Capital Account Management in Brazil

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Paper presented at the Rethinking Macro Policy II: First Steps and Early Lessons Conference
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IMF-WB Spring Meeting/Fiscal Forum
Rethinking Macro Policy II: First Steps and Early Lessons

April 18, 2013
Expansion of International Liquidity (US$ trillions)
(USA, Europe, United Kingdom and Japan) - 2007-2013

Source: Bloomberg
Produced by: Secretary of Economic Policy/Ministry of Finance - Brazil
Unconventional Monetary Policy

- Zero lower bound monetary policy in advanced economies associated with intense liquidity injection in their domestic financial system.

- Fiscal situation in most advanced economies is rather a problem than part of the solution.

- Central Bankers are trying to boost growth under such challenging circumstances.

- However, this has led to the “currency war”, as it is a non-cooperative or competitive not zero-sum game.
Ex-ante Real Interest Rate (% p.a), Before and Then

**BEFORE THE 2008 FINANCIAL CRISES**
Real Interest Rates in 2007

<table>
<thead>
<tr>
<th>Country</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany</td>
<td>1.93</td>
</tr>
<tr>
<td>France</td>
<td>1.81</td>
</tr>
<tr>
<td>USA</td>
<td>0.05</td>
</tr>
<tr>
<td>Italy</td>
<td>1.66</td>
</tr>
<tr>
<td>China</td>
<td>(1.61)</td>
</tr>
<tr>
<td>Mexico</td>
<td>3.57</td>
</tr>
<tr>
<td>Brazil</td>
<td>7.70</td>
</tr>
</tbody>
</table>

**AFTER THE 2008 FINANCIAL CRISES**
Real Interest Rates in 2013

<table>
<thead>
<tr>
<th>Country</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>-1.69</td>
</tr>
<tr>
<td>Germany</td>
<td>-1.46</td>
</tr>
<tr>
<td>China</td>
<td>-1.39</td>
</tr>
<tr>
<td>France</td>
<td>-1.19</td>
</tr>
<tr>
<td>Italy</td>
<td>-0.40</td>
</tr>
<tr>
<td>Mexico</td>
<td>0.62</td>
</tr>
<tr>
<td>Brazil</td>
<td>2.13</td>
</tr>
</tbody>
</table>

**Source:** Bloomberg

**Produced by:** Secretary of Economic Policy/Ministry of Finance - Brazil
Brazil is implementing a set of policies that sustains economic growth

- Flexible monetary policy
- Countercyclical fiscal policy
- Floating exchange rate regime with more competitive Brazilian Real under “currency war”
- Promoting investment, mainly in infrastructure sector, fostering productivity
- Reduction of financial costs of investments
- Reduction of tax costs with widen tax exemptions due to fiscal space
- Promoting long-term capital market
- And, also managing capital inflows as part of the economic policy toolkit
The policy toolkit to manage capital account

- Higher IOF rates on short-term capital inflows, including external loans up to 1 year.
- IOF rates derive margin deposit.
- IOF rates on excessive long position on BRL.
- Banks have to park at the Central Bank 60% of short dollar positions that exceed the limit of US$3 billion. The deposits should be in cash and receive no interest rate.
## IOF rates on Portfolio Investments and External Loans

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td><strong>Portfolio</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Income</td>
<td>1.50%</td>
<td>2.00%</td>
<td>4.00%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
</tr>
<tr>
<td>Long-Term Corporate</td>
<td>1.50%</td>
<td>2.00%</td>
<td>4.00%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.00%</td>
</tr>
<tr>
<td>Bonds</td>
<td>0.00%</td>
<td>2.00%</td>
<td>2.00%</td>
<td>2.00%</td>
<td>2.00%</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.00%</td>
</tr>
<tr>
<td>Equity</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Derivative Margin</td>
<td>0.38%</td>
<td>0.38%</td>
<td>0.38%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
</tr>
<tr>
<td>Deposit</td>
<td></td>
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<td></td>
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<td></td>
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<td></td>
</tr>
<tr>
<td><strong>External Loan</strong></td>
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<td></td>
<td></td>
<td></td>
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<td>up to</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>90 Days</td>
<td>5.38%</td>
<td>5.38%</td>
<td>5.38%</td>
<td>5.38%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
</tr>
<tr>
<td>270 Days</td>
<td>0.38%</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.00%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
</tr>
<tr>
<td>1 Year</td>
<td>0.38%</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.00%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
</tr>
<tr>
<td>2 Years</td>
<td>0.38%</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.00%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
</tr>
<tr>
<td>3 Years</td>
<td>0.38%</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.00%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
</tr>
<tr>
<td>5 Years</td>
<td>0.38%</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.00%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>6.00%</td>
<td>0.00%</td>
</tr>
<tr>
<td>Excessive Long</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.00%</td>
<td>1.00%</td>
<td>1.00%</td>
<td>1.00%</td>
<td>1.00%</td>
<td>1.00%</td>
</tr>
<tr>
<td>Positions On BRL</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
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</tr>
</tbody>
</table>

