Development and Counter-Cyclical Policies in Brazil

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19th Annual Hyman P. Minsky Conference on the State of the US and Word Economies, New York City, April 16, 2010

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 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:

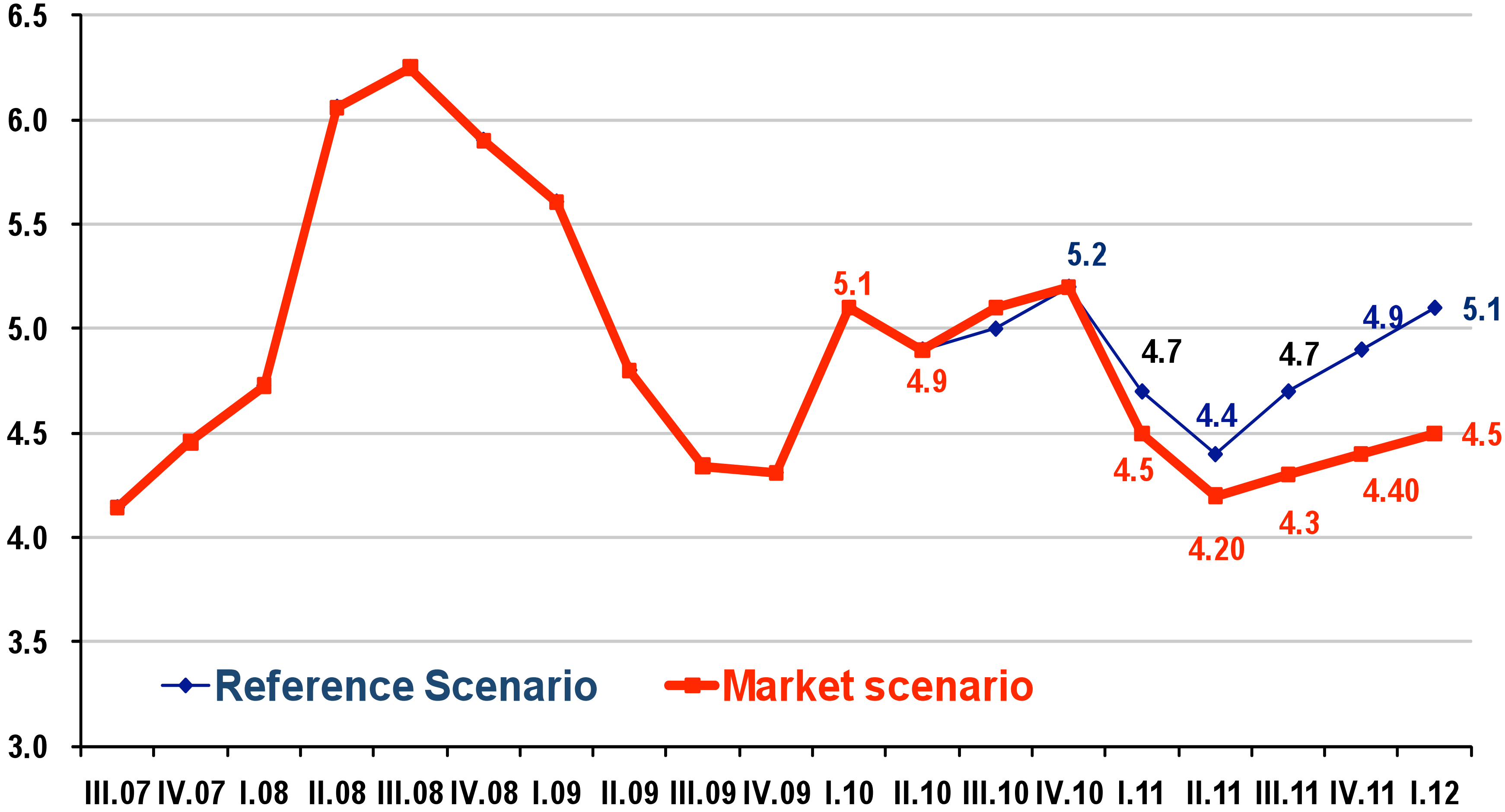
- What is the trend? Is it sustainable?

