



A Lost Decade?

An Emerging Market's Perspective (Brazil)

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The views expressed in this document are those of the presenter and do not necessarily reflect those of the Central Bank of Brazil or its board members.

Outline and Issues

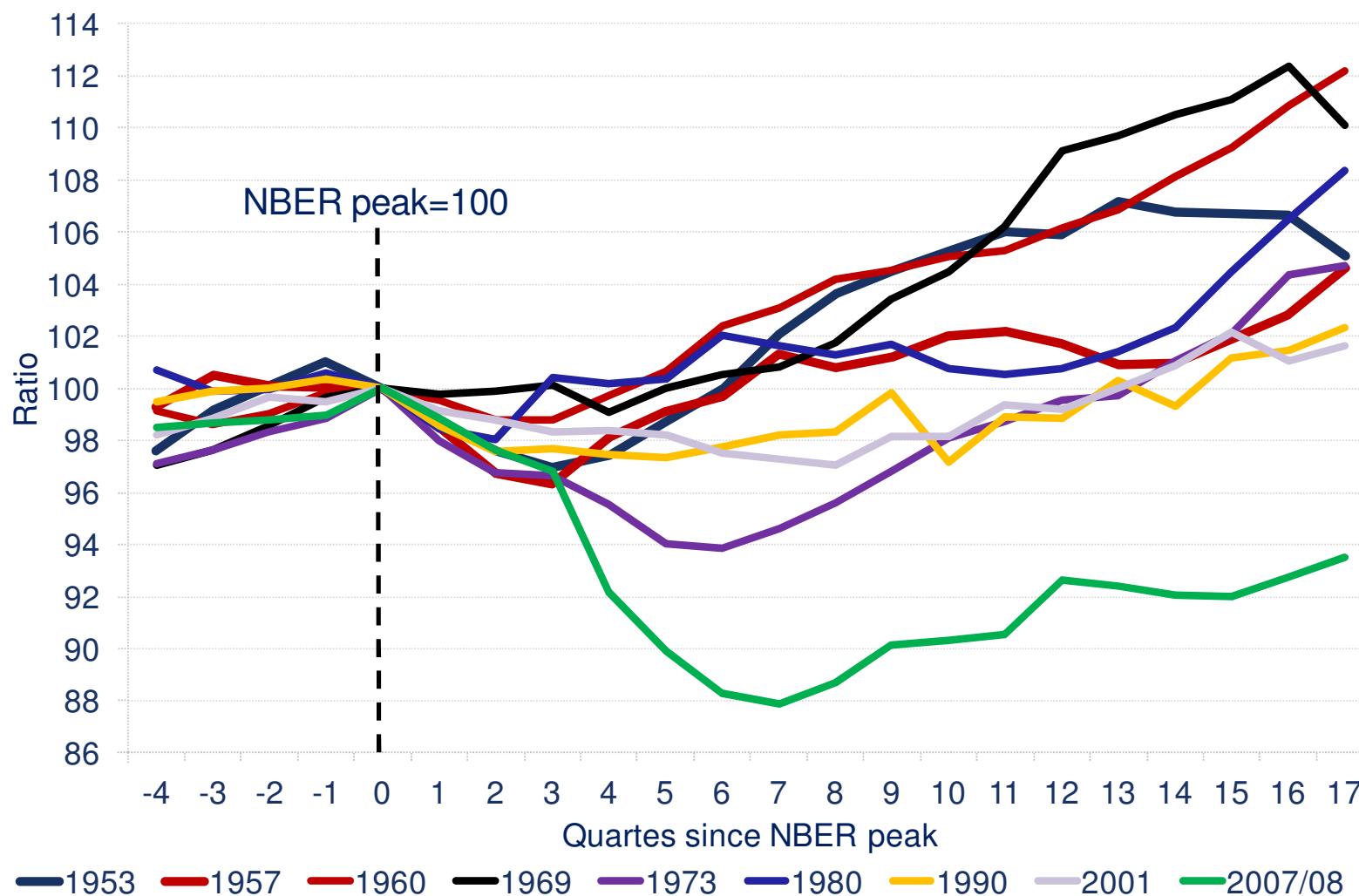
- 1. Already (2007-2012) in the Middle of a “Lost Decade” and Going...**
- 2. It Takes Time to Exit from High Debt Crisis**
- 3. This Crisis Offers Opportunities for EMEs like Brazil**
- 4. Macro & Financial Stability in a “New Normal” Environment with Sudden Stops and Floods**
- 5. Conclusions, Lessons for the G20**

1. Already (2007-2012) in the Middle of a “Lost Decade” and Going...



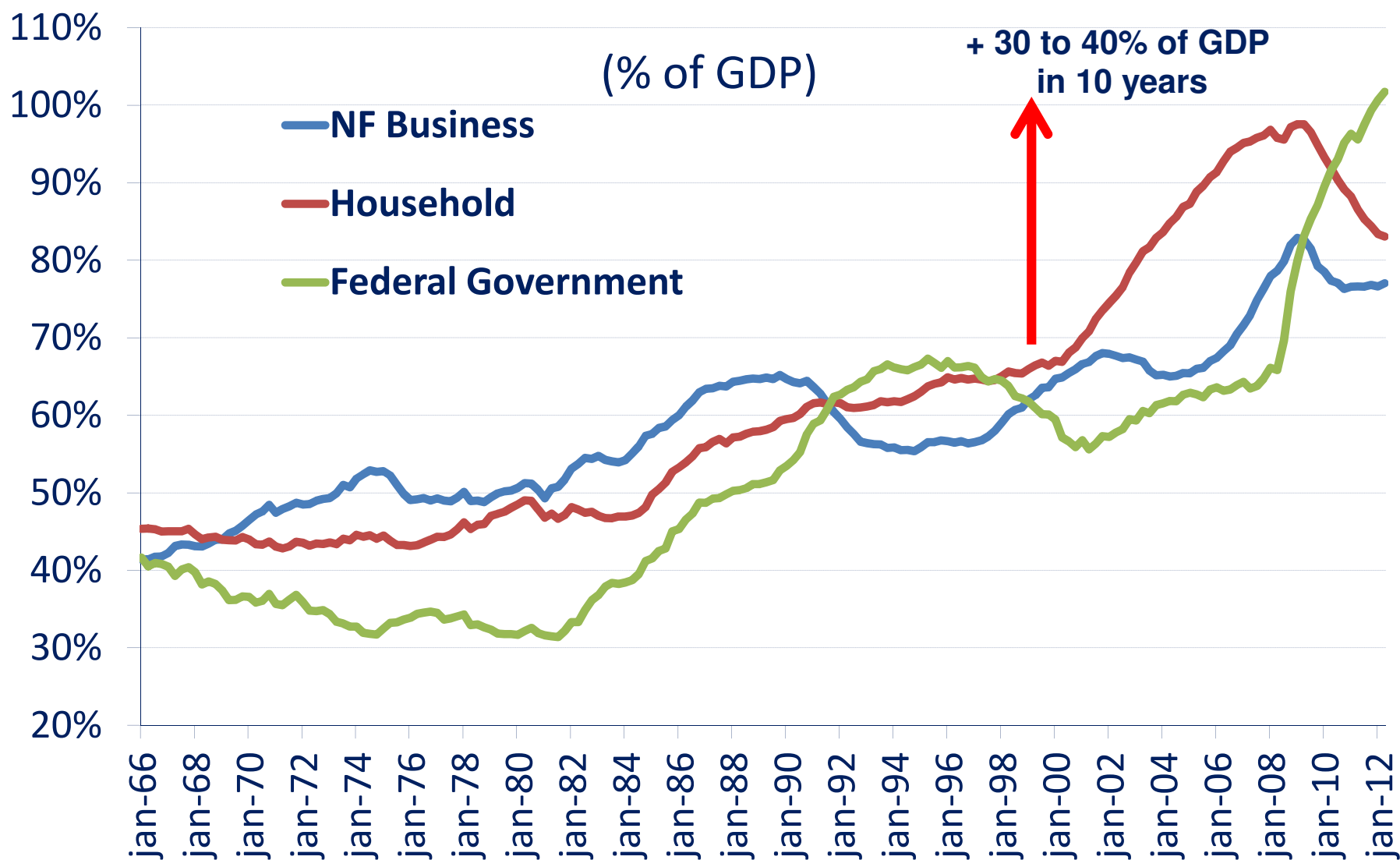
USA – Worst Recovery for Income Per Capita

Excluding current transfers receipts



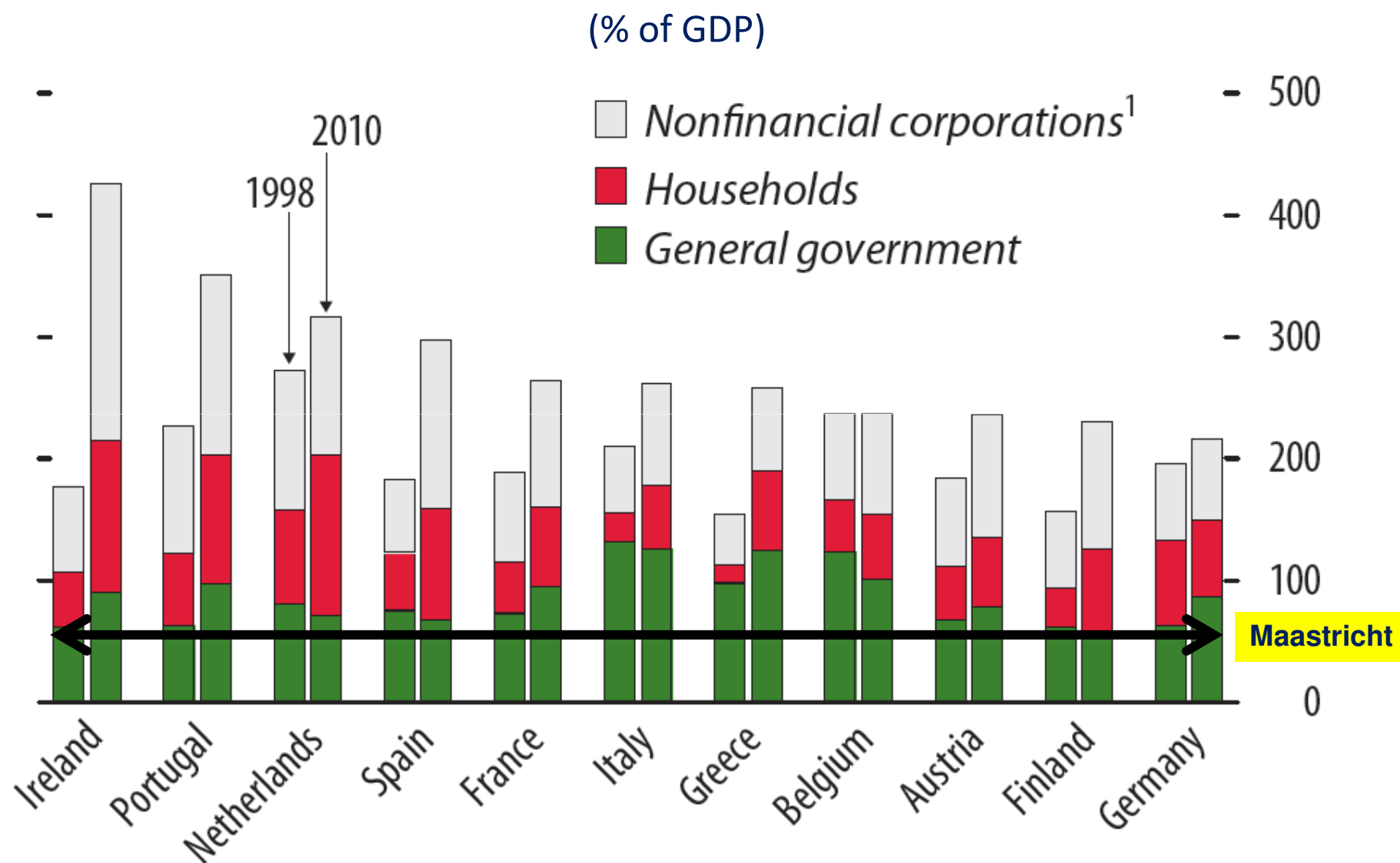
Source: Bureau of Economic Analysis

USA – High Debt for All Sectors



Source: FED Saint-Louis

Eurozone: Gross Debt by Sectors 1998 – 2010



Source: IMF – GFSR April 2012

2. It Takes Time to Exit from High Debt Crisis (as we know well in the Tropics)



Exit From High Debt: Usually 3 Ways

- **Default... but**

- Unprecedented Action by Govs (Transfer of Liabilities onto PS Balance Sheet)
- Unprecedented Action by CBs (QEs, LTRO, OMT) Removed Tail Risks



