Comments on "Fiscal and Monetary Challenges in Latin America"

XVIII CONFERENCIA ANUAL DEL FONDO LATINOAMERICANO DE RESERVAS

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Brazil – Inflation, Fiscal and Monetary policies

Rodrigo's presentation makes the case of a different reaction this time around from the LA 5

→ **True!** Past structural reforms, fiscal discipline, lower exposure to debt denominated in foreign currency and independent Central Banks have made possible a " (so far) close to state of the art" macro management

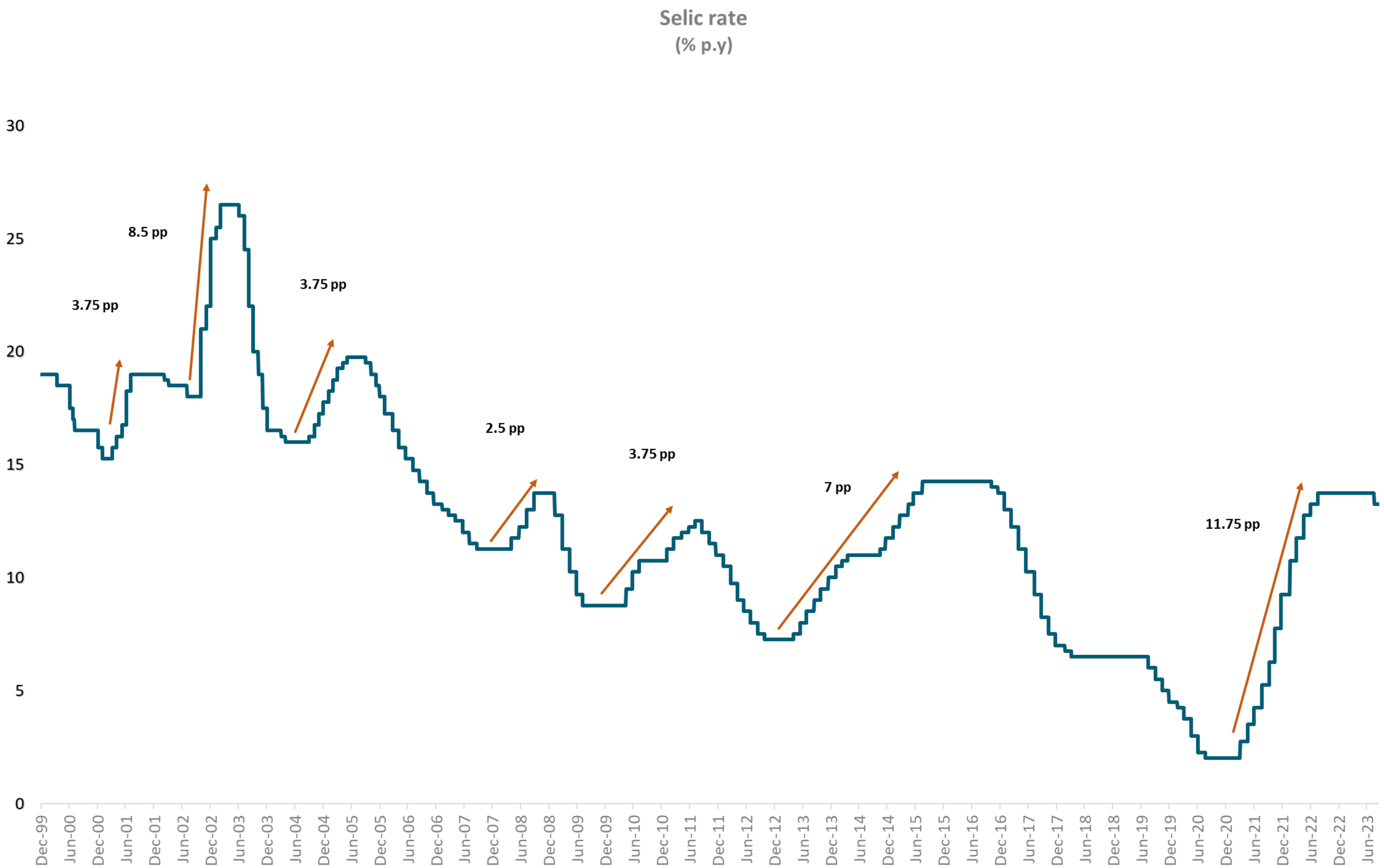
But there is still work to be done, particularly in Brazil: Services inflation remains way too high, long term inflation expectations are unanchored and fiscal challenges are still there

Expansion of Government expenditures remains positive in real terms and doubts over fiscal consolidation remain

These uncertainties can be one of the reasons for the lingering unmooring of inflation expectations – together with the expectation of higher external inflation rates and uncertainties over the Central Bank's future inflation fighting resolve