Exchange rate balance of payments:

- How low can the BRL/USD exchange rate go? Should we worry about the current account deficit?

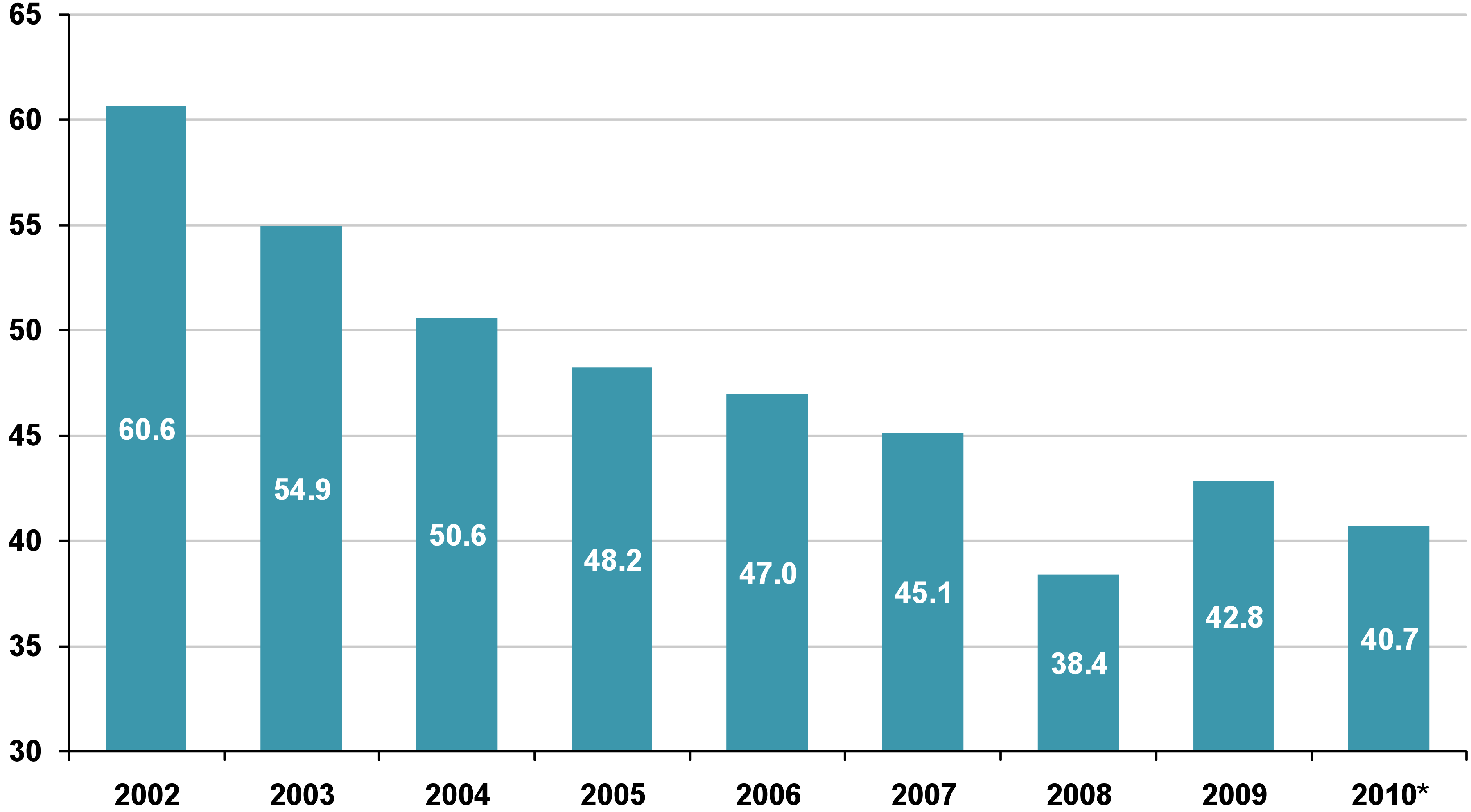
Consumer Inflation

(% change in the IPCA index OYA)