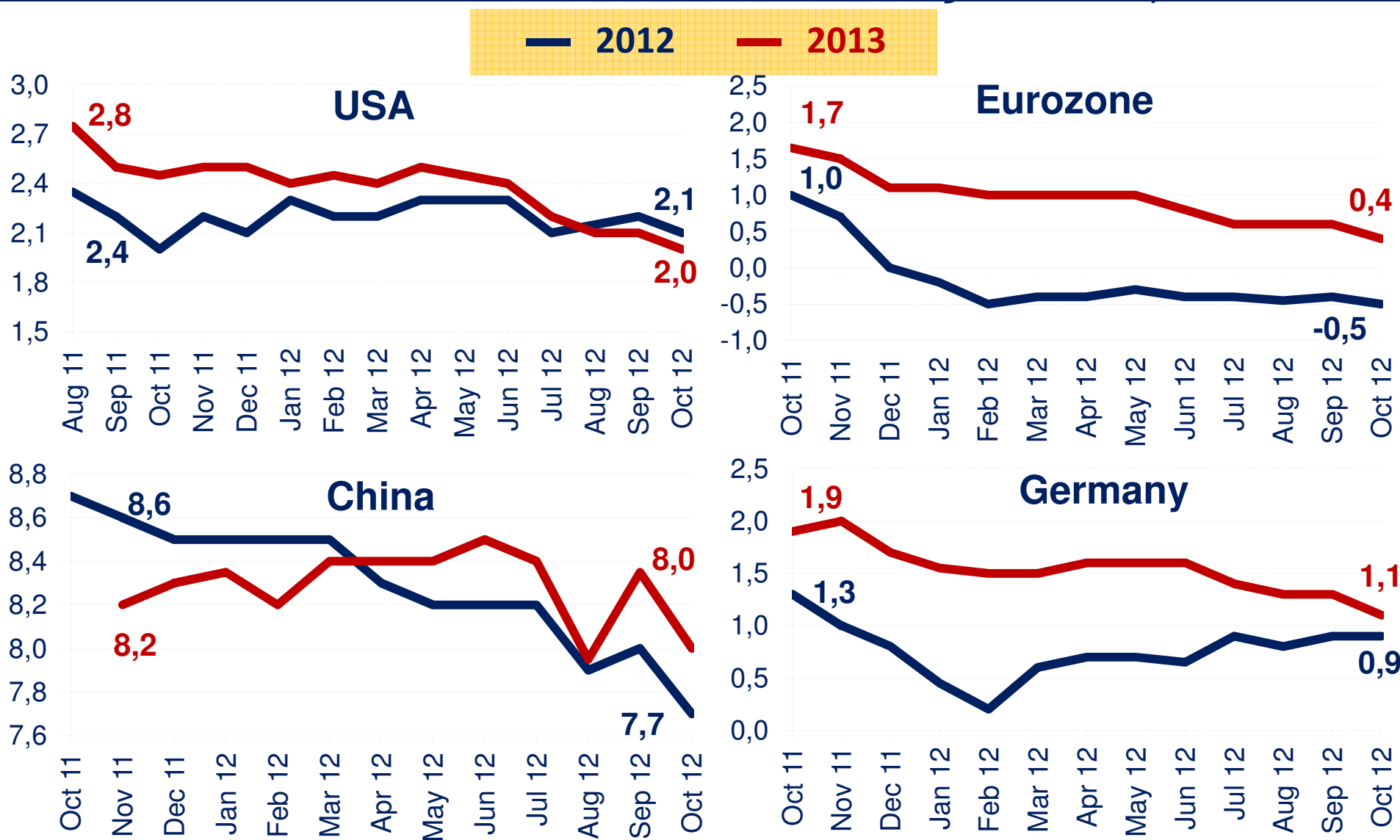
Exit From High Debt: Usually 3 Ways

- **Growth**

- Debt & Debt Service / Revenue & Income falls
- Collateral Value Recovers; Confidence Restored



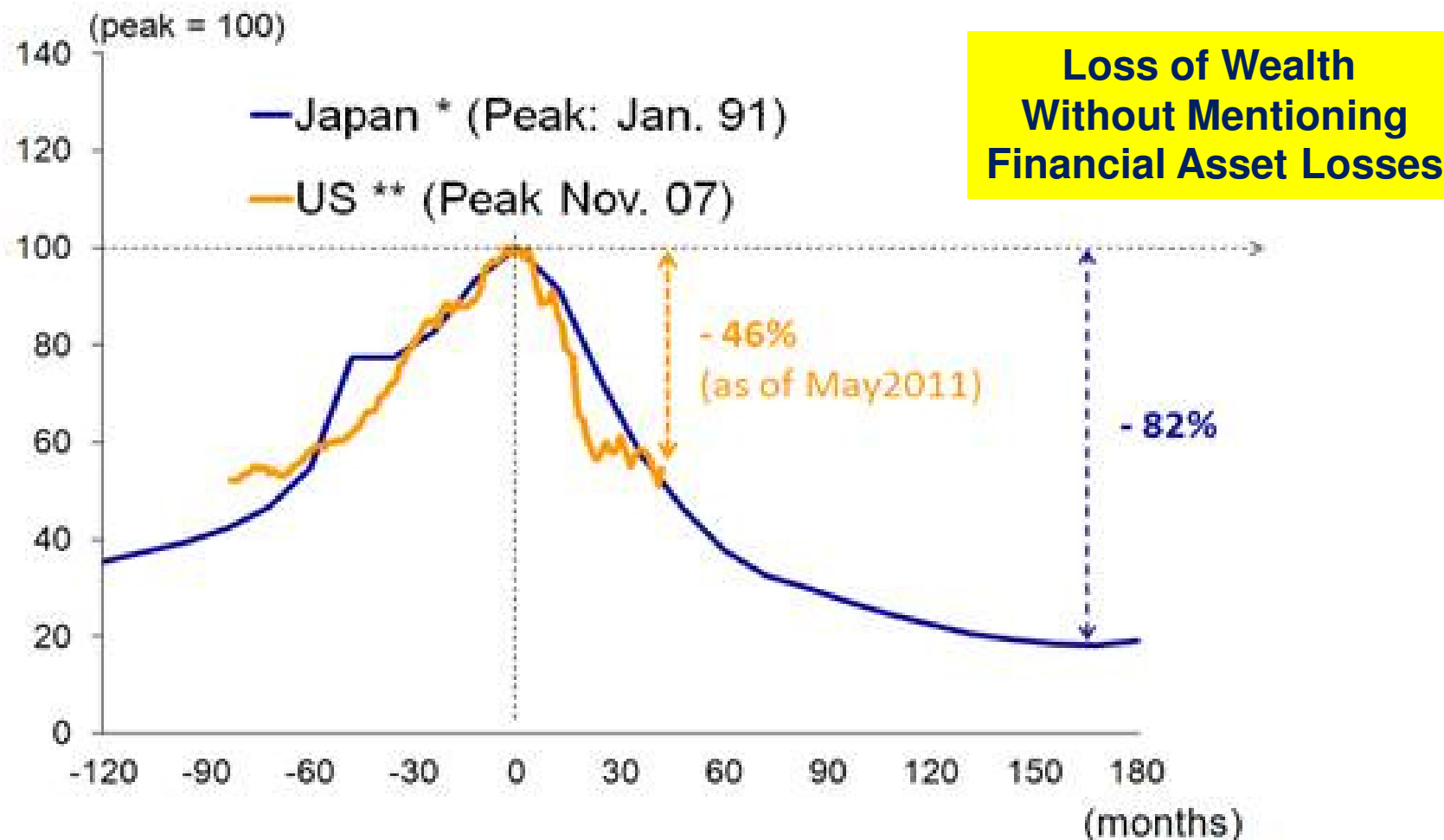
Expected Growth Rates for 2012 & 2013 throughout 2011-2012: USA, Eurozone, Germany, China)



Source: Bloomberg consensus

Lengthy Price Adjustment: USA & Japan

Commercial Real Estate Prices



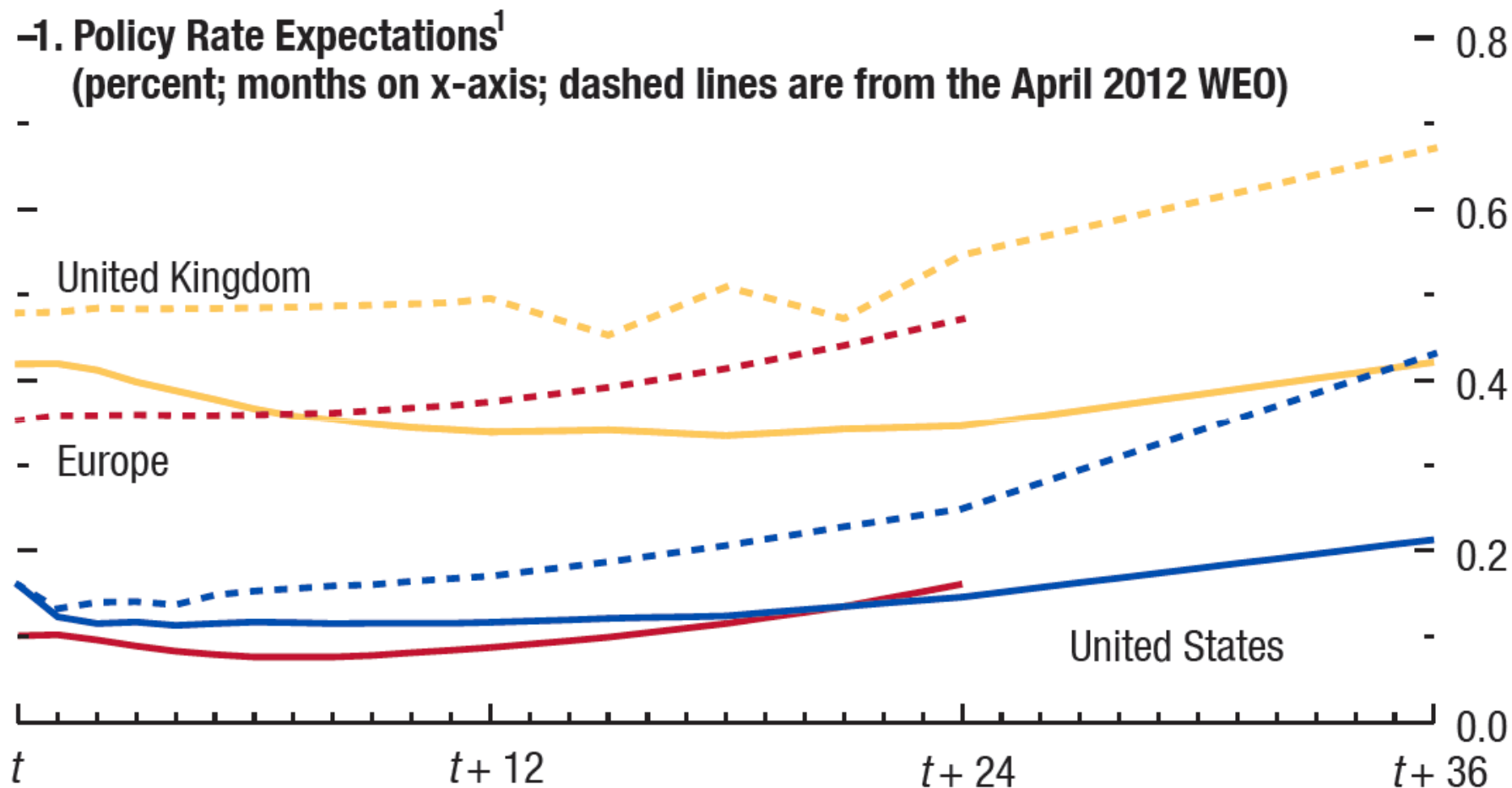
Exit From High Debt: Usually 3 Ways

- **Inflation**

- Negative Real Interest Rates
- “Forward-guidance”, Operation Twist, etc to trigger consumption and growth....

