International Monetary and Financial Committee

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IMFC Statement by Alexandre Tombini
Governor, Central Bank of Brazil

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

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Global Economic Outlook

1. Uncertainties about the global economy have increased since our last meeting in Lima in October 2015. Global growth projections were revised down and risks are tilted to the downside. Global growth in 2015, at 3.1 percent, was the lowest since the financial crisis of 2008-2009.

2. Such more restrained pace of global growth reflects a combination of both cyclical and structural processes that are still unfolding. The main factors behind this subdued performance include: i) slowdown of the Chinese economy related to its rebalancing toward a growth model with greater emphasis on domestic consumption; ii) tightening of financial conditions in the United States and its international spillovers; iii) drop of commodity prices, which triggered a substantial decline in investment in commodity sectors worldwide; and iv) insufficient deleveraging and other financial fragilities, as well as deflation risks, limiting growth in the Euro area and Japan.

3. The ongoing process of monetary policy normalization in the U.S.—initially flagged in May 2013—has encouraged important adjustments in the global economy but has also been a source of surges of volatility in the international capital markets. Tighter financial conditions, including due to an important appreciation of the U.S. dollar, impinged on many emerging market and developing countries (EMDCs) by means of lower capital inflows, a few episodes of capital outflows, and higher sovereign and corporate credit spreads.

4. The U.S. dollar appreciation and the terms-of-trade shocks reduced the room for many EMDC policymakers to react to the mediocre global growth outlook. Additionally, signs of weaker-than-expected Chinese growth, volatility of the Chinese renminbi and persistent capital outflows led to growing anxiety in the financial markets—despite plenty and strong buffers that EMDC have accumulated in recent years. The Chinese authorities' commitment to support growth and decisive policy communication were paramount to anchor growth expectations and contain exchange rate speculation.

5. At the turn of the year, the context was of heightened divergence in the monetary stances of the three major monetary areas. The Bank of Japan and the European Central Bank were

compelled to introduce new monetary stimulus, whereas the Federal Reserve "dot plot" forecasted 100 basis-points hike in the fed funds rate in 2016, after an initial increase in December 2015.

6. Some accommodation has taken place in international financial markets in recent weeks, contributing to lower risk aversion, rising asset prices, alleviating commodity-price distress and allowing some depreciation of the U.S. dollar. This relief came not only from the reassessment of the pace of normalization of U.S. monetary policy, but also from the Chinese authorities' decisive actions.

7. However, this calmness may not be stable. Lack of synchronicity in major monetary policies in the foreseeable future will probably widen again since the growth outlook for the U.S. economy outpaces the ones for Europe and Japan, where crisis legacies remain relevant in both public finances and banking systems. Economic stagnation can only magnify such weaknesses, and further policy action is urgent. The perception *per se* that monetary policies in advanced economies have had low effectiveness to foster economic growth—or may be close to running out of ammunition—makes the policy response even more challenging, and may overly prolong the ultra-low interest rate stance.

8. In sum, the main risks embedded in the global economy pose substantial challenges for policymakers from both advanced and developing countries. What we have seen so far highlight an ever higher interconnectedness in the global economy and an increasing relevance of emerging market economies. Building the basis of sustainable and inclusive global growth requires a set of complex policy actions and reforms in all countries, but it is probably going to take some time for those reforms to yield results. Meanwhile, it seems paramount to remain committed to sustain growth in the short term, as well as to ensure macroeconomic and financial stability. In this regard, finding the right balance between the long-term structural agenda and the right incentives to support growth and reduce unemployment in the short run, while taming financial markets' anxiety, continues to be a major task for policymakers.

Brazilian Economy

9. In Brazil, the complexity of the global economy has not been the only factor explaining the recent economic performance. At this exact moment, the private-sector behavior has been mainly driven by developments related to domestic political events, which have outweighed economic factors. Despite that, and like many other EMDCs including most countries in our constituency at the IMF, the commodity-price distress has had a meaningful impact in domestic investment, mainly in the energy and mining sectors.

10. Nevertheless, macroeconomic adjustments in Brazil are following the expected course, although at different speeds, and the country is already reaping some benefits. Indeed, the external accounts have surprised positively thanks to a sizeable adjustment in the real effective

exchange rate and the fall in domestic demand. The current account deficit declined from US$ 104 billion in 2014 to US$ 59 billion in 2015 and it is expected to further decline to only US$25 billion this year. Foreign direct investment, at US$ 77 billion in the past 12 months, remains vigorous in spite of the recent downgrades of sovereign and private rating credits.

11. It is worth noting that Brazil was able to cope with nearly 50 percent currency depreciation in the last four years without any financial system disruption. A comfortable level of buffers in the banking system (in terms of capital and provisions), adequate amount of international reserves and wisely designed tools for provision of exchange rate hedge by the Brazilian Central Bank led to this smooth transition.