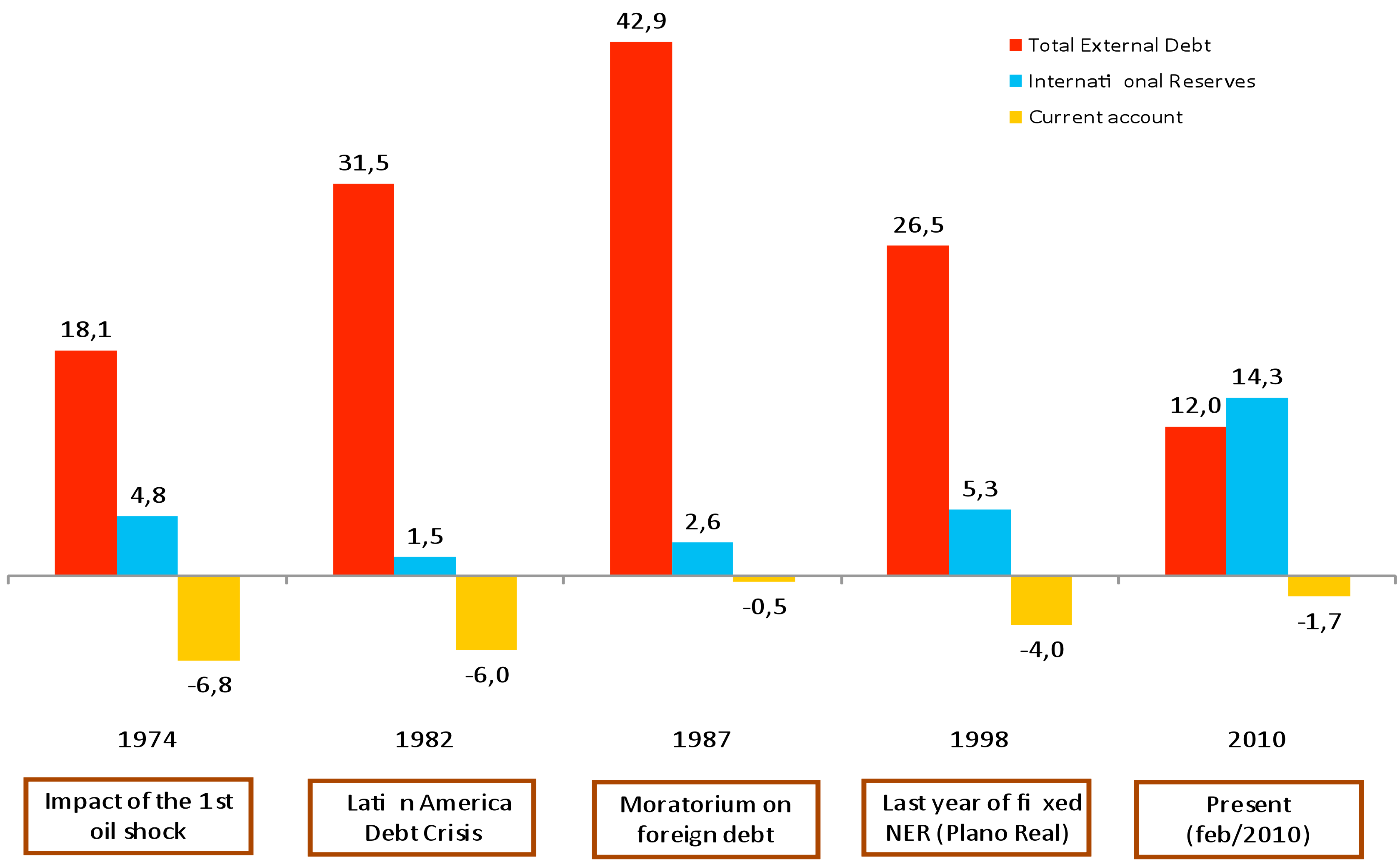
Source: BCB. Elaborated by: MF/ SPE