Monetary policy

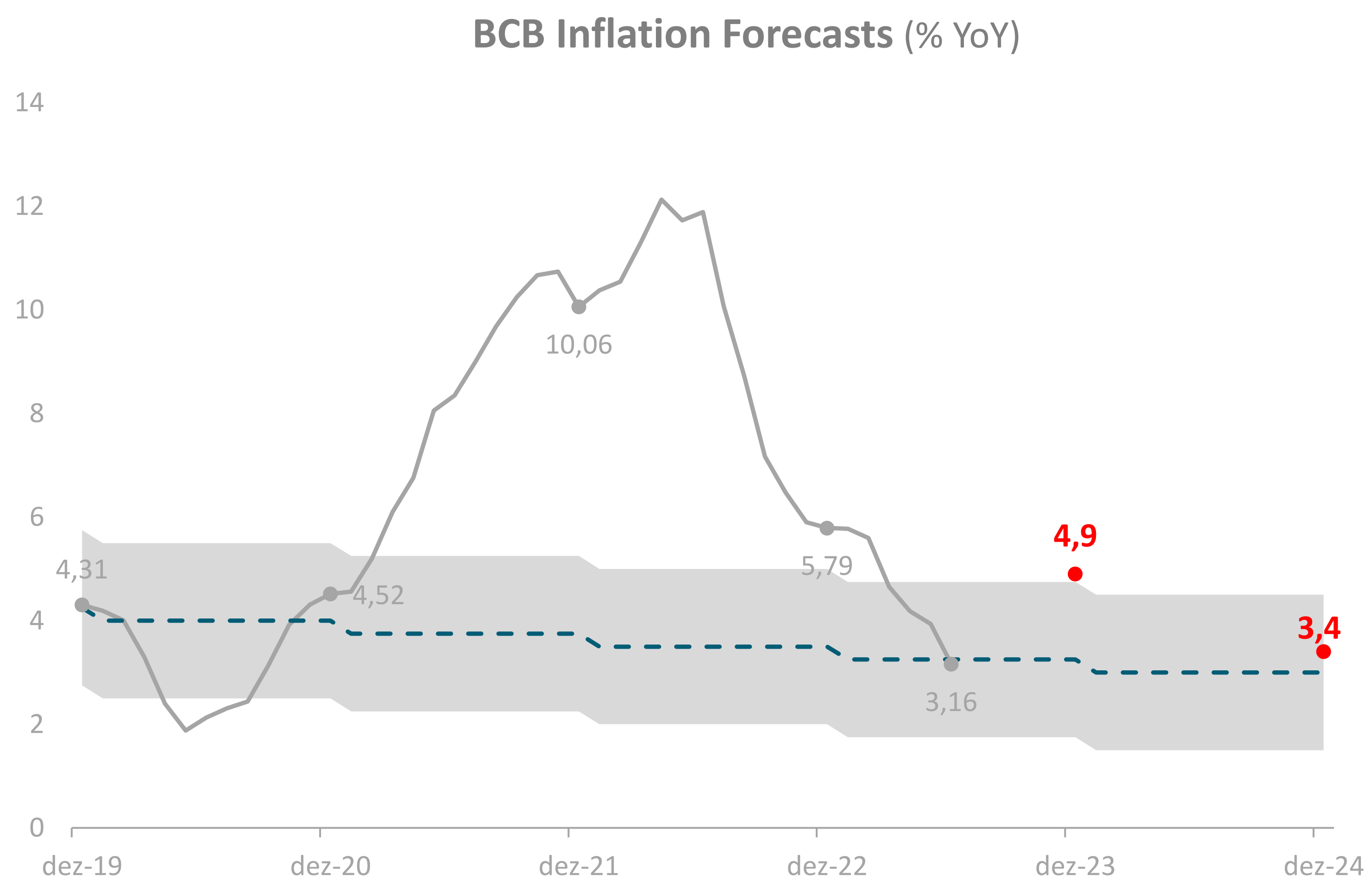
After rates on hold for 12 months, BCB has started a cautious easing cycle, with a 50 bps cut – challenges ahead remain....



Source: BCB

BCB Forecasts

Inflation should converge towards the targets over the next quarters, as the monetary tightening moderates activity