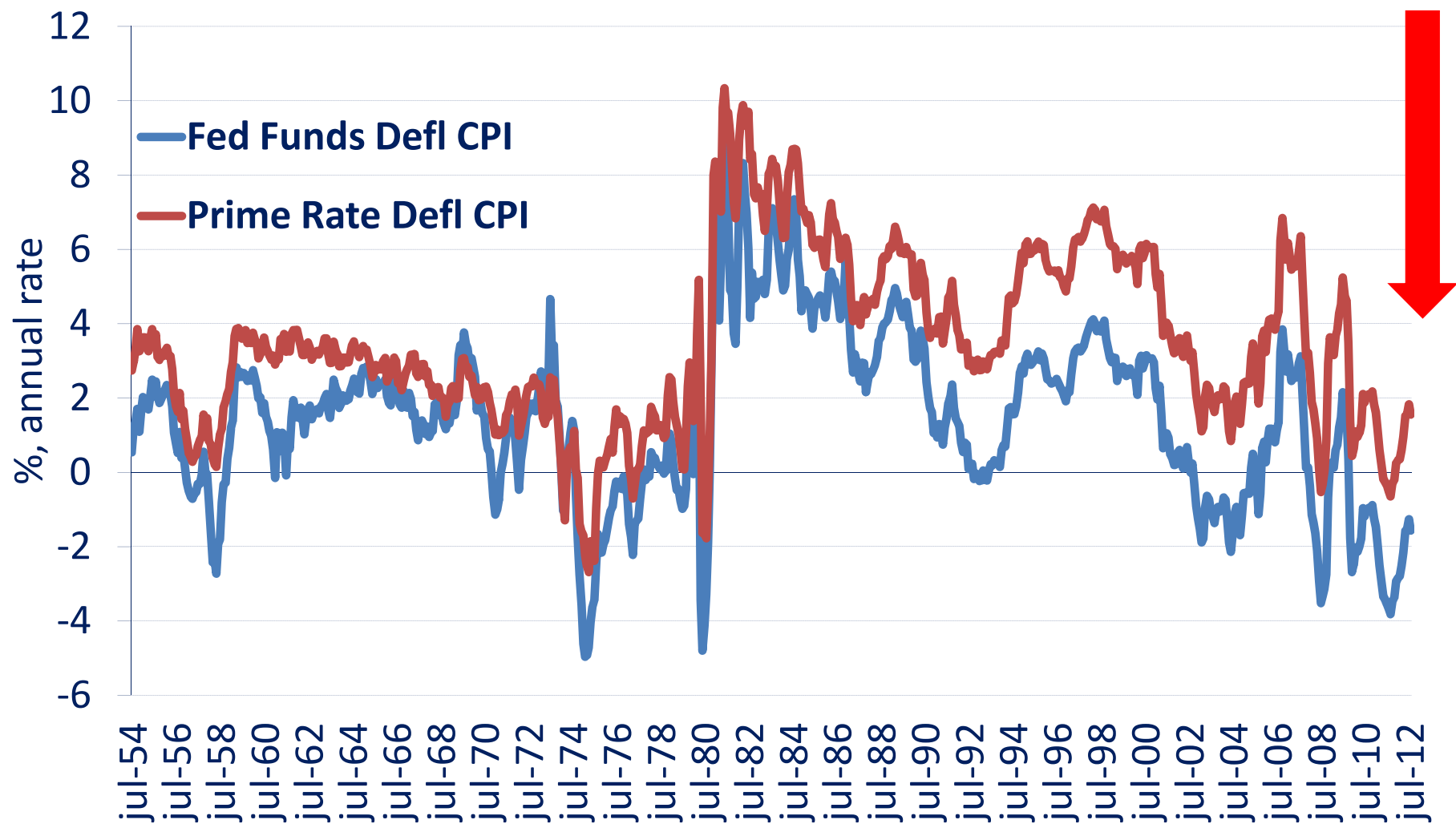


USA, Eurozone, UK- Policy Rates



¹Expectations are based on the federal funds rate for the United States, the sterling overnight interbank average rate for the United Kingdom, and the euro interbank offered forward rates for Europe; updated September 13, 2012.

USA - Real Interest Rates



Source: Bloomberg

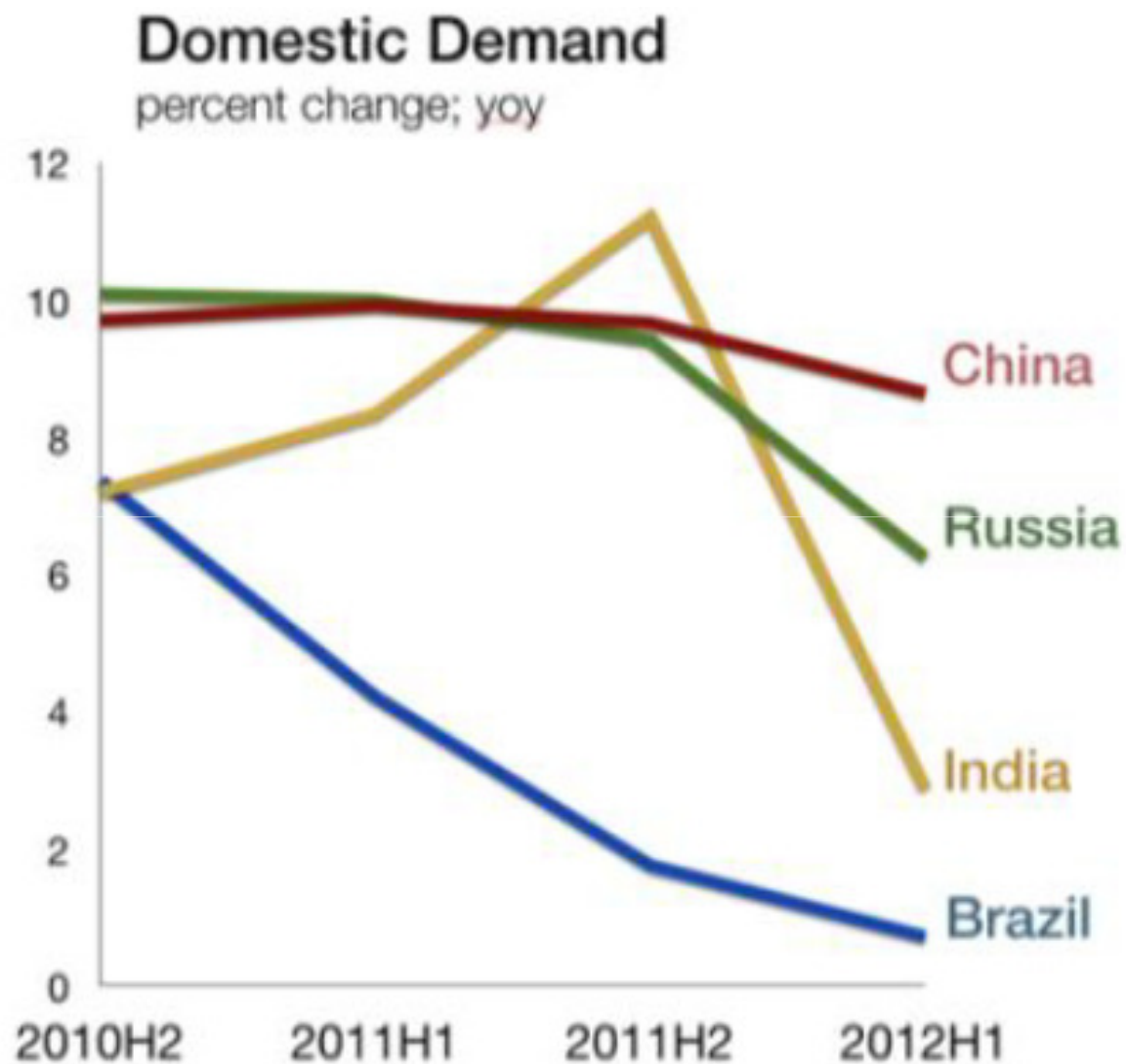
Why Is This Time Even Worse?



Why Is This Time Worse? **Debt+Political Uncertainty**

- 1. 3 Sectors Affected** Simultaneously with Very High Levels of Debt (Gov, Private NF, HHS) → affects Banks, vicious circle
- 2. All Systemic Economic Zones Affected &** Simultaneously in Crisis (USA, Euro + Japan) → RoW and EMEs (BRICs) affected, after using extensive counter-cyclical policies in 2008-09
- 3. Idiosyncratic Political Economy Issues** in each of the Systemic Zones (Fiscal Clift + Debt Ceiling in the US; Incomplete Monetary Union + Fiscal Federal Architecture in Europe; Domestic Politics in Japan & China)

Actual Growth Rates from 2010 to 2012: BRICs



Indeed Heading To 2nd Half of a “Lost Decade”

- **Prolonged Period of Mediocre Growth** hopefully with no “tail” event (i.e., a large macro-financial accident) transmission thru trade, finance & confidence channels
- **Conventional and Unconventional Policy Instruments Become (less or even) Inoperative**
 - FP & MP not usable and/or not effective
 - Weak/broken (credit) multiplier & (financial) accelerator
- **And Greater Uncertainty & Gloom → Agents’ expectations & behavior** (the CNN Channel?)