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 …

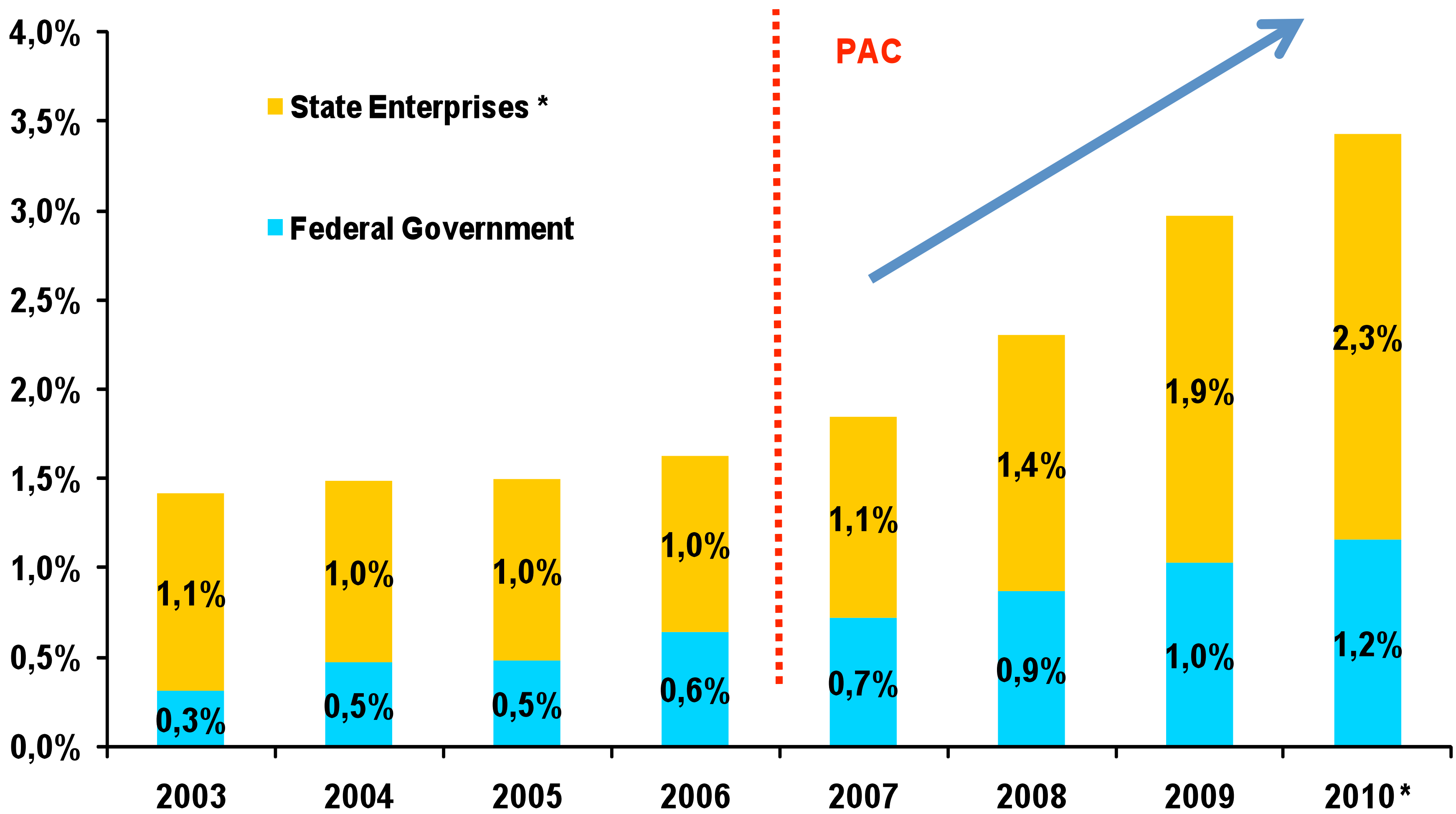
The Brazilian case:

