Development and Counter-Cyclical Policies in Brazil

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Economic Policy Response in 2008-09

➢ The Brazilian government already had a set of development policies in place when the crisis hit the economy.

➢ The main initiatives can be organized in three groups:
  ➢ Structural policies initiated before the crisis
  ➢ Temporary policies initiated during the crisis
  ➢ New structural policies initiated during the crisis

➢ Exit strategies: temporary does not necessarily mean a short period of time.
Main structural policies initiated before the crisis

Direct impact in 2009:

➢ Increase in income transfers to households (social security + minimum wage + poverty reduction = social safety net): +0.8% of GDP in 2009.

➢ Increase in public investment: +0.6% of GDP.

➢ Tax cuts and financial incentives to increase private investment: +0.2% of GDP.

➢ Restructuring of the federal government’s payroll expenditures, careers and wages: +0.3% of GDP.
Main temporary policies initiated before the crisis

FX and money markets

- Increase in the supply of FX to Brazilian firms by the Brazilian Central Bank: US$ 24.5 billion in export credit, US$ 14.5 billion in the spot market and US$ 45.3 billion in swaps.

- Reduction in banks’ reserve requirements (BRL 117 billion): 3.9% of GDP.

- Special credit facilities at the National Development Bank (total value = R$ 100 billion): 3.3% of GDP.

- Increase in the credit supply by the two main public commercial banks (Banco do Brasil and Caixa).
Temporary policies initiated before the crisis

Fiscal Policy

- Tax cuts in indirect taxes to increase consumption and investment (0.3% of GDP)
- Interest-rate subsidies to increase investment (zero real interest rate on a maximum of BRL 42 billion in loans, 1.2% of GDP, to finance investment in capital goods)
- Extraordinary budget transfers to state and local governments (0.2% of GDP)
- Expansion in the value and coverage of unemployment insurance (from three to nine months).
New structural policies initiated during the crisis

- Introduction of intermediary income brackets in the personal income tax (0.2% of GDP)
  - Before 2009: zero, 15% and 27.5%
  - Since 2009: zero, 7.5%, 15%, 22% and 27.5%

- New housing program aimed at the poor and low-middle income families
  - 1.2% of GDP in subsidies and incentives, in three years.
  - Target: build one million additional units.
Macroeconomic debates

Inflation and monetary policy:

➢ Did we do too much? Is the economy overheating? Demand-pull or cost-push inflation?

Budget balance and public debt:

➢ What is the trend? Is it sustainable?

Exchange rate balance of payments:

➢ How low can the BRL/USD exchange rate go? Should we worry about the current account deficit?
Net Public Debt
(in % of GDP)

* Projections.
Sources: BCB and IBGE
Elaborated by: MF/SPE
International Financial Fragility
(numbers in % of GDP)

Source: BCB.
Elaborated by: MF/SPE.
And about financial regulation ...

The Brazilian case:

- Too big to fail: large banks are not necessarily a problem with good regulation and resolution authority.

- Leverage and financial innovation: high capital and reserve requirements, no CDS, conservative loan to value ratios, no shadow banking and limited space to originate and distribute.

- Derivatives and risk exposure: registration and supervision should cover all parts involved, financial and non-financial.
Annex: examples of the impact of government policies in Brazil
Public Investment
(Federal Administration and Federal State Enterprises in % of GDP)

* Excludes foreign investments and forecast for 2010.
Sources: MF/STN and MP/DEST.
Elaborated by: MF/SPE
Banks’ reserves
(in % of GDP)

Quantitative tightening

Quantitative easing

*/ Projections for GDP in March.
Source: BCB. Elaborated by: MF/SPE
Residential Investment
(construction of new units hired through the financial system)

New Housing Program + 94.7%

Source: CEF
Graph by: MF/SPE