INTERNATIONAL MONETARY AND FINANCIAL COMMITTEE

Forty-Fifth Meeting
April 21, 2022

Statement No. 45-18

Statement by Mr. Guedes
Brazil

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

Statement by Paulo Guedes
Minister of Economy, Brazil

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

International Monetary and Financial Committee
April 2022

Brazil joins the international community in condemning the invasion of Ukraine. We are deeply concerned about the loss of life and humanitarian crisis triggered by the war, as well as its detrimental impact on the global economy. We call for an immediate cease fire to allow for a resolute and peaceful solution to the conflict, followed by the lifting of economic sanctions.

<u>Global outlook became cloudier, but policy response must be decisive</u>

The war in Ukraine and its fallout have aggravated an already uneven global recovery, further disrupting value chains, increasing inflationary pressures, and reducing growth prospects. With the emergence of new COVID-19 variants and economic scarring from the protracted pandemic, the global recovery was slowing down when the war in Ukraine started. On top of its appalling humanitarian costs, the war has unleashed ripple effects that went far beyond immediate direct trade and investment channels in the affected region. The disruption in supply chains and uncertainty in the global outlook were significantly amplified with considerable impact on economic efficiency. Pressures on food and energy prices have gained further steam. The global outlook is immersed in uncertainty and combines slower growth, high inflation, tighter financial conditions, high debt, and limited fiscal space. The geopolitical upheaval fueled into previous trends, raising the risks of economic and financial fragmentation with potentially long-lasting consequences.

High inflation and limited fiscal space pose important challenges for policy makers around the globe. While country circumstances vary, inflationary pressures have become more broadly disseminated and entrenched, requiring tighter monetary policy across most jurisdictions. Many policy makers and analysts, including the Fund, have mistakenly taken the broad-based inflationary pressure as temporary and mainly supply-driven, which would self-correct with the recovery. Inflation was being fueled also by excessive demand fed by sizable policy stimulus during the pandemic and the fadeaway of global labor arbitrage. Meanwhile, more than two years into the global pandemic, fiscal space has shrunk significantly and any additional fiscal support to protect the most vulnerable needs to be parsimonious and very well targeted. Countries coping with high debt and challenging debt rollover conditions cannot delay fiscal consolidation and must ensure that credible and responsible fiscal policy frameworks are put in place.

High, broad-based, and persistent inflation must be met by policy makers' unwavering resolve to bring it down and keep inflation expectations well anchored. Some emerging market economies (EMEs) started the tightening cycle well before the outbreak of the war in Ukraine, and are reaping the benefits of this early action. However, until recently, most advanced economies (AEs), in line with IMF assessment at that point, were considering inflationary pressures to be temporary and are now trying to catch up. With rising inflation expectations and the overwhelming evidence of tight labor markets increasing the likelihood and intensity of second round effects, monetary policy in AEs has shifted towards a less accommodative stance. While monetary policy should be data-dependent and attentive to the balance of risks, including to financial stability, it must show resolve in fighting rising inflation and not allowing inflation expectations to drift upward. As long established by the economic profession, there is no stable trade-off between inflation and growth. Letting inflation unchecked and allowing inflation expectations to become unanchored could lead to the need for even tighter policy in the future, significantly raising the costs of adjustment down the road, especially for the most vulnerable which cannot adequately protect themselves from the acceleration in price increases. For systemically important AEs, remaining behind the curve could lead to negative surprises due to the need for stronger and abrupt tightening later, possibly resulting in disorderly volatility in international capital markets.

On the fiscal front, policymakers must balance any additional support with the need for fiscal consolidation, especially in the context of high debt and rising interest rates. Only a few months ago, many believed that ultra-low interest rates were here to stay, and fiscal constraints would not be binding for the foreseeable future. Now, it must have become clear for most country authorities that fiscal consolidation should be at the forefront of the policy agenda. And the message from the Fund in this regard should leave no room for ambiguity. While recognizing the need to protect the most vulnerable through parsimonious and well targeted support, the fiscal policy stance must be responsible, ensuring sustainability over the medium term.

Meanwhile, efforts to foster the transition toward cleaner sources of energy must consider the more challenging reality on the ground. While higher opportunity costs will certainly accelerate investment in alternative, cleaner energy sources, policy prescriptions must be adjusted to already much higher energy prices that disproportionally hurt the poor and vulnerable. Calling for a faster transition without giving due attention to new, reliable, and affordable sources of cleaner energy may lead to higher volatility and lower growth and undermine political support to the transition, eventually delaying it. Moreover, as widely recognized, transition challenges for EMEs and low-income countries (LICs) are more substantial and require strong technical and financial support. Therefore, any references to climate change issues in IMF reports should be balanced and fully aligned with the UNFCCC and Paris Agreement, including the principle of common but differentiated responsibility.