- 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

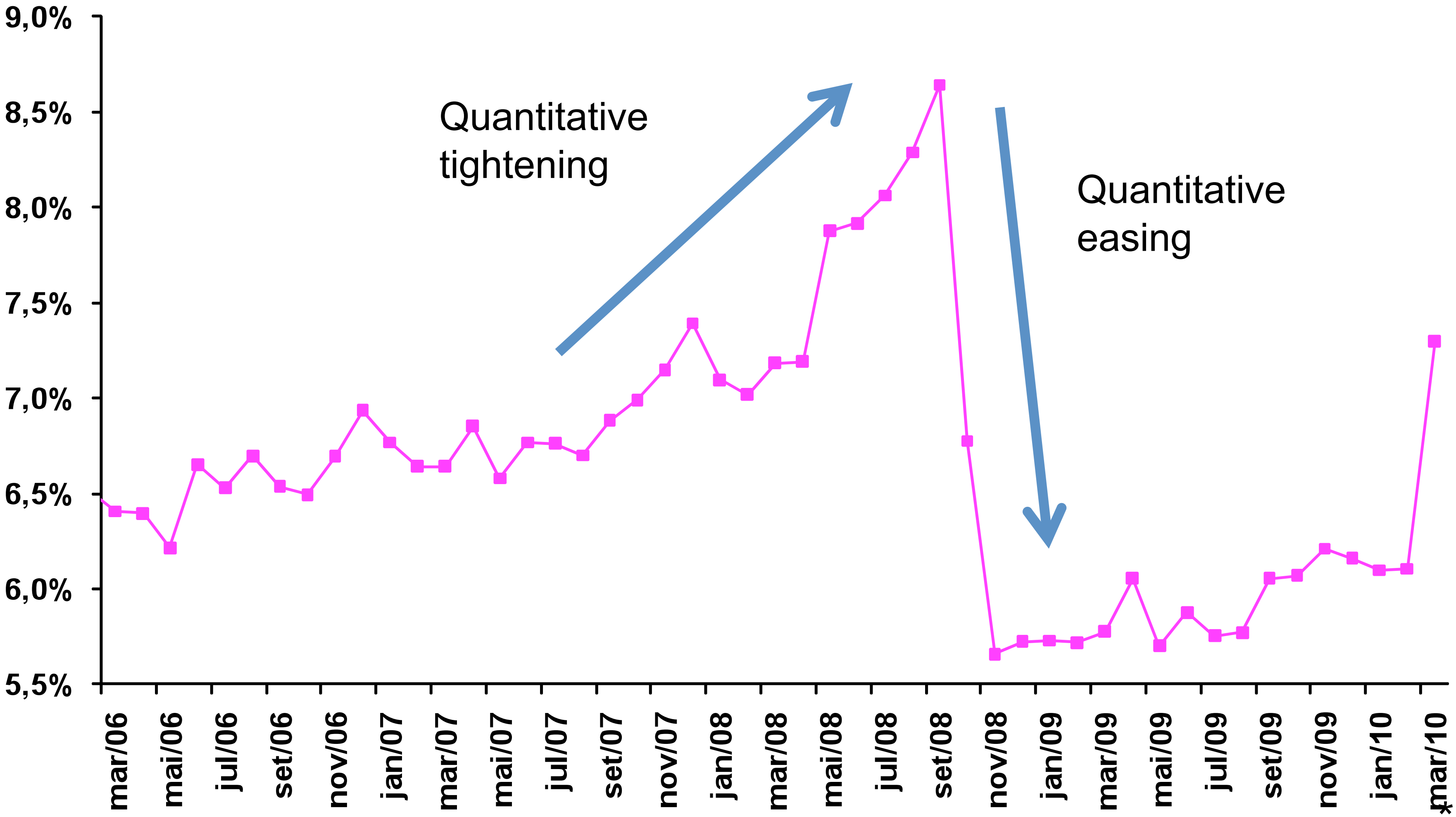
Public Investment