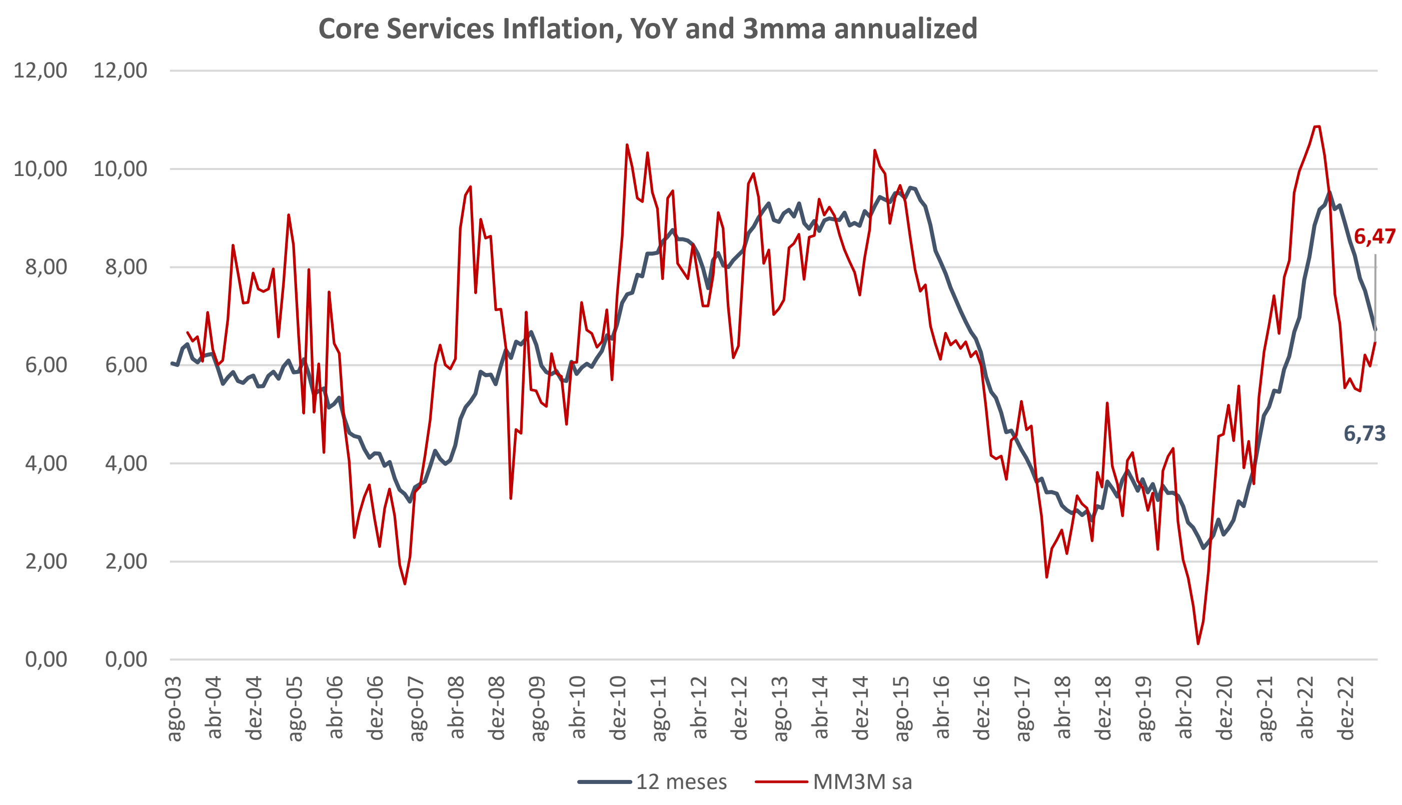


Source: BCB

Brazil - Inflation

Services inflation remains high, with very slow convergence

Major help from recente decreases in commodities