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IMFC Statement by Paulo Guedes
Minister of Economy

Brazil

On behalf of

Brazil, Cabo Verde, Dominican Republic, Ecuador, Guyana, Haiti, Nicaragua, Panama, Suriname, Democratic Republic of Timor-Leste, and Trinidad and Tobago

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Brazil deeply regrets the continuation of the invasion of Ukraine, which is causing unacceptable humanitarian suffering, and is disrupting the global economy in ways that affect particularly hard the poor and vulnerable populations. We renew our call for an immediate ceasefire to allow for a peaceful solution of the conflict, followed by the gradual normalization of economic relations.

High and pervasive inflation requires decisive policy action

The global economy is contending with high inflation and economic slowdown—with risks clearly on the downside. After considerable delays, monetary policy is finally being tightened at a faster pace in advanced economies. This is clearly what is needed at this juncture, as those economies are facing strong underlying inflationary pressures. The global economy is starting to feel the impact of tighter financial conditions, with growth projections being revised down in most regions. With the economic slowdown, higher interest rates, US dollar appreciation, and more volatile capital flows, the risks of financial distress in domestic and international credit markets have significantly increased. Meanwhile, supply bottlenecks from the Covid-19 pandemic and the war in Ukraine have impacted the real sector, with spillovers mainly through food and energy price increases.

Central banks must show unwavering resolve in the fight against inflation. Many observers, including at the Fund, have been greatly surprised by the intensity and persistence of inflation. Indeed, contrary to what many initially believed, inflation has surged as a result of underlying demand-supply imbalances and not only mainly due to temporary supply shocks. In this context, central banks should continue to normalize monetary policy and keep policy rates above neutral for a prolonged period, according to each jurisdiction´s specific circumstances. Moreover, frontloaded monetary tightening may be required to align expectations and break inertia, especially in those economies where wage and price expectations are more backward looking. Accordingly, we remain skeptical of the view that profit margins could absorb much of the wage price pressures that may occur in the coming quarters absent a meaningful slowdown in economic activity. We are also doubtful about the notion that declining real wages will anchor expectations and bring inflation down, attenuating the need of decisive monetary policy action. Central banks everywhere, but particularly in advanced economies (AEs), need to reaffirm their credibility. In this regard, we note that central banks in a handful of emerging market and developing economies (EMDEs) were ahead of the curve and are beginning to see the benefits of their actions.

In most countries, fiscal policy should be consistent with monetary tightening, aiming at a credible consolidation path, even when creating room to support the most vulnerable. Persistent fiscal imbalances may feed into inflation pressures and make the job of central banks even more difficult. Plausibly, inflation pressures were unleashed by extensive fiscal stimuli, on top of monetary policy accommodation, after the Covid-19 shock. Of course, in case of new rounds of supply shocks, including from energy and food prices, the authorities may need to offer targeted support to the most vulnerable. In such cases, changing the composition and reprioritizing expenditures will be key to address social needs without hampering macroeconomic rebalancing.

Economic slowdown and tighter financial conditions raise the risks of financial instability. The faster pace of monetary policy tightening is leading to higher volatility, lower valuations, and higher risk premia in several key financial markets. This could also lead to sharp correction in housing markets and corporate failures in more vulnerable sectors. With the prospect of quantitative tightening in major central banks, liquidity conditions in financial markets could deteriorate further. The high levels of sovereign debt accumulated during the pandemic, particularly when denominated in foreign currency, leave many governments exposed to disorderly market conditions, especially in countries with limited buffers. Central banks, particularly in AEs, should calibrate and communicate the steps ahead as clearly and timely as possible.

While a global recession is not in the WEO baseline scenario, risks have increased substantially. Bringing inflation down will require, unfortunately, a further slowdown in economic activity. A credible and consistent policy mix will help to achieve this with the least possible cost. Any hesitation or policy inconsistency may unmoor expectations, raising the likelihood of pushing the world into recession. We caution against any complacency in this area.