**Source:** Ministry of Finance

**Produced by:** Secretary of Economic Policy/Ministry of Finance - Brazil
Carry Trade Transactions: changing capital account composition

Carry Return* (% accumulated on a 12-month basis)

March, 2008

Poland
Czech Republic
Brazil
Chile
Norway
Switzerland
Hungary
Euro Zone
Denmark
Sweden
New Zeland
Philippines
Australia
Japan
Canada
India
Russia
Singapore
Malaysia
Mexico
United Kingdom
China
Indonesia
South Korea
South Africa

March, 2013

Chile
Mexico
Philippines
New Zeland
China (offshore)
South Korea
China
Australia
Sweden
India
Malaysia
Singapore
Russia
Poland
Norway
Canada
Indonesia
Hungary
Euro Zone
Denmark
Brazil
United Kingdom
Switzerland
Czech Republic
Japan
South Korea
South Africa

* The carry return is equal to the return on investment in fixed income securities minus the cost of foreign currency loans.

Source: Bloomberg

Produced by: Secretary of Economic Policy/Ministry of Finance - Brazil
Brazil: macroprudential measures put forward since 2011 stamped appreciation

Source: Thomson Reuters
Produced by: Secretary of Economic Policy/Ministry of Finance - Brazil
<table>
<thead>
<tr>
<th>Year</th>
<th>Other Foreign Investments</th>
<th>Foreign Direct Investment</th>
<th>Portfolio Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan 2008</td>
<td>40.000</td>
<td>0</td>
<td>16.442</td>
</tr>
<tr>
<td>Jul 2008</td>
<td>-20.000</td>
<td>0</td>
<td>16.442</td>
</tr>
<tr>
<td>Jan 2009</td>
<td>-20.000</td>
<td>0</td>
<td>16.442</td>
</tr>
<tr>
<td>Jul 2009</td>
<td>0</td>
<td>0</td>
<td>16.442</td>
</tr>
<tr>
<td>Jan 2010</td>
<td>29.823</td>
<td>0</td>
<td>16.442</td>
</tr>
<tr>
<td>Jul 2010</td>
<td>0</td>
<td>0</td>
<td>16.442</td>
</tr>
<tr>
<td>Jan 2011</td>
<td>63.737</td>
<td>0</td>
<td>16.442</td>
</tr>
<tr>
<td>Jul 2011</td>
<td>0</td>
<td>0</td>
<td>16.442</td>
</tr>
<tr>
<td>Jan 2012</td>
<td>0</td>
<td>0</td>
<td>16.442</td>
</tr>
<tr>
<td>Jul 2012</td>
<td>0</td>
<td>0</td>
<td>16.442</td>
</tr>
<tr>
<td>Jan 2013</td>
<td>16.442</td>
<td>0</td>
<td>16.442</td>
</tr>
</tbody>
</table>

Source: Central Bank of Brazil
Produced by: Secretary of Economic Policy/Ministry of Finance - Brazil
**Foreign Direct Investment**

(On 12 Month Basis – USD Million)

- **Intercompany Transactions**
- **Equity Capital**

*Source: Central Bank of Brazil*

*Produced by: Secretary of Economic Policy/Ministry of Finance - Brazil*
Why?

- Less “liability dollarization” and low “fear of floating”
- Reduced debt to GDP ratio and country risks
- Better public debt denomination and maturity
- Low interest on debt to GDP ratio
- Good economic perspectives in the medium term
Net Public Sector Debt
(% of GDP)

Source: Central Bank of Brazil

Produced by: Secretary of Economic Policy/Ministry of Finance - Brazil

* February, 2013

-24.7% of GDP
Increase of Investors Confidence for Sovereign Bonds

Commitment to fiscal responsibility throughout the years combined with economic growth have contributed to the reduction of credit risk* in Brazil.

YIELDS OF 10-YEAR BRAZILIAN AND US BONDS (% PER ANNUM)

* Measured by the differential of yields on issue date from 10-year Brazilian bonds denominated in USD and yields from US Treasury bonds, same maturity traded on the secondary market on the same date.

** From October 2012, Brazilian and US Treasury 10-year yield bonds (same maturity) traded on the secondary market on the same date.

Source: Brazilian Treasury Secretariat/Ministry of Finance and Bloomberg  Produced by: Secretary of Economic Policy/Ministry of Finance
Summing up

- Excessive international liquidity provokes side effect in emerging market economies.

- Brazil has put forward a set of macroprudential macroeconomic policy including capital account management, along with conventional monetary policy.

- Capital account management is much more a technical issue rather than an ideological one.

- It has been obtained successful results under the circumstances.

- Growth prospects: investment is the main economic policy in a context of inflation under control, growth-friendly fiscal consolidation program, solid financial system, and strong income inequalities reduction.
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