prices seems to be behind us



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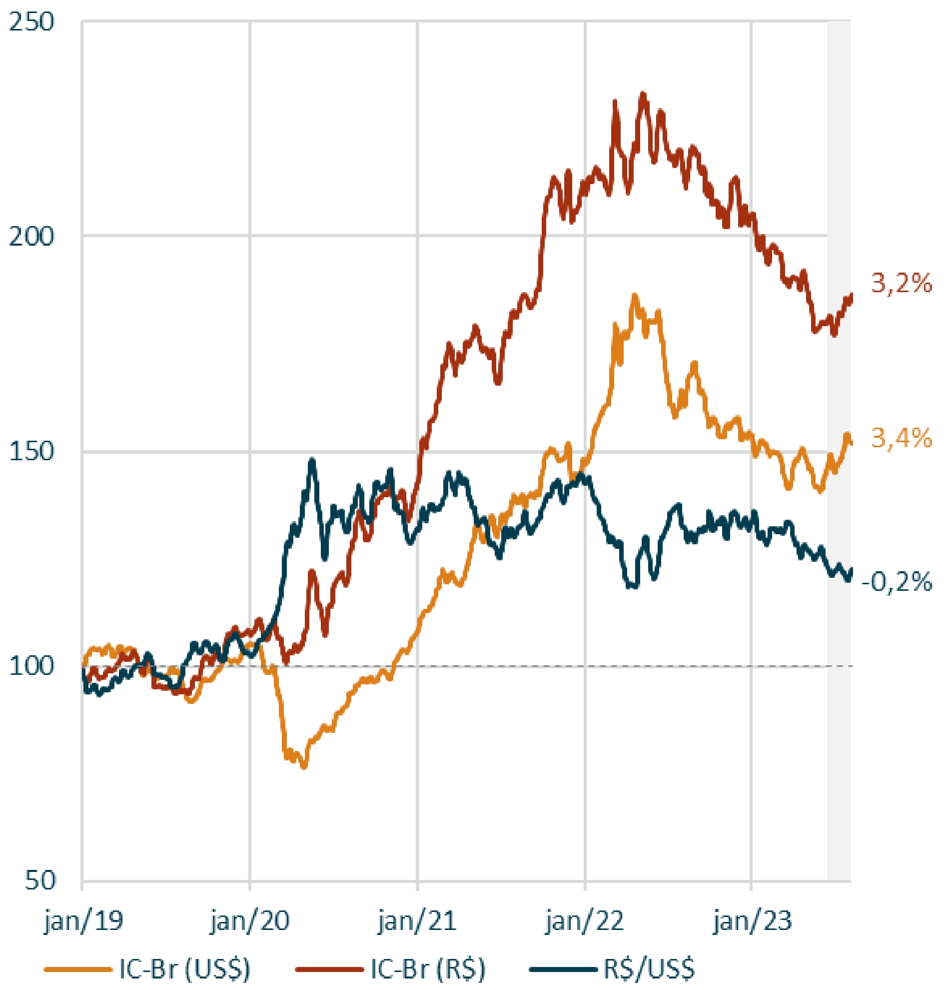
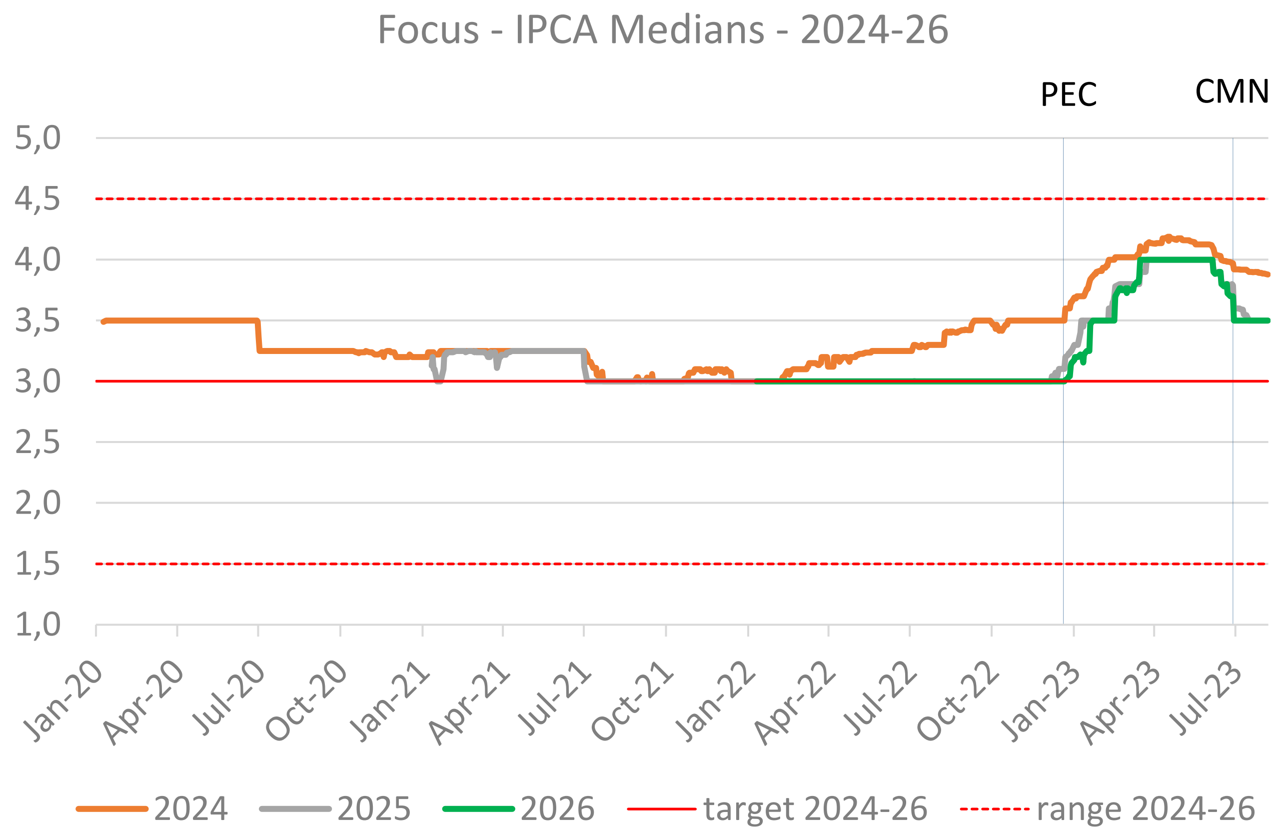
MM5D, 2019 = 100

