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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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Our deepest sympathies go to the families of Covid-19 victims and to those suffering from the hardships of this tragic pandemic.

<u>Positive results from decisive policy action but uneven recovery</u>

Decisive policy action has mitigated the impact of the pandemic and led to widespread upside revisions to growth. Growth in 2020 surprised some international organizations on the upside, however, it should not be totally unexpected. By mid-2020, the scale and forcefulness of the policy responses by advanced and emerging market economies indicated a reversal of the initial sharp downturn that followed the shock. Additional fiscal stimuli in key advanced economies and progress in vaccination suggest stronger global growth in 2021 than initially expected. Large output gaps and subdued inflation have led central banks to signal a protracted accommodative monetary policy stance in major advanced economies. However, market perceptions of fiscal and inflationary risks and related repricing of financial assets could lead to a more challenging environment for emerging market economies.

While there is reason for cautious optimism, the recovery has been uneven and subject to high uncertainty. That said, we see countries mostly improving at different paces rather than diverging. For sure, existing policy space, structural features, prevalence of new virus variants and speed of vaccine rollout are important factors behind the diverse pace of recovery in different parts of the world. On the other hand, factors that have contributed to a steeper downfall, could help on the way up. For instance, developing countries with large contact-intensive informal labor markets were particularly affected, but flexibility in those sectors could lead to a stronger response, as we overcome the pandemic.

Equitable access to vaccines to foster quick and worldwide vaccination is the highest-return investment globally. The availability and pace of vaccination is a key factor to accelerate recovery and, hence, fiscal rebalancing. Different paces of vaccine rollout magnify asymmetries between countries, with developing, especially low-income, countries facing greater challenges. Therefore, international cooperation is key to ensure that vaccines become adequately available in every country. We call on the public and private sectors, as well as multilateral organizations and bilateral cooperation to help bridge the financing and distribution gaps, including by incentivizing technology transfer and voluntary licensing of intellectual property.

Easy financial conditions have been key to lessen the fallout from the shock but fed into rising vulnerabilities. Leverage ratios have continued to increase to historically high levels with loose financial conditions and could threaten financial stability. As policies remain accommodative, financial stability must be closely monitored, and prudential frameworks strengthened. Liquidity support has helped keep solvent firms afloat, protecting jobs and averting scarring. However, letting go of nonviable firms, which is part of the cleansing process in a recovery, will be complicated by the high exposure of the financial sector to those companies.

Brazil: revamping the tools to sustain a strong recovery

Brazil's economy rebounded sharply in the second semester of 2020. Fiscal, monetary, and financial policy support dampened the massive shock and laid the ground for a strong recovery. Given the comprehensive and coordinated policy response, labor market adjustment took place mostly in the informal sector, while savings and credit expanded. This augurs well for a quick pick up in economic activity as the restrictions imposed by the pandemic dissipate. However, the new wave of Covid-19 casts higher than usual uncertainty and stress to the current scenario. Nonetheless, formal job creation posted a record 260 thousand for the month of January and the economy is projected to grow 3.2 percent this year.

With the recent Covid-19 upsurge, the new round of income support to the most vulnerable was tied to structural fiscal discipline measures. The emergency assistance was reinstated together with a constitutional amendment to re-anchor the fiscal accounts and ensure a downward path for public debt over the medium term. According to the new framework, among other measures, when certain triggers are activated, public sector wages and hiring are frozen at the federal, state, and municipal levels. Broad parliamentary support was gathered for this approach in which emergency assistance was unleashed together with stronger rules to rein in public expenditures. Hence, fiscal support and the protection of the vulnerable population came alongside measures to preserve fiscal sustainability.

After providing extraordinary monetary stimulus for quite some time, the central bank (BCB) started a process of partial normalization of monetary policy. The sustained increase in commodity prices and exchange rate depreciation, accompanied by the rebound in economic activity and the formal labor market have led to an upward adjustment in inflation and inflation expectations. Fulfilling its mandate, the central bank has raised the policy rate to ensure inflation and inflation expectations remain within target for the relevant horizon for monetary policy. Even with the recent policy rate hike, monetary policy remains very accommodative. Moreover, the financial sector, which was very well positioned when the crisis struck, has shown remarkable resilience.