More Risks Might Appear End 2012-Early 2013

- **China's deceleration & landing** (soft or hard?)
- **Eurozone untested new framework (ESM+Banking Union+OMT)**
 - Spain (to ask or not to ask?)
 - Contagion into Italy/France?
- **USA Fiscal Clift and Debt Ceiling**

3. This crisis offers opportunities / risks for EMEs like Brazil



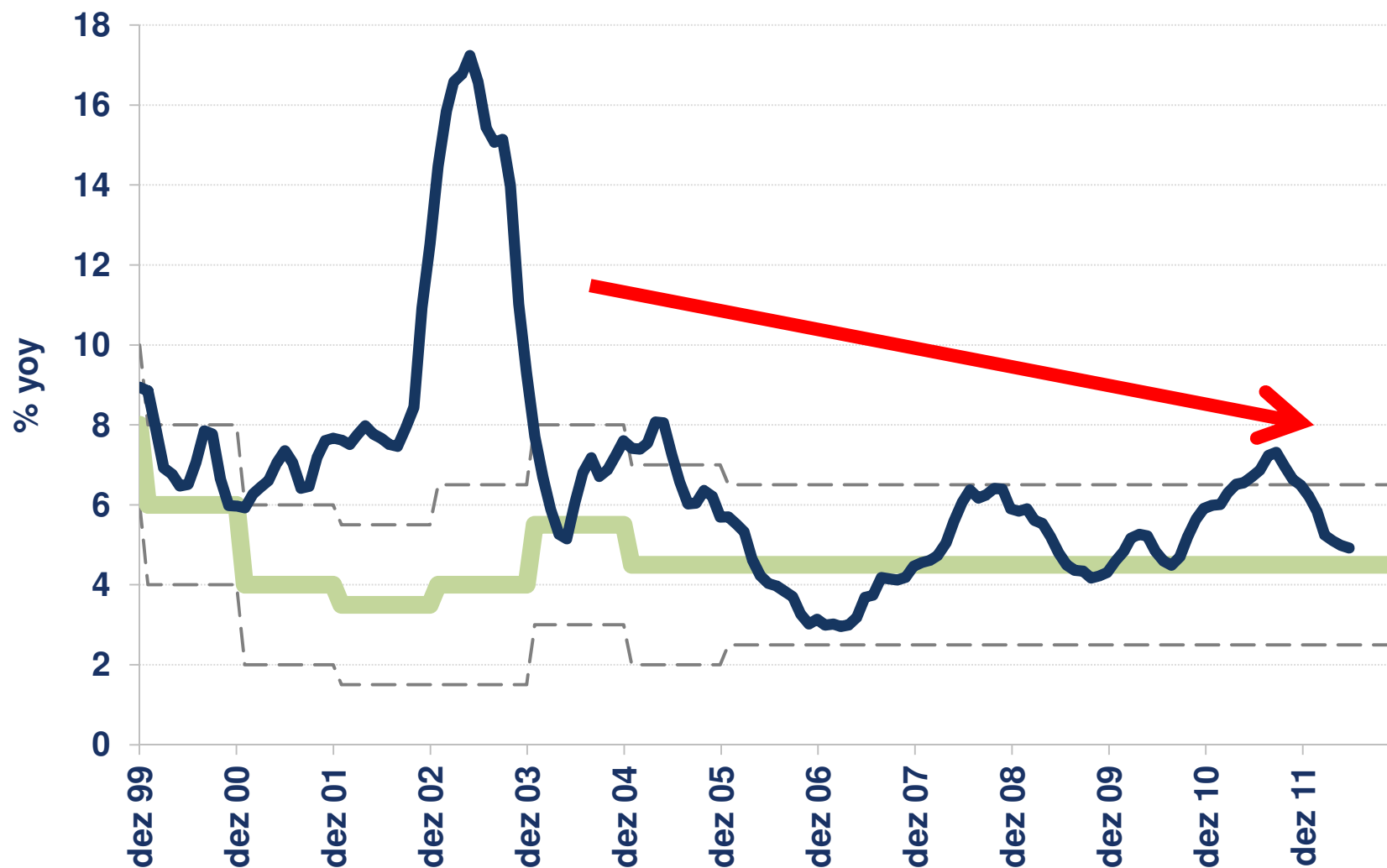
Opportunity for EMEs Like Brazil

- **Maintaining Macro & Financial Stability → Lower Risk:**
 - Fiscal (Debt), Flex ERR, IT → Credibility → lower rates
 - Strong FS Regulation, combining MP & MaP
- **Continuing Structural Reforms → Higher Productivity:**
 - Human K, Physical K (Infra) → TFP
 - Lower idiosyncratic costs (burocracy, high taxes, etc.)
- **Socio-political stability → LT Sustainability:**
 - Inclusion, integration, inequality & poverty reduction
 - Building policy awareness & consensus

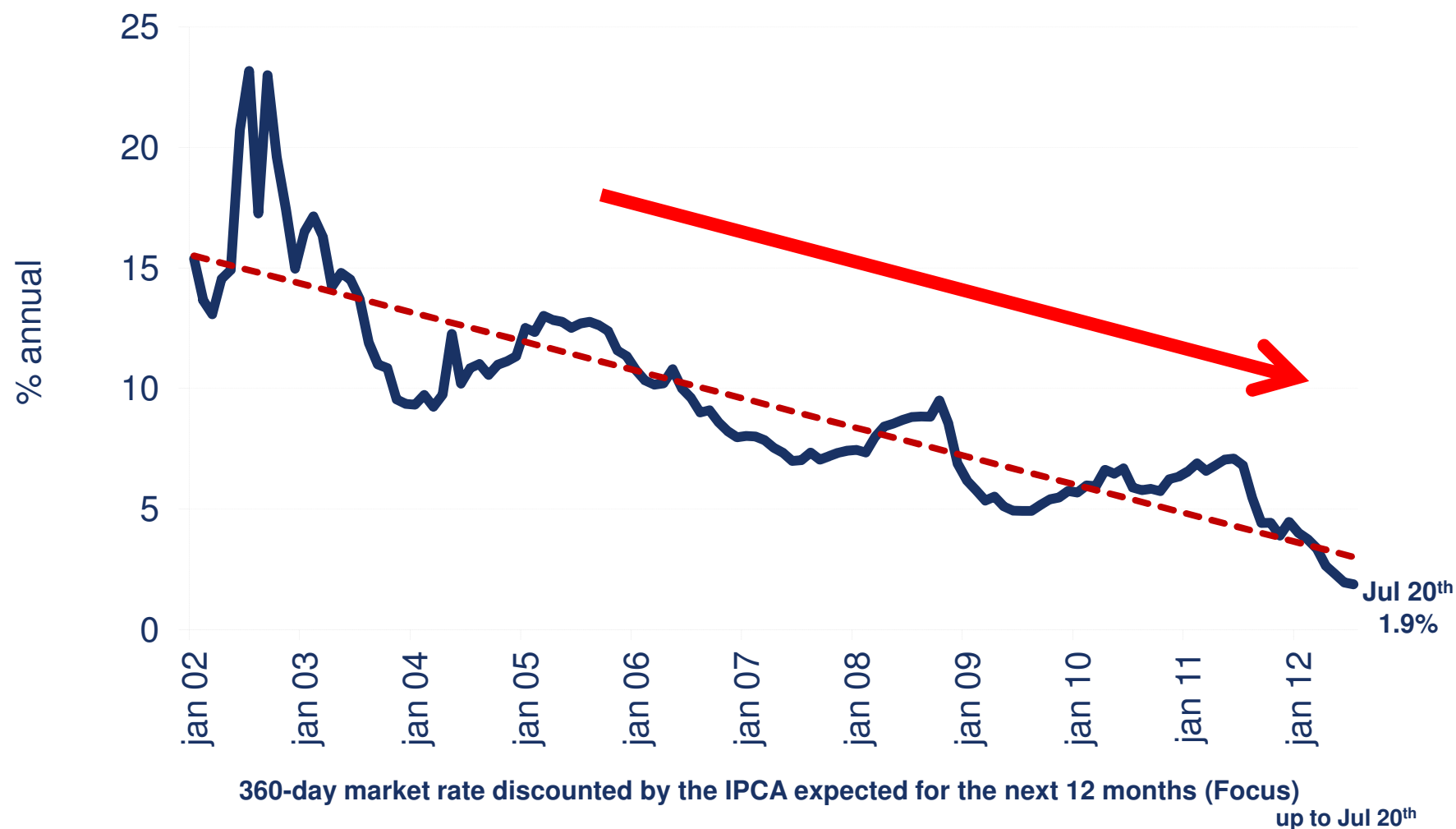
In Volatile World Beware of Markets' Cyclothimic Behavior