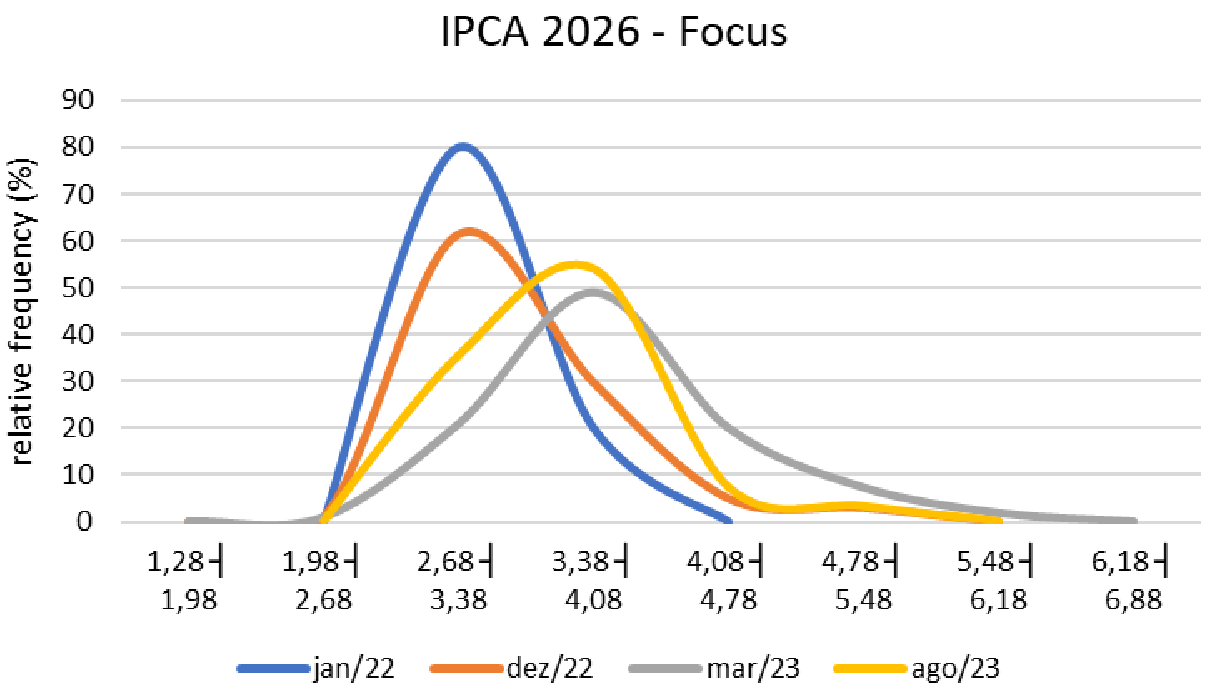


Source: IBGE, BCB

Inflation Expectations

Inflation should converge towards the targets over the next quarters, as the monetary tightening moderates activity