Meanwhile, the market-friendly reform agenda to unleash Brazil's growth potential proceeds resolutely. In addition to the pension reform and the constitutional emergency amendment which tightened the fiscal framework, Congress recently approved the central bank independence law, after 20 years of failed legislative attempts. The broad-based transformational agenda covers diverse initiatives, several of them already implemented, including an efficiency-enhancing tax reform, de-earmarking and decentralizing expenditures, privatizations, further flexibilization of the labor market, and new regulatory frameworks for natural gas, cabotage, sanitation, and foreign exchange market, the latter in line with OECD principles. Furthermore, an extensive agenda of red tape removal and ease of doing business continues to make important progress.

In a nutshell, the approach to boost sustainable and inclusive growth in Brazil is three-pronged: intensifying mass vaccination, providing short-term fiscal support coupled with medium-term fiscal consolidation, and proceeding with pro-market reforms.

<u>The IMF at the center of the global financial safety net</u>

We welcome the broad support that has been mustered for a substantial general allocation of SDRs and commend the leadership of the Managing Director in this process. This injection of liquidity will help the membership by complementing international reserves and providing additional and timely leeway for Covid-related spending. Our focus now is to ensure that this allocation is successfully completed as quickly as possible. In the meantime, we urge the Fund to explore ways in which SDR holdings of countries with strong external positions could be channeled, under adequate safeguards, to complement Fund resources in support of reform efforts by low-income countries as well as small and medium-sized middle-income countries, the so-called "forgotten middle."

The Fund raised to the challenges posed by this unprecedented crisis. The initial response was focused on providing emergency assistance, with the notable approval of 85 emergency arrangements since the outset of the crisis. As we move to the stabilization and recovery stages of the pandemic, IMF support is transitioning toward programs to support macroeconomic stability and structural reforms. This healthy move, however, requires some adjustments in the way the IMF does business.

While we applaud the temporary increases in access limits to Fund facilities, more needs to be done to meet the needs of the Fund's most vulnerable members. One piece of the puzzle is to revamp the PRGT. We welcome the ambitious proposals being considered by the Executive Board to harmonize PRGT and GRA limits, increasing the level of financial support to PRGT-eligible countries and heightening the quality of Fund engagement with those counties. Of course, reforms need to be matched by funding arrangements to ensure the sustainability and financial soundness of the PRGT trust. We are open to consider a comprehensive funding package, in which the donor contributions would be complemented by mechanisms to mobilize Fund's own resources, including by promoting a new round of gold sales.

Small and medium-sized middle-income countries are among the most vulnerable part of the membership. They are generally not eligible to the PRGT, but they usually have constrained access to international capital markets and limited technical capacity. Also, a sizable portion of the world's poor live in those countries. They were hard hit by the pandemic, with their progress toward meeting the SDGs suffering a significant setback. Moreover, many of them are particularly susceptible to natural disasters, which have become more frequent and intense with climate change. Those countries are natural candidates to become beneficiaries of an effort to channel SDRs to complement IMF-supported programs.

The close policy dialogue with country authorities in well-tailored surveillance is among the most valued service the Fund offers to the membership. The richness of surveillance lies on its country-specificity and in the cross-country institutional knowledge that is unique to the Fund. Global consistency of bilateral surveillance should result from successive iterations, reflecting deep analysis of country-specific circumstances and features. It should never be imposed by a top-down approach. Rather, it should entail nuanced and candid policy advice that is reflected in both IMF country and cross-country outlets.

Traction of IMF policy advice would be much enhanced by focusing on the areas where the institution has a long and well-established expertise and on where it cannot be replaced on par by others. The magnitude of the challenges faced by the membership on fiscal, monetary, external, and financial policies is enormous. Other issues can be brought into the scope of surveillance, but only through the lenses of their macroeconomic dimensions. Such focused approach is of the essence to ensure that the limited IMF resources are employed where they can yield the most and where the Fund does not have any close substitute.

Finally, the Fund's effectiveness and legitimacy hinges on a successful conclusion of the 16th General Review of Quotas (GRQ) in line with previous commitments. We welcome the timely completion of the doubling of the NAB and the new round of bilateral borrowing agreements. We commend the countries that participate in both initiatives. However, the quota-based nature of the Fund needs to be restored, by relying again mostly on own rather than borrowed resources. Moreover, the Fund's size should be commensurate with the bulk of the risks facing the global economy, which implies a substantial increase in the current size of the Fund, as preliminarily shown by staff. Also, the 16th GRQ must deliver on the decade-long quota and governance commitments, which call for quota shares to better reflect the economic weight of its members, while protecting its poorest and smallest members. We welcome the initial discussions and look forward to a successful and early conclusion of the 16th GRQ.