Keep Inflation on Target for 8th Year in a Row

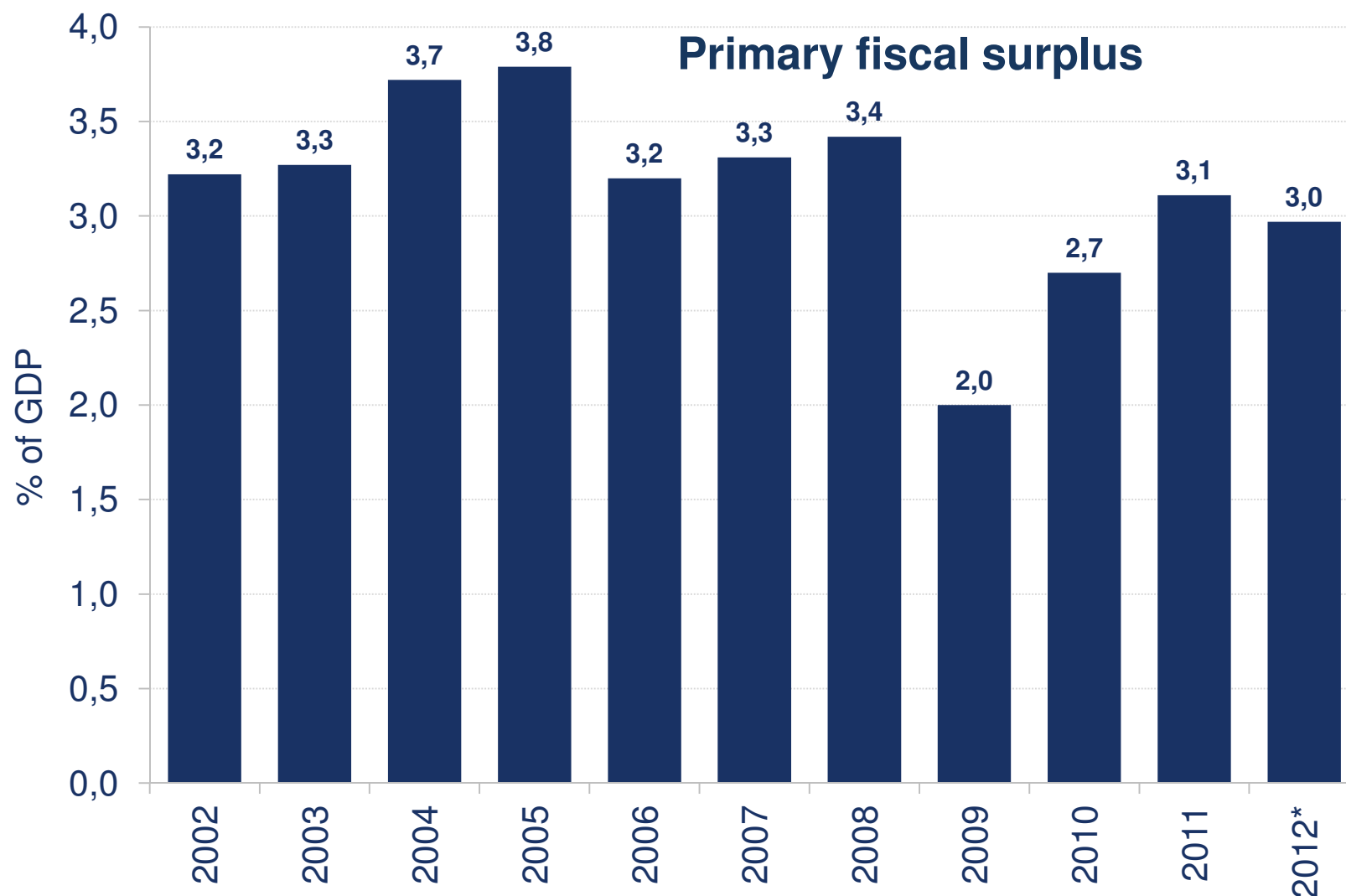


Low Inflation & Risk → Declining Real Interest Rate



Source: BM&FBovespa / BCB

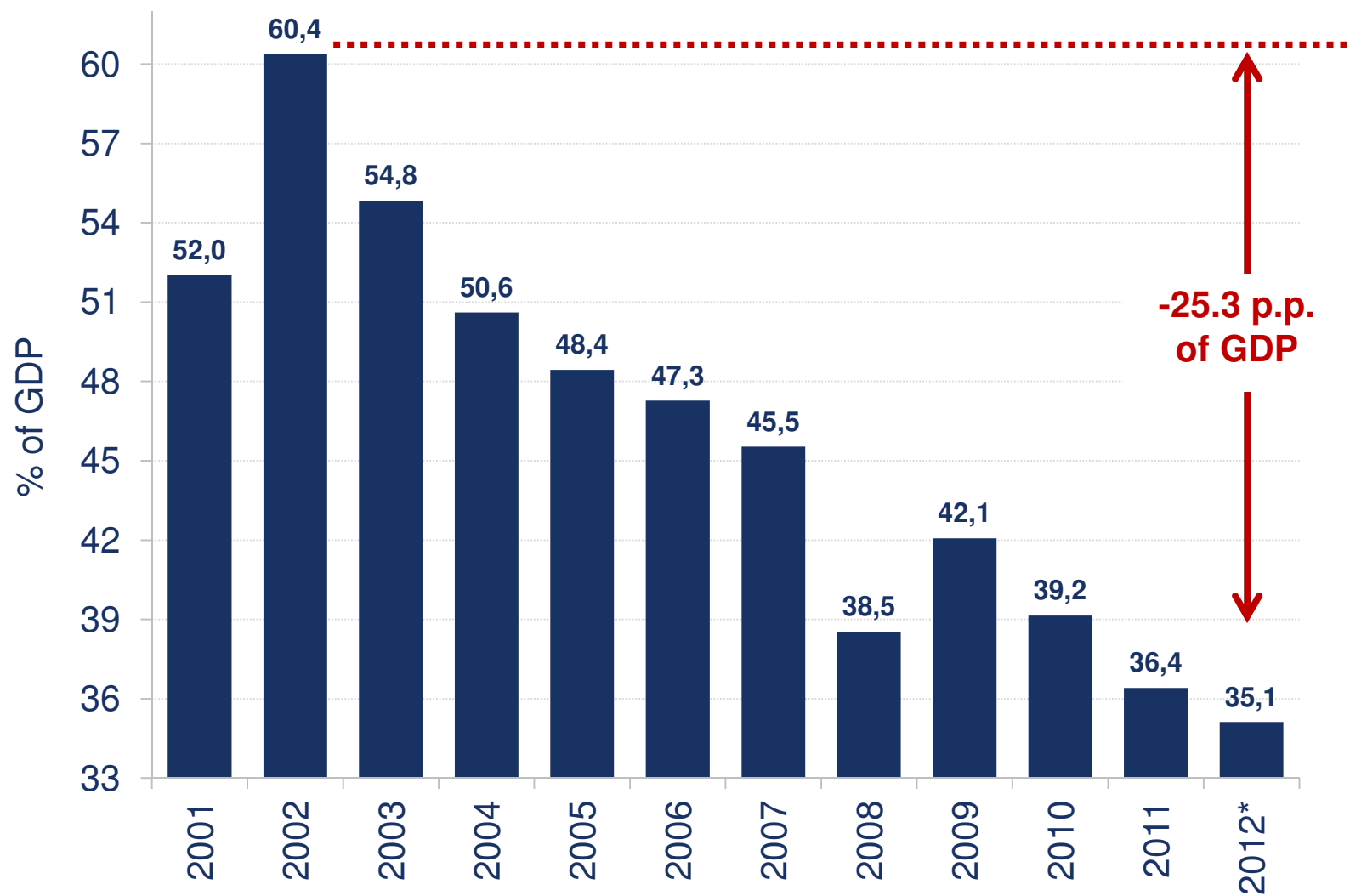
Continued Commitment to Strong Fiscal Targets



*May 12

Source: BCB

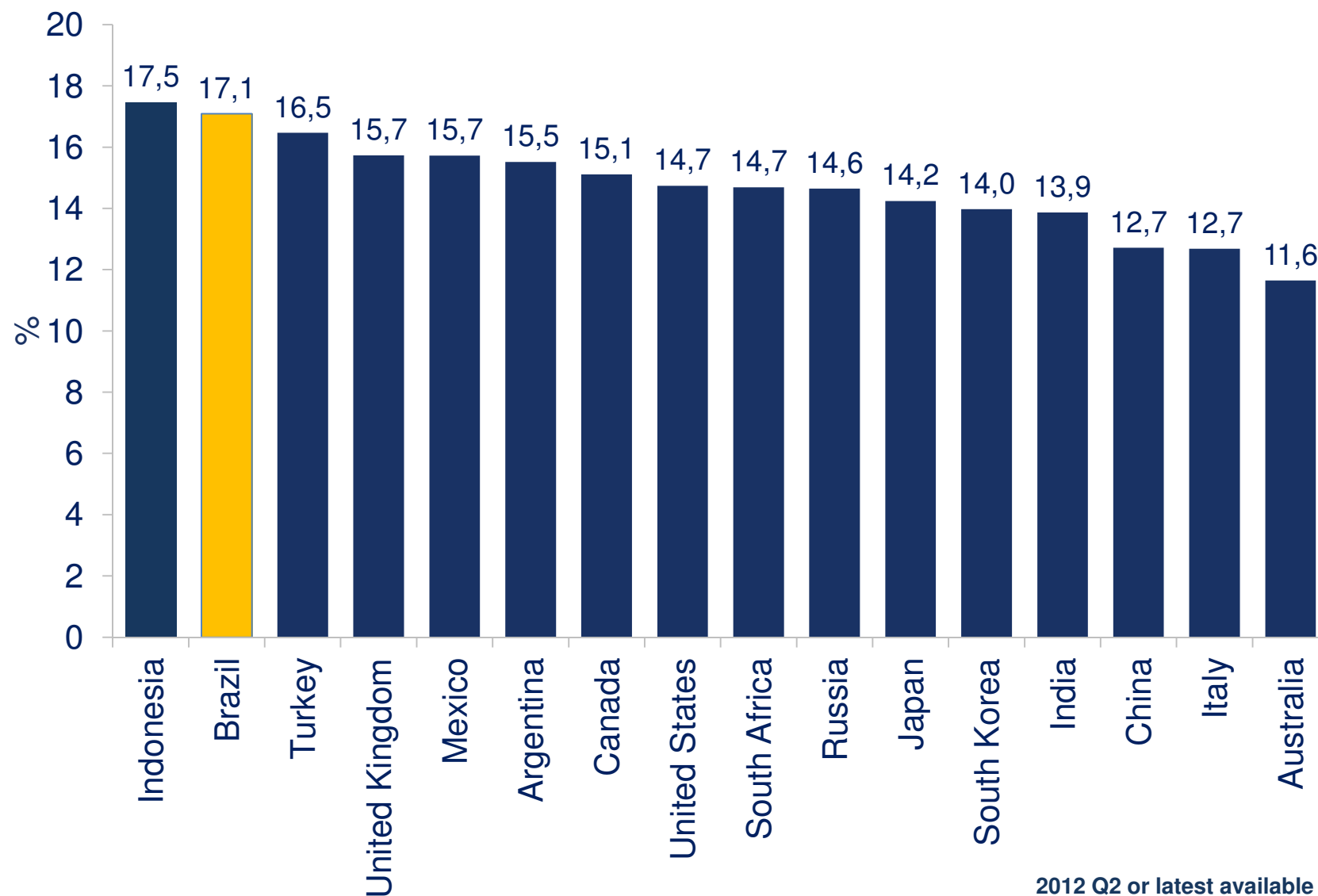
Keeping Sound Net Public Debt Dynamics



*Jun 12

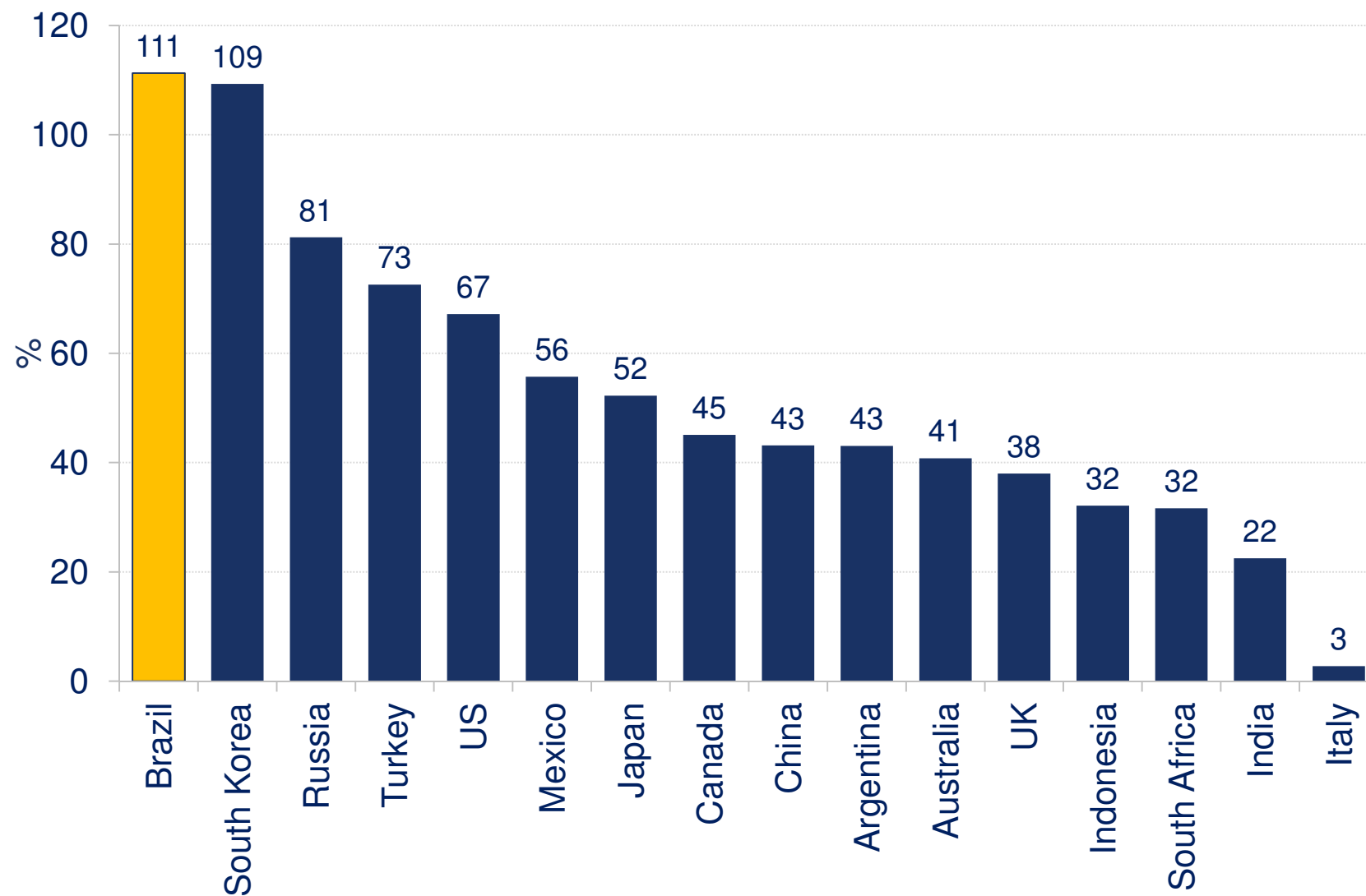
Source: BCB

Keep High Bank Capital / Risk-Weighted Assets (%)