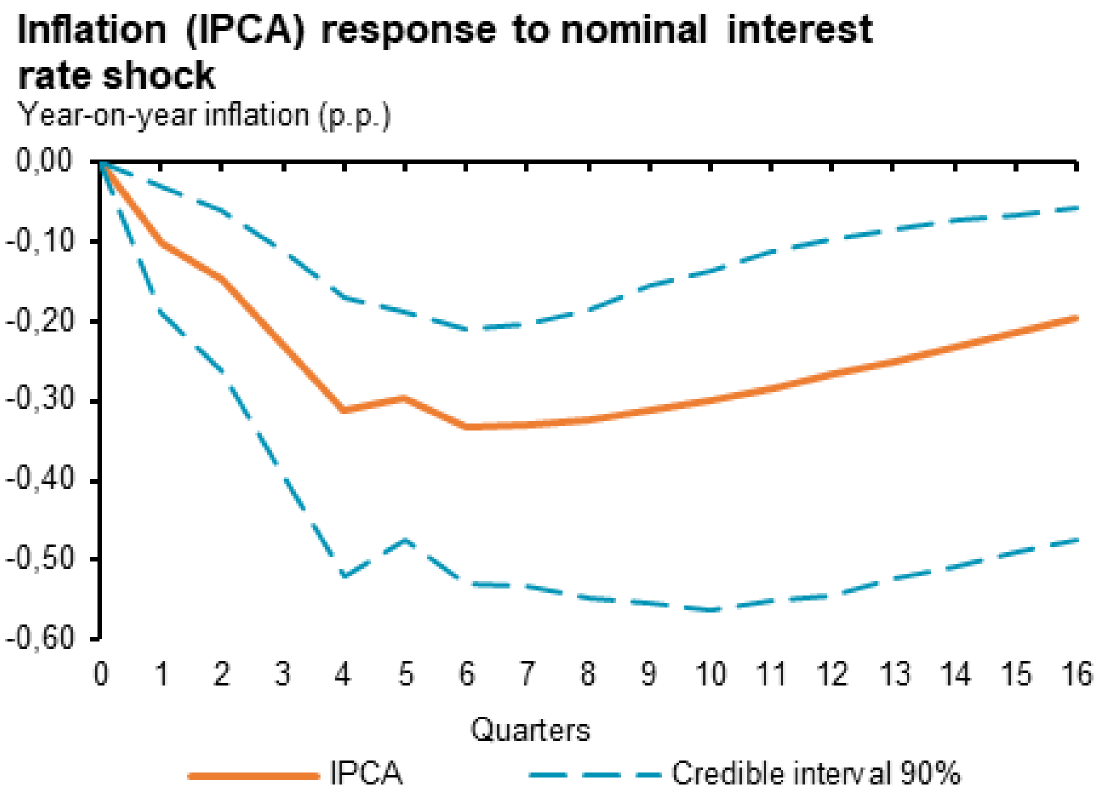


Source: BCB

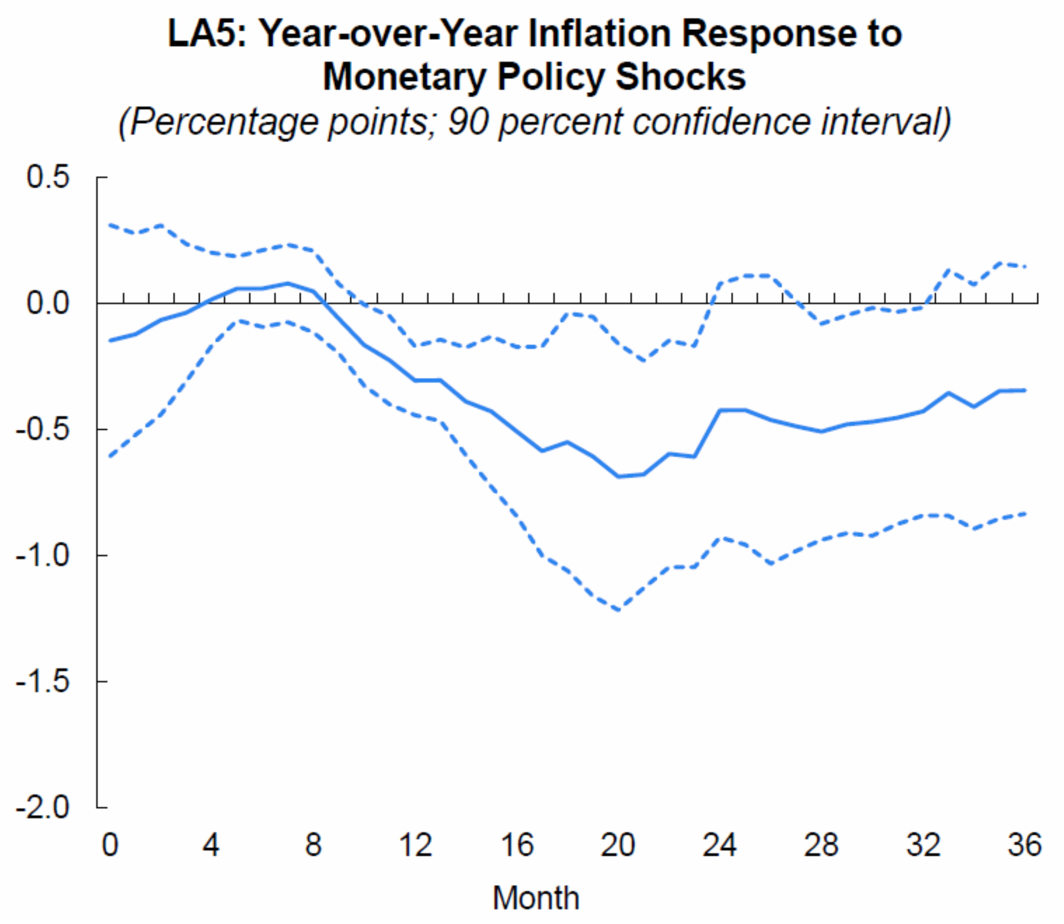
Brazil - Monetary policy

We work with an 18 month maximum effect from monetary Policy – going through the largest effect of tightening now in 2023H2

Complete convergence to target Only in 2025



Source: BCB estimates



Source: IMF staff calculations

Mind the (Output) Gap!