(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

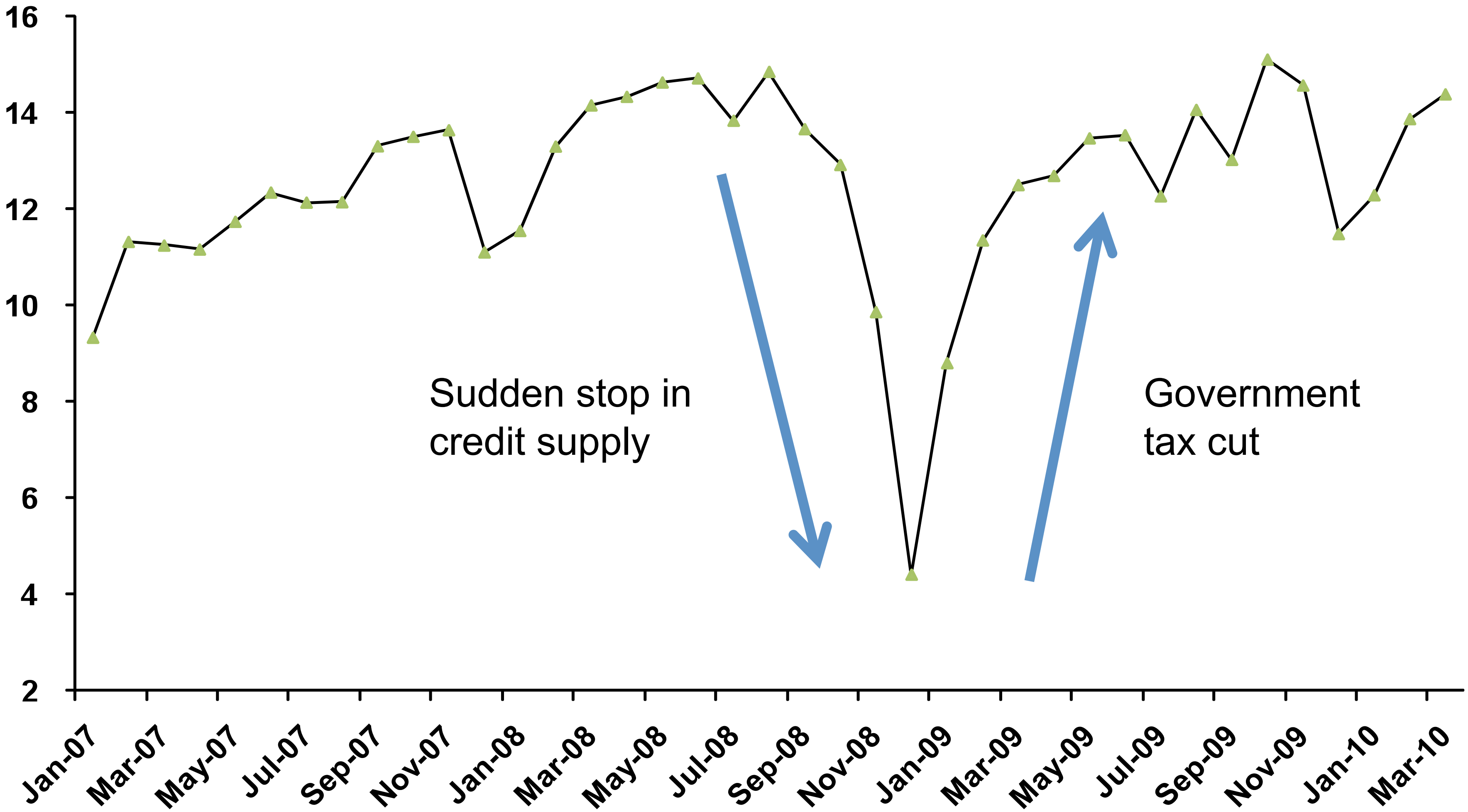
Banks' reserves
(in % of GDP)