Source: IMF

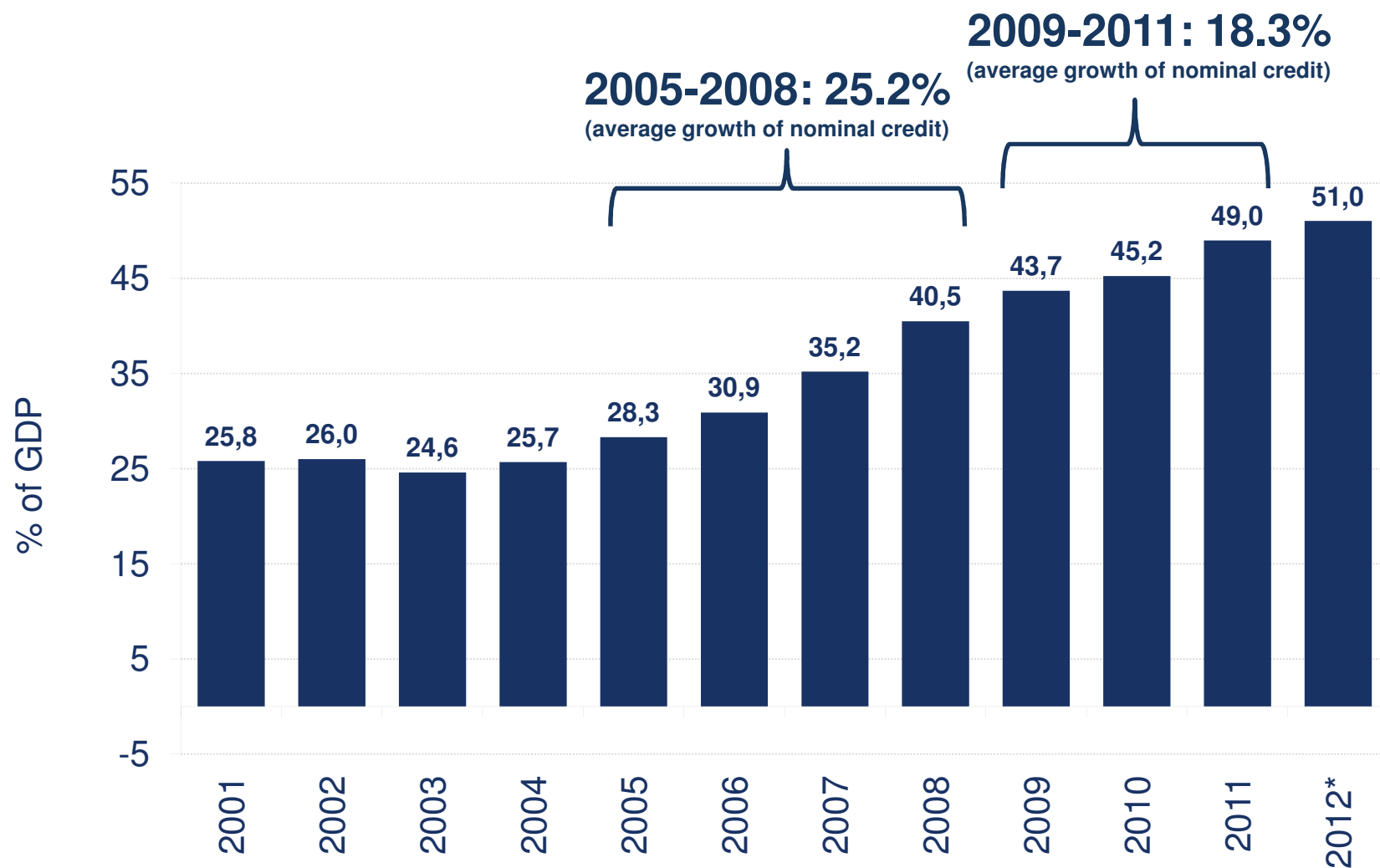
Keep High Liquid Assets / Short Term Liabilities



2012 Q2 or latest available data

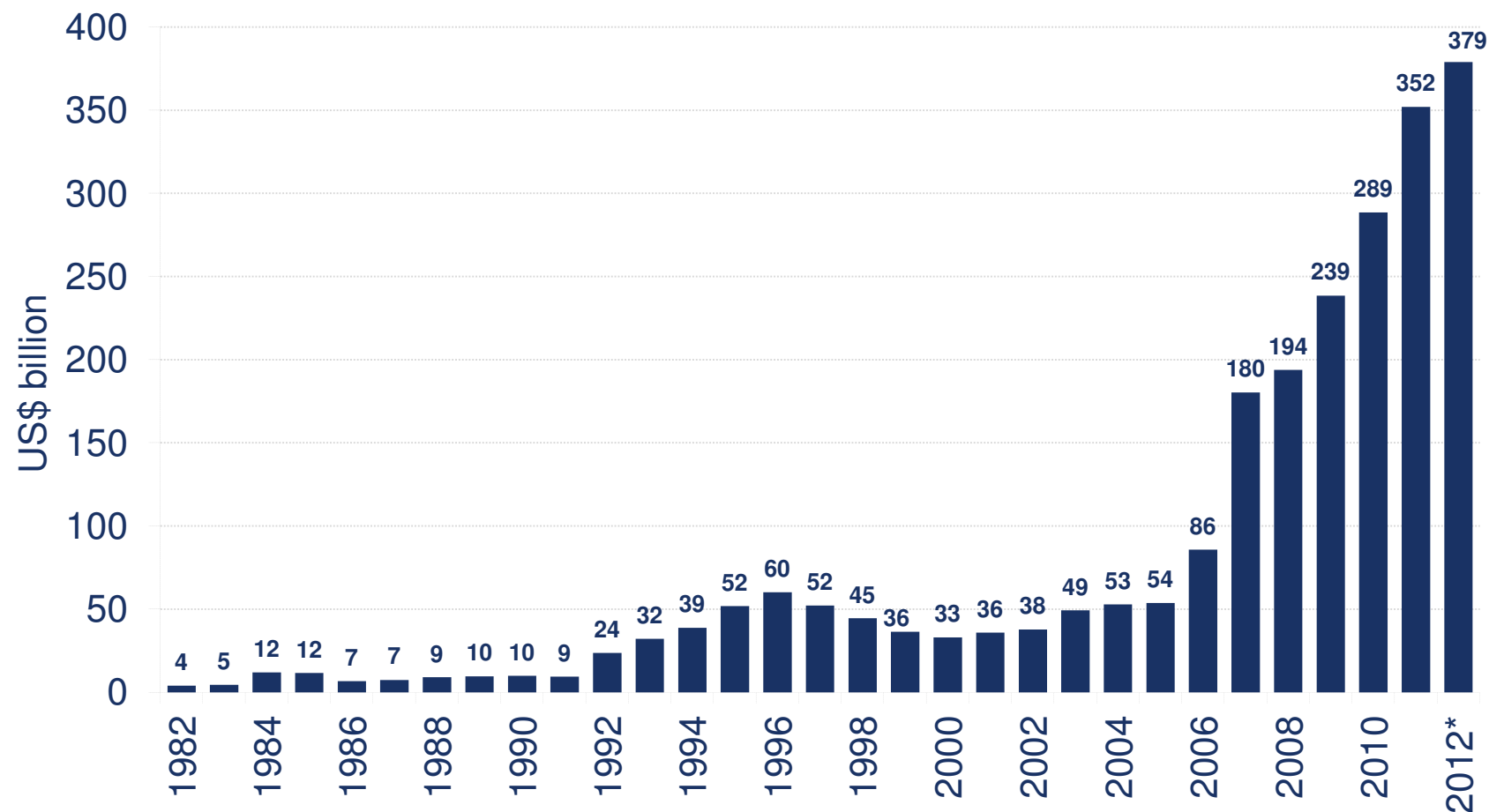
Source: IMF

So that Credit / GDP grows at sustainable pace



*Aug 12

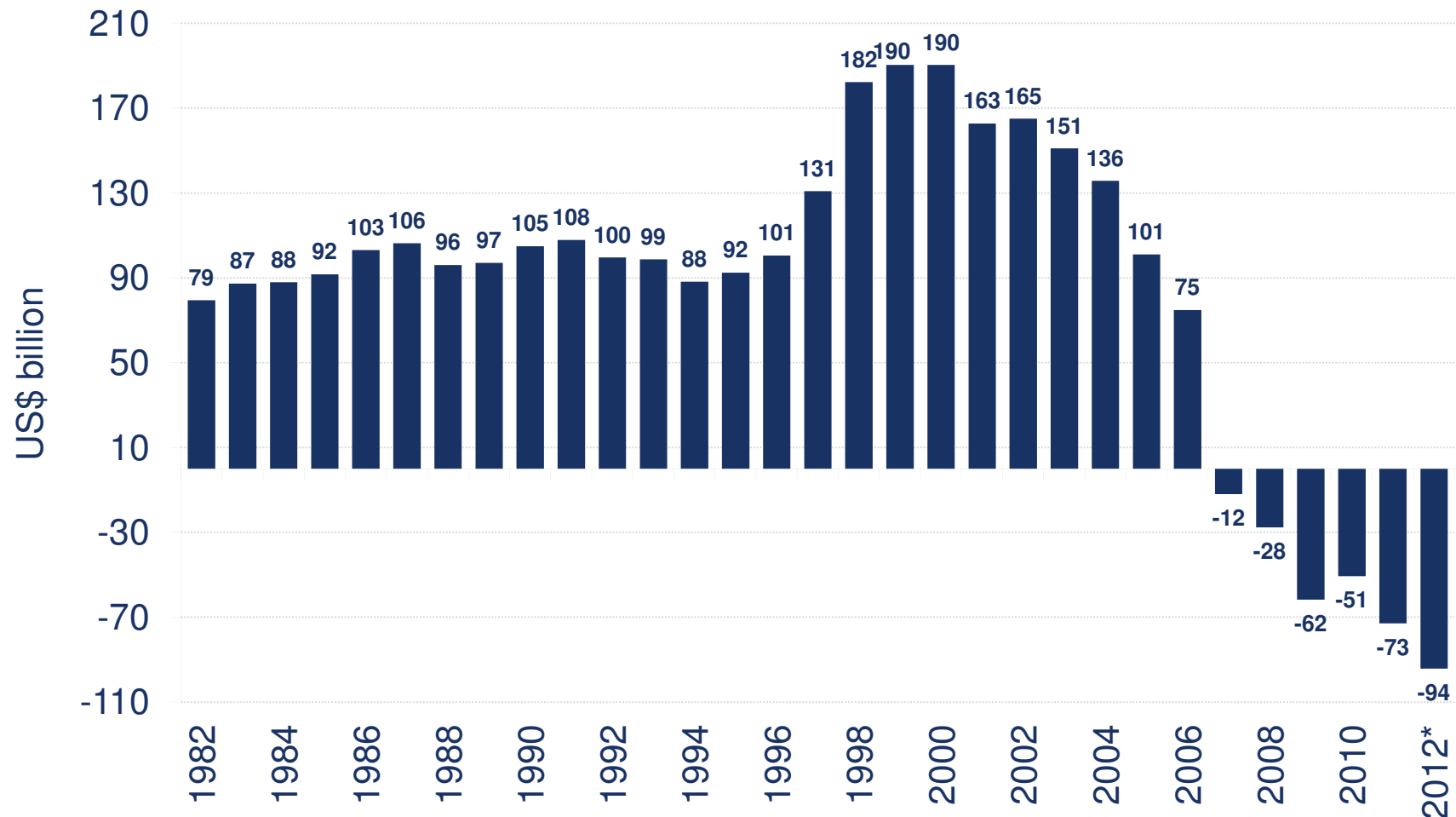
Keep High International Reserves as Self-Insurance