12. On the monetary side, inflation has started to recede, after peaking last January. Given that significant price realignments from public tariffs are no longer expected and the major impact from exchange rate depreciation is behind us, inflation dynamics is beginning to respond more forcefully to the economic downturn. Indeed, inflation is expected to converge to the target at a fast pace from now on. Faster-than-expected labor and credit markets responses have contributed to accelerate the convergence of inflation and inflation expectations for 2016. However, due to the complexity of current balance of risks for inflation, there is no room for accommodative measures.

13. Fiscal consolidation, along with tax reforms and spending reviews, remains crucial. External sector adjustment and inflation convergence are necessary, but not sufficient to restore business and households' confidence. Accordingly, the government has sent many proposals to Congress aiming at improving the long-term fiscal outlook. In the meantime, other initiatives and reforms have been drafted. These proposals include measures to mobilize additional revenues in the short and medium-term, as well as structural measures to rationalize and limit public expenditures.

14. In conclusion, the political developments have had a meaningful impact on recent economic performance, but we must not lose sight of the progress made so far in terms of macroeconomic adjustment. The external accounts have adjusted, the competitiveness of the tradable sector is improving consistently, and inflation started to converge to the target at a more robust pace. In the meantime, fiscal consolidation remains the most pressing economic challenge. Although the current political environment has not favored the approval of fiscal reforms, as soon as there is more clarity on this front, the fiscal challenges will surely be dealt with and the economic prospects will improve accordingly.

IMF Reforms

15. Our constituency welcomes the entry into force of the Fourteenth General Review of Quotas in January this year. This important review included a doubling of quotas and a major shift in quota shares toward dynamic emerging market and developing countries, while

protecting the voting power of the poorest members of the Fund. Four emerging market economies (Brazil, China, India, and Russia) are now among the 10 largest IMF members.

16. The Fifteenth General Review, including a new quota formula, is to be completed by the 2017 Annual Meetings. We re-emphasize the commitment of the membership that any realignment in quota shares is expected to result in increases in the quota shares of dynamic economies in line with their relative positions in the world economy, and hence likely in the quota share of emerging market and developing countries as a whole.

International Monetary System

17. A large global financial safety net is fundamental to safeguard the stability of the international monetary system. We fully support the ongoing efforts by the IMF to evaluate its shortcomings, challenges and necessary improvements. In a world that is slowly sliding towards multipolarity, the international monetary architecture has also become multilayered. We agree that its evolution has been less articulated than desirable, but the current multilayered structure—international reserves as first line of defense, bilateral and regional financing arrangements and the Fund—reinforce its stability.

18. We trust the Fund's current lending capacity is at the minimum level required to provide liquidity to the membership. Moreover, the Fund's catalytic role to promote inclusiveness in the global safety net is paramount, particularly for those non-systemic members with lesser access to the multilayered system—such as the small states and low-income countries.

19. We welcome the decision by the Fund's Executive Board to include the renminbi in the basket of currencies that form the Special Drawing Rights (SDR). We support initiatives to broaden the use of the SDR and welcome the discussion on a possible SDR allocation later this year.

De-Risking and Correspondent Banking

20. As the global community struggles to recover from the financial crisis, there has been a welcome wave of financial regulatory reforms to prevent another crisis from happening on such a large scale. An unintended consequence of these enhancements was the exacerbation of the de-risking phenomenon, where financial institutions terminate or restrict correspondent banking relationships in many emerging market and low-income countries.

21. While this issue is not new, the impact has rapidly spread to many countries over the last few years. The adverse impact on trade, investment and remittances has serious implications on the macroeconomic stability and development of these countries. De-risking can result in reduced access to external finance, undermine efforts to promote financial inclusion and lead to development of unregulated financial flows. Given its seriousness, our constituency continues to advocate for an urgent resolution to the issue.

Policy Advice and Evenhandedness

22. We welcome the focus of the IMF on issues that, although may not appear at first sight directly linked to its mandate, are important to boost economic growth and ensure financial stability, such as financial inclusion, climate change, and technological progress. Moreover, we fully support further work on how income inequality may interact with productivity growth over the medium term. In collaboration with other institutions, the Fund should use its economic expertise to better understand these issues and their effect on the economy, and to adjust its policy advice, where warranted.

23. We welcome steps taken by the Fund to address evenhandedness concerns in surveillance. The aptitude of the institution to maintain evenhandedness in its economic analysis and policy recommendations is critical for its credibility, legitimacy and effectiveness. We look forward to a broader perspective that also addresses evenhandedness concerns in regard to the use of Fund resources.