<u>Brazil: ahead of the curve</u>

Brazil has taken timely and decisive actions to ensure fiscal sustainability and fight inflation. With a strong fiscal response of 7.0 percent of GDP in 2020, the primary fiscal deficit increased to 10 percent of GDP and public debt jumped to 89 percent of GDP at the end of that year. However, subsequent fiscal restraint and a strong economic rebound led to a series of monthly primary fiscal surpluses, starting in August 2021, bringing public debt back to pre-pandemic levels (77.5 percent of GDP in both August 2019 and August 2022). At the same time, we promptly recalibrated emergency assistance to the poor, making it even better targeted and set at a level consistent with the ongoing economic recovery and job creation. The Central Bank of Brazil (BCB) was among the first to react decisively to inflationary pressures, starting its tightening cycle in March 2021. While many observers around the world mistakenly took global inflationary pressures as temporary, in Brazil we realized very soon that a combination of factors were at play, including a surge in demand (on top of a supply shock). Notwithstanding the significant challenges to the global economy, we continue to rebalance our economy on both the fiscal and monetary fronts, averting an upward inflation spiral and steering public debt onto a continuously downward path.

Fiscal outturns have surprised on the upside in both 2021 and 2022. A responsible fiscal stance has kept public debt on a declining path while allowing the adoption of important measures to support the most vulnerable and mitigate the impact of higher food and fuel prices. Even with the needed flexibility to accommodate a sequence of shocks, fiscal credibility and sustainability have been strengthened. Tax revenue collections are at a record high, increasing by 17.5 percent in real terms in 2021, despite a reduction in tax rates. As a share of GDP, the primary fiscal deficit in 2021 was lower than in the pre-pandemic years, representing also one of the largest fiscal turnarounds among the major economies in the world.

Inflation is retreating and the BCB halted its hiking cycle in September. Since March 2021, the BCB has increased the policy rate by 11.75 percentage points. Monetary policy tightening in Brazil, therefore, was timely, has been intense, and its cumulative effect is expected to put inflation firmly on a convergence path to the target range. Having acted early, Brazil is now at a different point in the tightening cycle from most countries. It is already harnessing the benefits of early and decisive action, with declining inflation and resilient economic activity. Indeed, year-end inflation for Brazil is projected at less than 6 percent, lower than in many AEs. Meanwhile, Brazil's floating exchange rate has played its role as shock absorber, while the depth of our foreign exchange and domestic capital markets have been preserved.

Economic growth in 2022 will surprise on the upside. Annual GDP growth has remained positive for six consecutive quarters, reaching 3.3 percent (y-o-y) in the second quarter. The Brazilian economy is expected to grow by 2.5 percent in 2022, beating all early projections, which at the beginning of the year hovered around only 0.3 percent. High frequency indicators show a continuous strengthening of business and consumer confidence, as well as robust economic activity. The dynamism of the economy can be illustrated by (i) the strength of the services sector; (ii) a lower unemployment rate (dropping well below pre-pandemic levels); (iii) the expansion of private sector-financed investment; and (iv) the development of credit and capital markets. International reserves remained virtually unchanged during the pandemic, while the current account has remained sustainable, with external financing needs easily covered by FDI.

This administration has delivered transformational structural reforms, whose positive effects will continue to be felt for the foreseeable future. In order to bring the fiscal accounts to a sustainable path, a parametric pension reform was approved in 2019, with substantial savings for the public sector. Even during the pandemic, we continued to pursue reforms that had been on the shelves for a long time, some of them for decades. Our goal has been to make the Brazilian economy more open, efficient, and business-friendly, reducing the weight of the State, particularly in economic activities that the private sector can and should carry out with much greater efficiency. We successfully approved new regulatory frameworks for sectors such as sanitation, cabotage, natural gas, start-ups, telecommunications, railways, ports, among others, leveraging private sector investment commitments of the order of US$ 200 billion over the next ten years. At the same time, we strived to streamline the public sector and make it more efficient and focused on its intrinsic functions. Along these lines, we managed to approve the independence of the central bank (a bill that was stuck in Congress for two decades), a new procurement law, and promoted broad digitalization in the public sector. We also privatized Eletrobras, the largest electricity company in Latin America.