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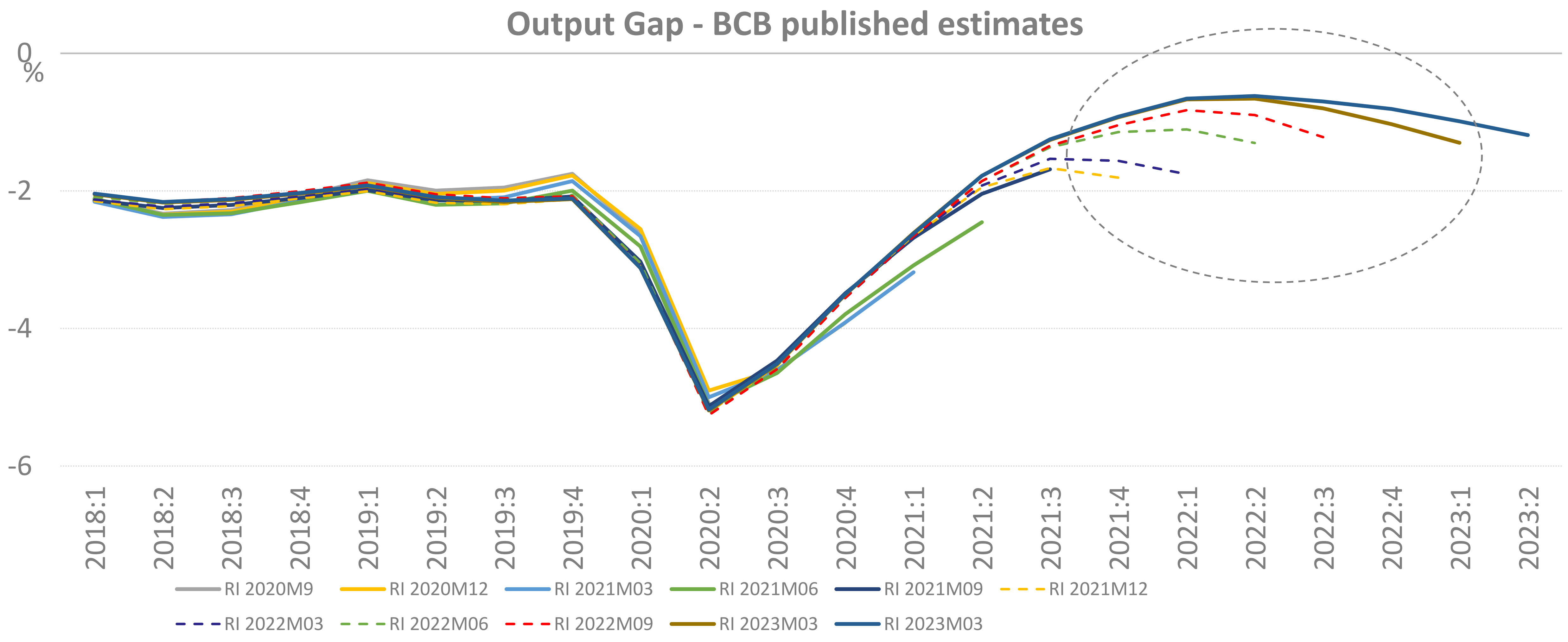
Real Time estimates of the output gap are subject to large uncertainty; Large Revisions upward over the past year