Onshoring would not be a desirable solution to ongoing supply chain and international trade disruptions. Lockdowns and restrictions to international mobility have unsettled supply chains with spillover effects on international trade. However, pandemic related disruptions will be transitory and their diminishing impact over time suggests that global supply chains are being restored. Therefore, diversification and substitutability of sources of inputs, and increased supply chain resilience is the best way forward. We call on IMF members to close ranks in the defense of multilateralism and global cooperation, staving off pressures for fragmentation of the global economy.

Risks to financial stability have increased significantly since we last met. The high uncertainty surrounding the global outlook, as well as the significant shocks on the inflationary and geopolitical front, have driven market volatility up and, although no major financial event has so far taken place, the repercussions to financial markets are still unfolding. With higher inflationary pressures, higher policy rates and steeper yield curves in AEs will be compounded by a faster pace of quantitative tightening. A sudden correction in still stretched asset prices in AEs can bring significant adverse effects to asset prices and capital flows, exposing financial fragilities. Some EMEs and LICs are already facing higher sovereign spreads and exchange rate volatility. In contrast, those countries that have started tightening earlier are better prepared, as they face a more unstable global environment from a stronger position. However, with reduced space for accommodative policy responses, the global economy faces very significant risks of severe amplification of shocks through financial markets. All things considered, debt build-ups and economic and financial fragmentation pose important risks to the global economy. Accordingly, the IMF should focus on its traditional core mandate, providing sound and independent macroeconomic policy advice and timely technical assistance, and fulfilling its important role to support more vulnerable economies to meet their foreign currency liquidity requirements in case of more turbulent conditions.

Brazil: early policy response and continued push for reforms

The Brazilian economy rebounded strongly in 2021 and GDP returned to its pre-pandemic level early that year. Brazil has registered net creation of 2.7 million jobs in 2021, and unemployment has already reached its pre-pandemic level and is on a steady downward trend. A strong vaccination rollout (85 percent of the population with at least one dose, 75 percent fully vaccinated, and almost 40 percent with a booster) has helped to contain the lethality of the Omicron wave—which has receded from its peak. Monetary policy tightening, as well as slower global growth, decelerated the pace of transition from our cyclical recovery to sustainable growth.

The government has remained committed to a responsible fiscal stance and the public sector delivered in 2021 a much stronger result than expected. Despite the strong policy response to the pandemic in 2020, and the flexibilization to accommodate the effects of a new wave of COVID-19 in 2021, fiscal responsibility has been preserved throughout the crisis. Even the significant boost in the cash transfer program was accommodated within the expenditure ceiling, by a new constitutional rule rescheduling the payments of court-mandated liabilities. With expenditures kept firmly under control, and the fiscal revenue windfall from the recovery in economic activity and related increase in nominal GDP, the primary balance of the public sector improved by more than 10 percentage points from a deficit of 9.4 percent of GDP in 2020 to a surplus of ¾ percent of GDP in 2021—and in January 2022, the 12-month primary fiscal surplus reached 1.2 percent of GDP. In contrast, IMF staff projected a primary deficit of 1.7 percent of GDP in 2021, as late as September last year, when the Article IV consultation was completed. As a result of the better performance, the gross debt of the general government declined from a peak of 89 percent of GDP in February 2021 to 79.6 percent of GDP in January 2022.

The Central Bank of Brazil (BCB) has acted early and forcefully to fight high and persistent inflationary pressures. Since March 2021, the policy interest rate has been hiked by 975 basis points to 11.75 percent. Inflation pressures have resulted from a combination of stronger domestic economic activity, higher international commodity prices, and exchange rate depreciation. The war in Ukraine exacerbated pressures on food and energy prices. The longer this conflict lasts, the heavier global inflation pressures will be. Fiscal consolidation, the advanced stage of the monetary tightening cycle, and improved terms-of-trade have eventually translated into a strong appreciation of the exchange rate in Brazil this year—more than 15 percent since January against the US dollar. The BCB is closely monitoring inflation dynamics and will continue to act as needed to fight inflation and keep inflation expectations well anchored. While the continuing sequence of global shocks makes the economic environment more challenging, the BCB is fully committed to bringing inflation and inflation expectations back to the target. The floating exchange rate remains a key shock absorber and interventions are carried out only when the market is dysfunctional or unable to absorb large flows. It is important to safeguard free market conditions so as to preserve the depth of not only the foreign exchange market but also of domestic capital markets.