Furthermore, we made important strides in trade liberalization, by reducing tariffs unilaterally and celebrating trade agreements, supporting our productivity and competitiveness agenda. Trade has been one of the mainstays of the modernization of the Brazilian economy. Brazil has expanded its trade integration with the world, increasing the economy's productivity and supporting economic growth sustainably. Our trade agenda is based on three pillars: (i) the celebration of trade agreements; (ii) the modernization of the tariff structure; and (iii) the reduction of non-tariff barriers. Import tariffs have been slashed by 20 percent across-the-board and unilaterally, and a significant number of items have been disencumbered from the requirement of import licenses. We have also concluded broad trade negotiations with the European Union, EFTA, and Singapore and continue engaged and making steady progress in negotiations with several other trading partners. Since 2019, Brazil has concluded negotiations of 15 new agreements on trade, a number significantly higher than in previous administrations. As a result, the share of Brazil's trade flows to GDP rose from 29 percent in 2018 to 39 percent in 2021. Progress on this agenda is even more relevant considering the reconfiguration of global value chains, which opens a window of opportunity for Brazil.

In sum, Brazil is out of synch with the global economy, positively surprising the skeptics, including the IMF. Inflation has been consistently revised down and GDP growth revised up, in the opposite direction of most other countries, showing the benefit of acting early and resolutely with accurate evaluation and policies. Moreover, several shocks to the global economy have not stopped Brazil from moving forward with a comprehensive, structural, business enabling reform agenda. The outcomes of our actions and resolve have started to be realized and, if maintained, will continue to steer the Brazilian economy's performance for many years.

<u>The irreplaceable role of the IMF, keeping the focus on its core mandate</u>

The Fund has a critical role to play in addressing the current challenges faced by the global economy. Confronting multi-decade high inflation, high debt levels, synchronized growth deceleration, and largely exhausted fiscal space, policymakers around the world must count on the IMF as a beacon of high-quality analysis and advice to rebalance world and national economies with the least possible costs. The Fund is unique as a repository of over seven decades of knowledge in macroeconomic management. While the Fund's agenda has been broadened in recent years to incorporate non-core issues, we reiterate our view that the IMF must concentrate on its traditional core mandate, which brings the most value added to the membership. Unfortunately, IMF bilateral and multilateral surveillance have overlooked the nature, magnitude, and extension of the inflation surge that started during 2021. As a result, Fund policy advice was misguided in several instances. The Fund should therefore refocus and strengthen its macroeconomic and financial analysis, surveillance, and policy advice to fully restore the credibility that was lost in this process.

We welcome the forthcoming discussion on how to improve IMF lending instruments, including their effectiveness. Thorough and timely Board engagement is needed to develop new or adjust existing instruments to better serve the membership while preserving effective safeguards. We are particularly keen in enhancing the Fund's flexibility and agility to act in a timely manner to help countries regain macroeconomic and financial stability. In this context, we welcome the progress in outlining the guidance note for the new strategy for countries in situation of fragility and call for greater Board engagement. We also welcome the upcoming operationalization of the Resilience and Sustainability Trust (RST) and look forward to the pilot programs to be supported by it. We look forward to an early review of the RST to enhance the scope of policies and structural reforms that can be supported by the Trust, making it more aligned with the needs of the membership.

A successful and timely conclusion of the 16th General Review of Quotas (GRQ) remains a top priority. We continue to see the Fund's critical role at the center of the Global Financial Safety Net. The more the global economy becomes interconnected and subject to a variety of shocks, the greater the Fund's importance. We favor a substantial increase in the IMF quotas, restoring its quota-based nature while keeping borrowed resources under the New Arrangements to Borrow (NAB) as a secondary line of defense. A new quota formula, properly reflecting the relative economic weight of members in the world economy, coupled with the protection of quota shares of low-income countries and small developing states, would be the best guide for allocating quota increases. If consensus around a new quota formula cannot be reached, the current formula cannot be used as the benchmark for quota allocation as it would not reflect the consensus built within the membership in the 2010 Quota and Governance Review. We call on the Committee of the Whole to work diligently toward a timely and successful conclusion of the 16th GRQ.