If wrong on current level, impact on inflation can be longlasting



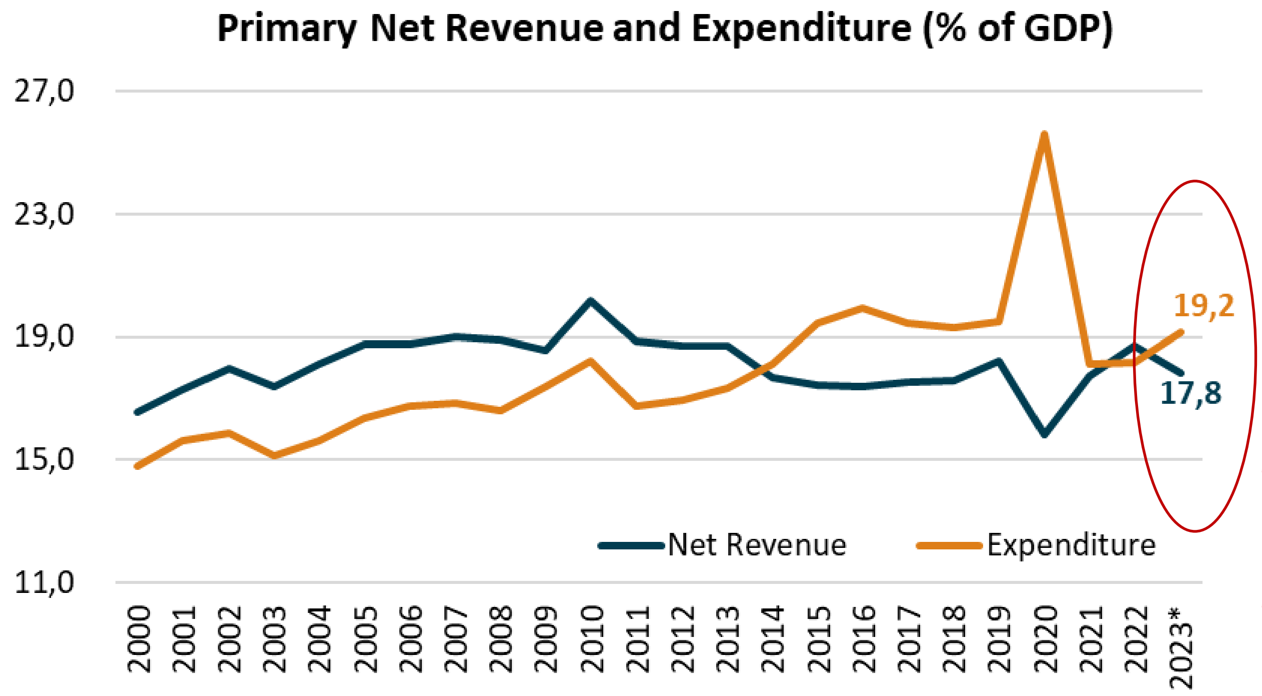
Source: BCB

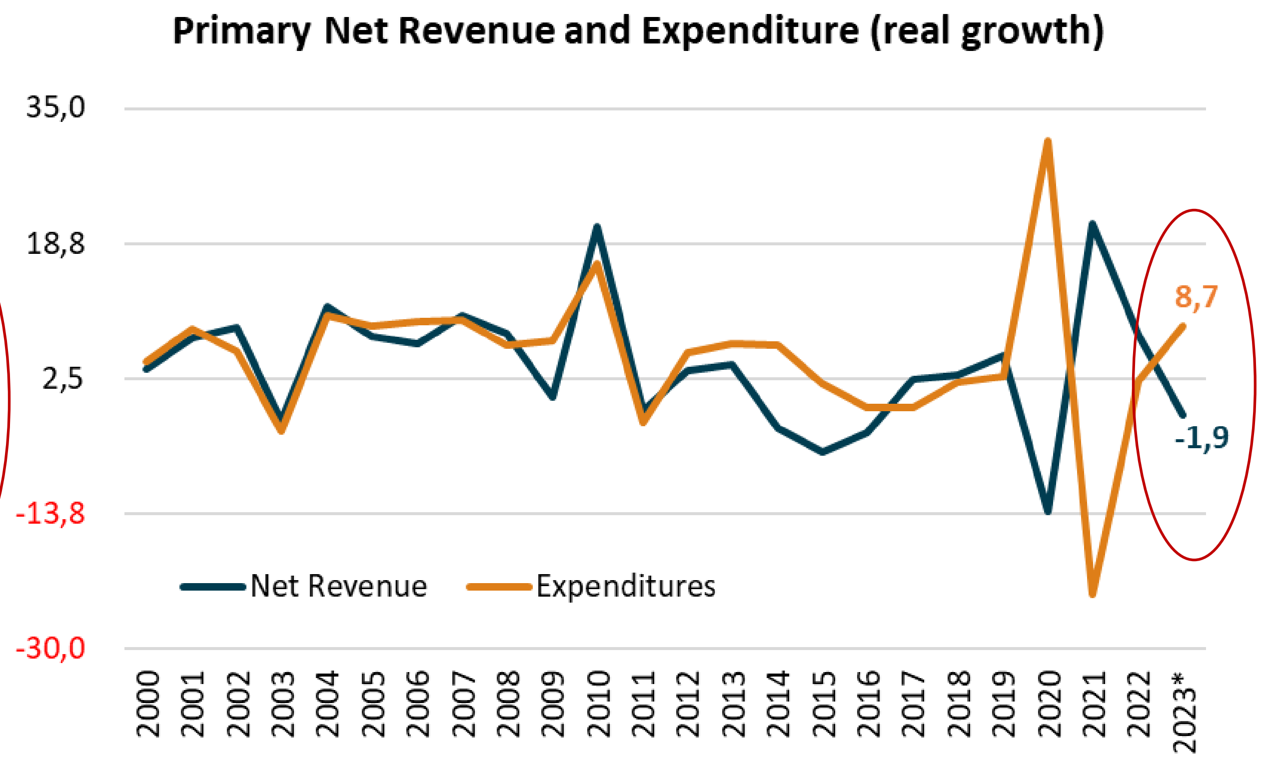
Fiscal Policy

Fiscal consolidation will require large increase in Revenue over coming Years, even under the new fiscal framework

Large increase in taxation can have competitiveness and inflationary consequences

Uncertainties over the achievment of the new primary surplus targets





Source: STN; * Forecasts from the Treasury's 3rd bimester report on revenues and expenditures

Monetary policy

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256th Copom meeting – August 3rd 2023

- Considering the assessed scenarios, the balance of risks, and the broad array of available information, Copom decided to reduce the Selic rate by 0.50 percentage point, to 13.25% p.a., and judges that this decision is consistent with the strategy for inflation convergence to a level around its target throughout the relevant horizon for monetary policy, which includes the year of 2024 and, to a lesser extent, 2025. Without compromising its fundamental objective of ensuring price stability, this decision also implies smoothing economic fluctuations and fostering full employment.

- The Committee reinforces the need to persist on a contractionary monetary policy until the disinflationary process consolidates and inflation expectations anchor around its targets.

- Copom considered the alternative option to reduce the Selic rate to 13.50%, but it concluded that it was appropriate to adopt a 0.50 percentage point pace in this meeting due to an improvement in the inflation dynamics, reinforcing however the firm objective of keeping a contractionary monetary policy to reanchor expectations and bring inflation to the target in the relevant horizon. The current context, characterized by a stage in which the disinflationary process tends to be slower and with partial reanchoring of inflation expectations, requires serenity and moderation in the conduct of monetary policy. If the scenario evolves as expected, the Committee members unanimously anticipate further reductions of the same magnitude in the next meetings, and it judges that this pace is appropriate to keep the necessary contractionary monetary policy for the disinflationary process. The Committee emphasizes that the total magnitude of the easing cycle throughout time will depend on the inflation dynamics, especially the components that are more sensitive to monetary policy and economic activity, on inflation expectations, in particular the longer-term ones, on its inflation projections, on the output gap, and on the balance of risks.


Thank you!
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