy is showing early signs of recovery, further fiscal and monetary stimulus might be needed in 2021 as the outlook remains extremely uncertain. In addition, elevated debt levels are weighing on the country's downside risks, underscoring the need for appropriate policy actions to preserve debt sustainability. The pandemic has also delayed the implementation of major structural reforms, and we would like to encourage the authorities to resume their reform agenda as soon as possible to strengthen the economy's resilience to shocks.

The authorities should stand ready to provide additional fiscal stimulus next year while safeguarding debt sustainability. Should the economic recovery in 2021 end up weaker than currently anticipated and the effects of the pandemic linger, additional fiscal support would be needed. We welcome the authorities' commitment to maintaining the expenditure ceiling in the 2021 budget. However, preserving the ceiling will require further reallocation of resources. We encourage the authorities to advance key fiscal structural reforms within the four pillars outlined by staff, including measures to reduce mandatory spending and strengthen social safety net programs. We also agree that further actions to consolidate the budget over the medium term will be necessary to eliminate the primary deficit and preserve debt sustainability.

The central bank should continue to support the recovery and closely monitor the financial system. The monetary authorities should be commended for rapidly easing their policy stance early in the crisis and providing adequate liquidity to the banking system, notably by reducing the policy rate and banks' reserve requirements. *We note the staff's assessment that there is room for further lowering the policy rate given that inflation remains well below target. However, at the same time, staff consider the current monetary policy stance to be "strongly expansionary." Given the extremely uncertain outlook, as well as the potential impact of very low interest rates on asset price instability, as highlighted by Mr. Bevilaqua in his Buff statement, we wonder whether the authorities' more cautious approach regarding the need for further policy rate cuts would not be warranted. Staff comments are welcome.* That said, the impact of the changes in policy rate on the exchange rate and on capital flows should be monitored closely. We also welcome the evidence of continued resilience of the financial system despite the crisis. The banks' conservative approach on loan provisioning has been appropriate. The central bank should continue to monitor closely the financial system while using to the fullest extent the flexibility in the current regulatory framework.

Advancing structural reforms is needed to increase the country's potential growth while enhancing resilience to shocks. We agree with the priority areas highlighted by staff, in particular the need for a comprehensive tax reform in order to improve the business climate and reduce inequality, the conclusion of trade agreements currently under consideration with the main trading partners, and the pursuit of the restructuring of state-owned enterprises. We also urge further progress in strengthening the AML/CFT framework.

With these remarks, we wish the authorities success in their endeavors.