as of Sep 27th

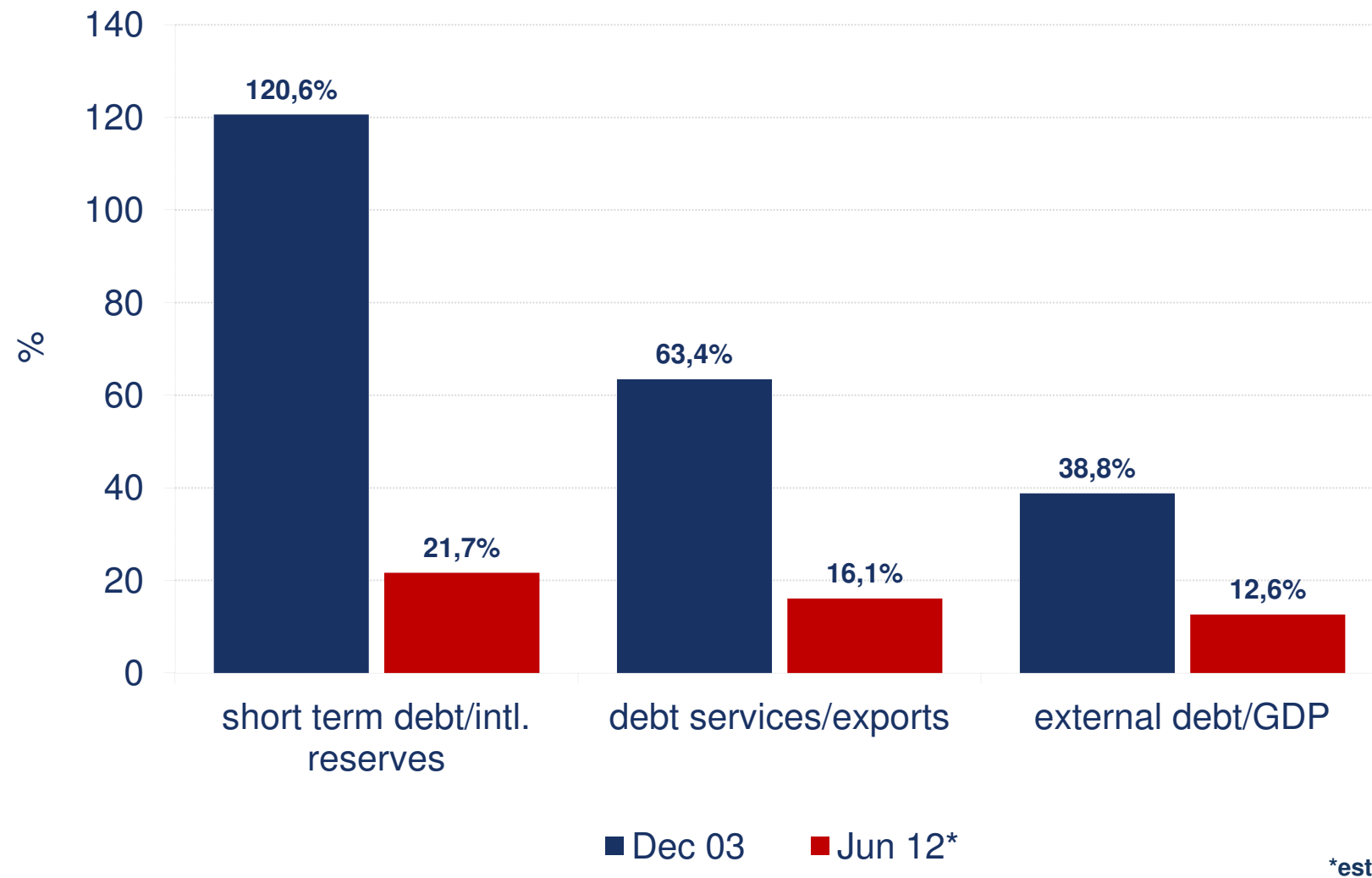
Source: BCB

Becoming a Net External Creditor



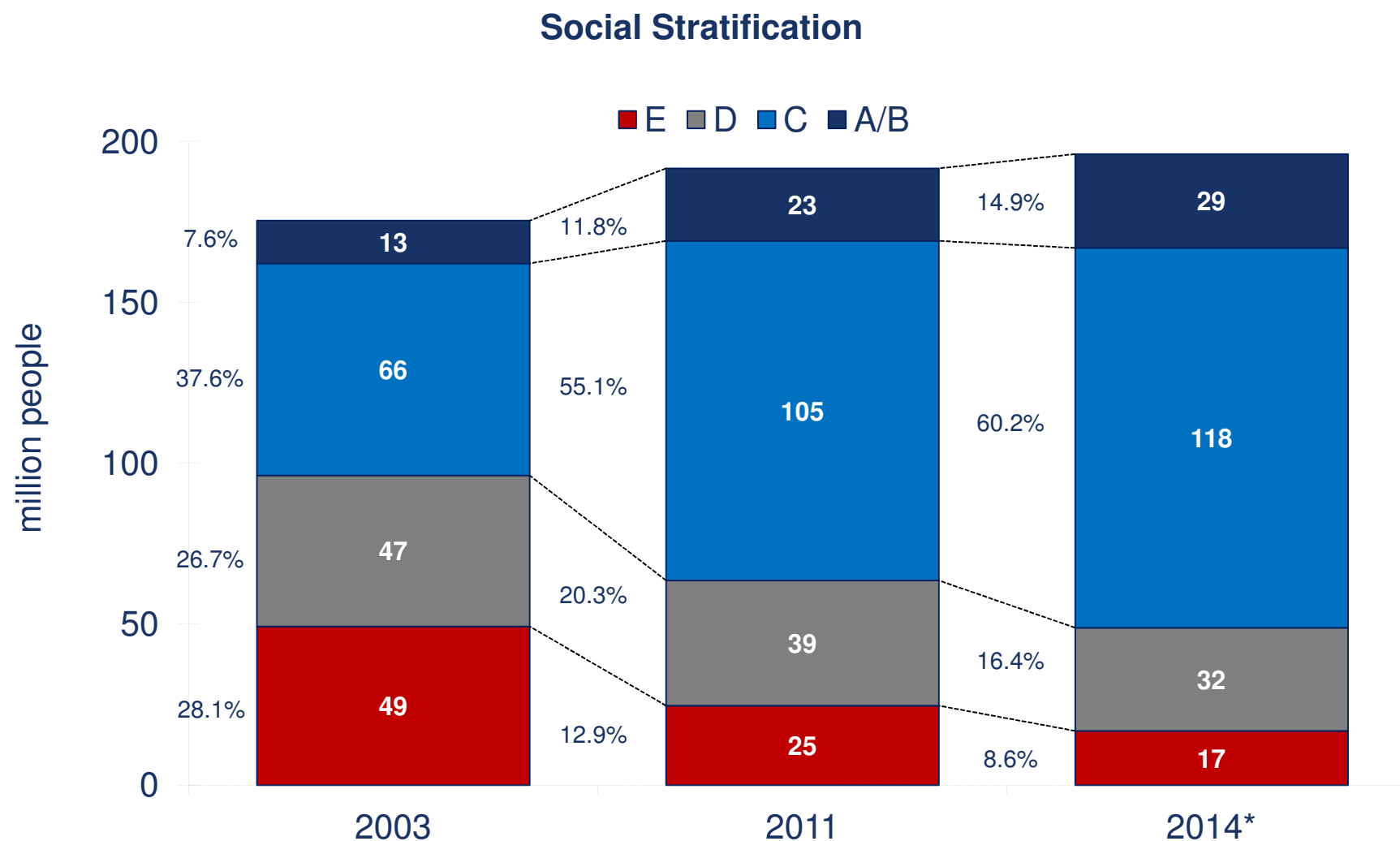
*estimate Jun 12

Maintaining Strong External Debt Ratios



Source: BCB

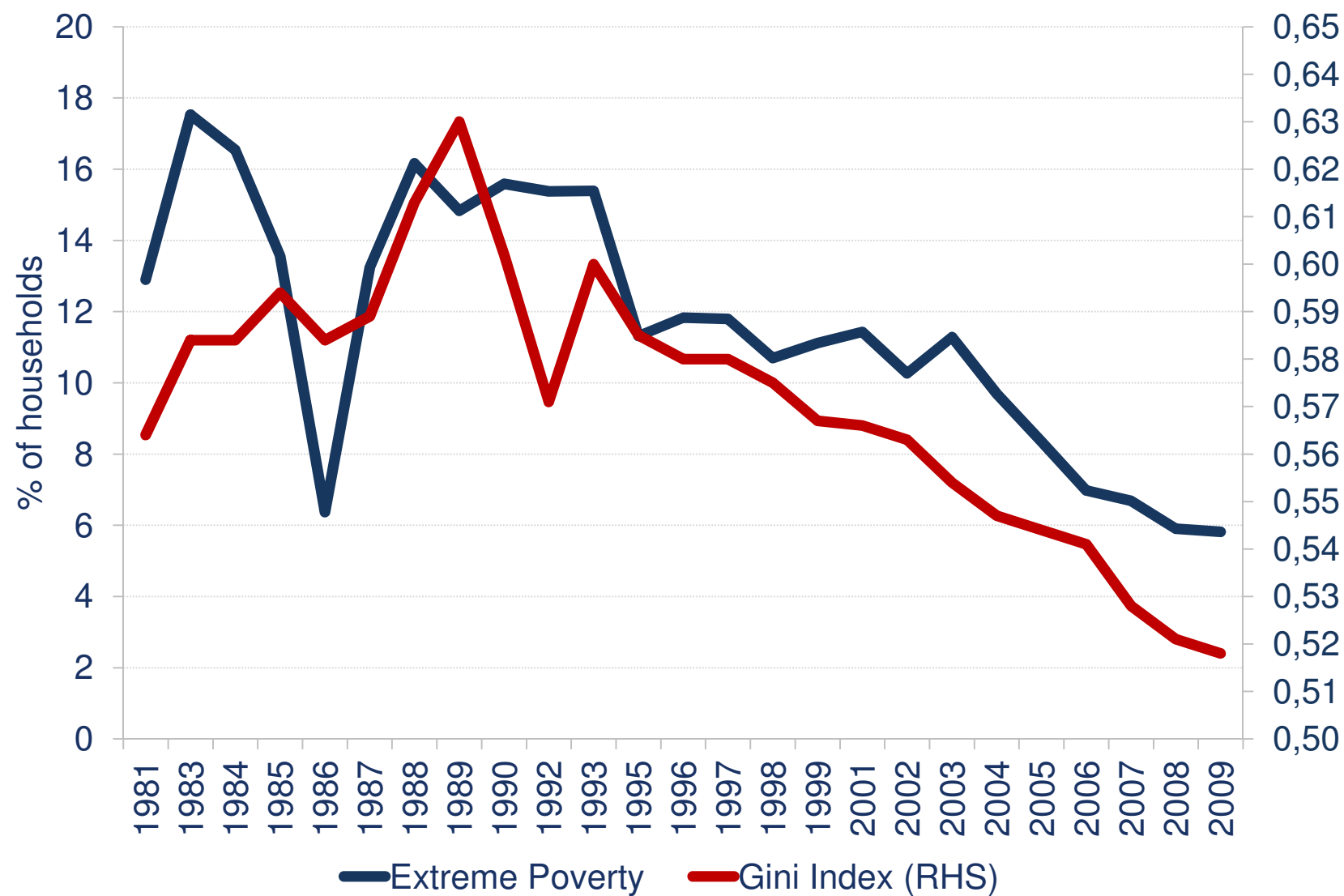
Growing Middle Class → Domestic Market & Stability