*/ Projections for GDP in March.
Source: BCB. Elaborated by: MF/SPE

Auto Production

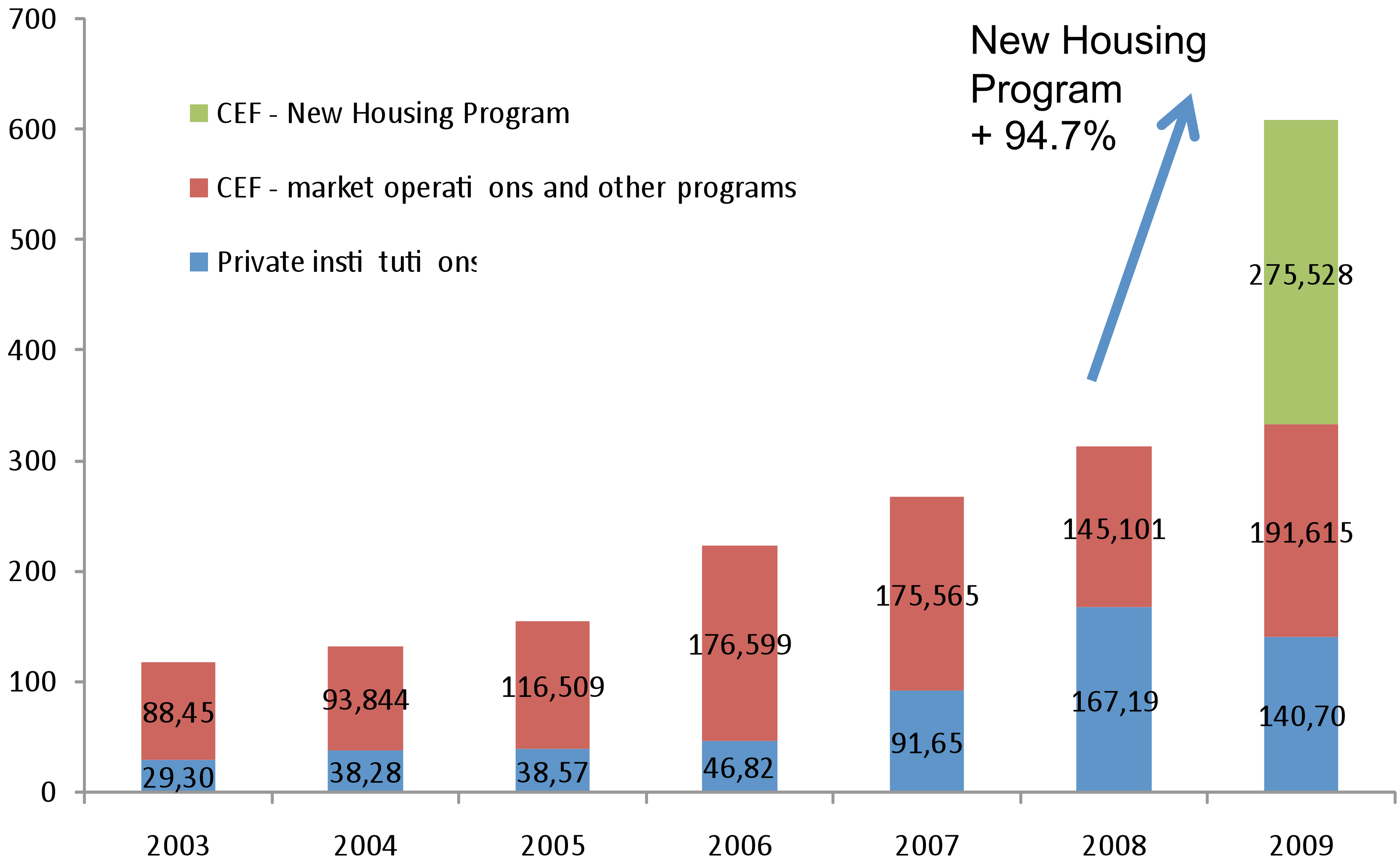
(Daily average in thousands of units)



Source: ANFAVEA. Elaborated by: MF/SPE

Residential Investment

(construction of new units hired through the financial system)



Source: CEF Graph by: MF/SPE