The structural reform agenda remains a top priority to the government and important steps to enhance Brazil's growth potential have been taken. We never stopped our drive to pursue a broad reform agenda and remove obstacles to a friendly business environment and higher and more inclusive growth in Brazil. Even during the very disruptive periods of the pandemic we accomplished many historical feats, among them, central bank legal autonomy, a new bankruptcy law, a new sanitation legal framework, a new natural gas law, broad digitalization of public services, and a new procurement law, to name a few. Furthermore, we deepened our trade liberalization and competitiveness strategy with an additional 10% import tariff reduction on ICT and capital goods, and a horizontal reduction of 25% on both imported and domestic manufactured products. More recently, our focus has shifted to the tax and administrative reforms, the privatization of state-owned companies, and developing modern regulatory frameworks that attract private investment. Our ambition and motivation for implementing structural reforms remains undeterred, despite the challenging and complex international economic environment.

In sum, Brazil continues to adjust its economy in a responsible way, while protecting the vulnerable and proceeding with a reform agenda to enhance sustainable and inclusive growth. Even in a context of overlapping shocks, Brazil has done its homework and is poised to benefit from a more balanced domestic economy not only during periods of instability, but also when uncertainty dissipates, and the global economy resumes a stronger growth path.

The IMF's key role at the center of the global financial safety net

Fund's surveillance and policy dialogue must remain focused on the critical macroeconomic challenges facing the membership, where it can add the most value. The combination of growth deceleration, high inflation, tightening financial conditions, supply disruptions, limited fiscal space, and pervasive uncertainty has resulted in a uniquely challenging environment for policymakers, raising the premium for dexterity in macroeconomic management. As countries have different exposures to geopolitical risks, pandemic waves, and monetary tightening, policy recommendations must remain fully informed by country circumstances. That said, IMF messaging on inflation and debt sustainability must be compelling and should not leave any room for ambiguity. We therefore strongly support the call to focus surveillance on inflation, financial vulnerabilities, fiscal adjustment, and economic scarring from the pandemic.

The IMF should stand ready to step up its support to help member countries navigate this very challenging international environment. Emergency assistance from the Fund was timely and invaluable for many member countries during the heights of the pandemic crisis. As emergency eased, Fund financial and technical assistance has shifted toward supporting adjustment and reform efforts to foster a strong, sustainable, and inclusive recovery. Now, with the geopolitical shock, potential demand for IMF financial assistance may increase substantially, and the Fund should be ready to provide support as needed. The choice of instrument may vary from case to case, but the full set of facilities in the IMF toolbox, including precautionary instruments, should be deployed as warranted. In this regard, fully funding the PRGT is critically needed to ensure that sufficient resources will be available for the poorest members. In particular, high-income countries that have never contributed to the PRGT should volunteer to do so, as expanding the base of contributors is essential to meet funding targets.

We welcome the creation of the Resilience and Sustainability Trust (RST) and underscore the importance of keeping its purpose broad to encompass different reform priorities. The RST will help channel SDRs and complement the IMF toolbox by providing long-term finance on concessional terms in support of policies and reforms that enhance economic resilience and address structural bottlenecks to inclusive and sustainable growth. LICs, small developing states, and the so-called "forgotten middle" are among the groups of countries that can benefit the most from RST support. Prioritizing and sequencing reforms in line with country circumstances is critical to increasing the likelihood of success when implementing a broad reform agenda. Excessively constraining the areas to be supported by the RST could undermine country ownership and disrupt proper prioritization and sequencing of reforms, possibly leading to suboptimal results. Hence, we call on management and staff to accelerate their efforts to put in place, by the RST's interim review, collaboration frameworks with the World Bank and other multilateral partners to leverage their expertise on the implementation of a fuller range of pertinent topics to be supported under the RST.

We welcome the new IMF strategy for fragile and conflict-affected states (FCS) underscoring that flexibility is the key for its success. The new strategy is comprehensive, well-crafted, and predicated on the right principles, while addressing recommendations of the Independent Evaluation Office (IEO) report on the matter. The challenge now is to properly implement it, ensuring that, among other things, macroeconomic frameworks adequately consider the reality on the ground, country ownership is enhanced, and conditionality remains well targeted and parsimonious. Ultimately, success in implementing the FCS strategy will require a change of culture within IMF staff, management, and the Executive Board.

A successful and timely conclusion of the 16th General Review of Quotas (GRQ) is ever more crucial. In a significant range of scenarios, Fund resources may prove insufficient to deal with future crises, and even more so now than only a few months ago. Moreover, quotas currently account for less than half of the Fund's lending capacity. This undermines basic pillars of IMF governance and effectiveness as a quota-based institution. Increasing quotas also provides an opportunity to correct significant misalignments between members' quota shares and relative economic weight, which would be best done by a new quota formula, with much larger weight on GDP PPP. At the same time, quota shares of PRGT-eligible countries and small developing states should be preserved, to avoid diluting the voice of those important groups in the membership. We call on the IMF Executive Board to work on a feasible roadmap with concrete milestones and deliverables, to ensure that the 16th GRQ will be successfully concluded by the established deadline.