*FGV forecast

Source: FGV

Declining Poverty and Inequality

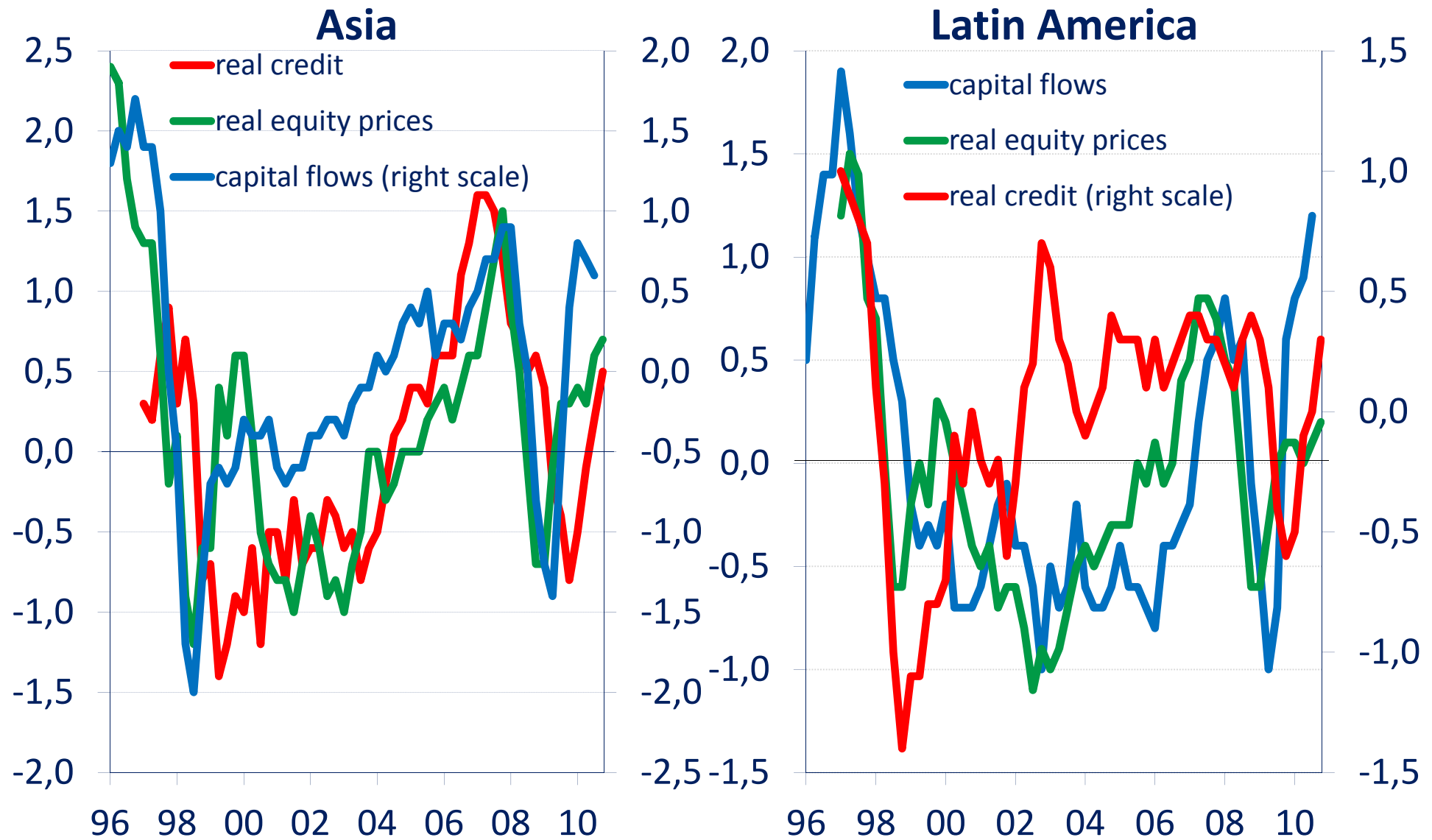


Source: IPEA

4. Macro-Financial Stability in a “New Normal” environment with Sudden Stops and Floods

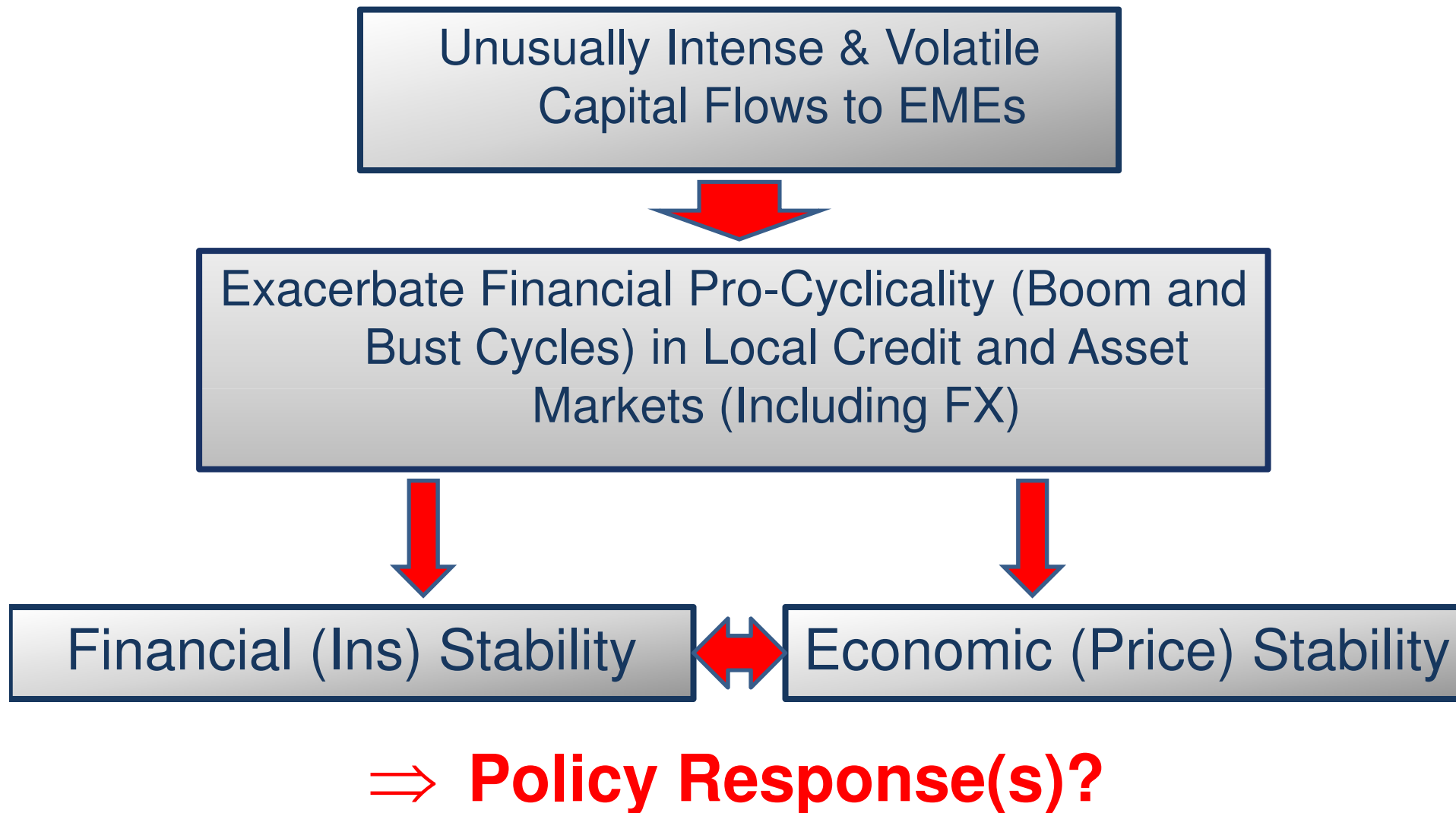


Capital Inflows, Real Credit Growth, and Real Equity Prices, 1996-2010 (z scores)



Source: International Monetary Fund, *Global Financial Stability Report* (April 2011)

Pbs in Post-QEs: Dealing with Excessive K Flows



Pragmatic Policy Responses in EMEs (Brazil)

- **Prevention Better than Cure, against excessive financial pro-cyclicality:** (some) prevention (leaning against the financial cycle) better than “mopping-up” (cleaning) financial-credit bubbles after they burst
- **To “lean against the cycle” and prevent bubbles, use a combination of instruments (Macroprudential or MaP & MP+FP)** to reach objectives of financial & price stability; it works well (Brazil’s experience)

Pragmatic Policy Responses in EMEs (Brazil)

- **Keep Existing Frameworks that are Working Well** (e.g., Fiscal Responsibility institutional arrangements, Floating ERR with minimal interventions, Inflation Targeting Framework)
- **Strengthen Prudential Regulation and Financial Infrastructure** (e.g., G20-FSB, Basel 3 agenda → higher level & quality of K, counter-cyclical buffers, strong supervision, comprehensive resolution frameworks, etc.)

5. Conclusions



Lessons for the G20: difficult time for coordination

- **Can the G20 strengthen macro policy coordination?**
 - Initial G20 Role (in 2008-2009) supporting counter-cyclical policies was important but faded
 - Structural reforms issues under Mutual Assessment Process & G20 Framework for Countries Policies has faced **national biases to protect domestic policy room for maneuver** (e.g., US, Eurozone, Japan, UK QEs, China's ER policy, etc.)
→ little progress on Global Imbalances, etc.
 - Legitimacy & representation issues (e.g., Quotas at IMF-WB, binding decisions?, etc.)
- **Continue Financial Sector Reform with the FSB & Basel Cmte:**
 - Implementation of Basel III Accord; TBTF-SIFI Agenda
 - Cross-border flows & Spillovers

Lost Decade for AEs Can Be Used by EMEs, Brazil

- **5-6 Years Window of Opportunity to:**
 - Add More Credibility to Macro-Financial Framework
 - Grow Credit & Financial Markets at Sustainable Pace
 - Remove Bottlenecks (H & Infra K)
 - Work on Regional Integration (BRICS, Mercosul, Unasul)
 - Work on each of your idiosyncratic problems (e.g., high interest rates, urban-rural inequality & divide, etc.)
- **Begin Addressing LT Issues With Other EMEs:**
 - More Balanced Growth Sources (Commod. / Manufact., Domestic / Foreign)
 - CC & Endowments (Energy, Natural Resources, etc.)
 - Social & Political Stability

Thank you