INTERNATIONAL MONETARY FUND

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BRAZIL

September 2021

2021 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR BRAZIL

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2021 Article IV consultation with Brazil, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its September 10, 2021 consideration of the staff report that concluded the Article IV consultation with Brazil.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on September 10, 2021, following discussions that ended on July 5, 2021, with the officials of Brazil on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on August 20, 2021.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Brazil.

The documents listed below have been or will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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IMF Executive Board Concludes 2021 Article IV Consultation with Brazil

FOR IMMEDIATE RELEASE

Washington, DC – September 22, 2021: On September 10, 2021, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Brazil.

Economic performance has been better than expected, in part due to the authorities' forceful policy response. GDP regained its pre-pandemic level in 2021Q1 and momentum continues to be favorable, supported by booming terms of trade and robust private sector credit growth.

Tragically, the COVID-19 pandemic has claimed the lives of more than 550,000 Brazilians. Renewed lockdowns following a severe second COVID-19 wave early this year and the rollout of vaccination have helped bring down infections since April, with new daily COVID-19 cases and deaths falling significantly from their peaks. The government has procured sufficient doses to inoculate the adult population in 2021, with the most vulnerable population expected to be fully inoculated by the end of the year.

Real GDP is projected to grow by 5.3 percent in 2021. An improving labor market and high levels of household savings will support consumption and, as vaccinations continue, pent-up demand will return for in-person services. Depleted inventories will be rebuilt and the upswing in commodity prices will support new investment. Inflation is expected to fall steadily from recent peaks toward the mid-point of the target range by end-2022. After jumping to 99 percent of GDP in 2020, public debt is expected to drop sharply to 92 percent of GDP in 2021 and remain around that level over the medium-term. Uncertainty around the outlook is exceptionally high but risks to growth are viewed as being broadly balanced.

Key challenges remain. Currency depreciation and a surge in commodity prices have fed into headline inflation and inflation expectations even as the output gap remains negative. The labor market is lagging the recovery in output, and the unemployment rate is high, especially among youths, women, and afro-Brazilians. Emergency cash transfers will eventually expire and, in the absence of a permanent strengthening of the social safety net, poverty and inequality could become more acute. Near term fiscal risks are low, but the high level of public debt continues to pose medium-term risks. Restoring high and sustained growth, increasing employment, raising productivity, improving living standards, and reducing vulnerabilities will require policy efforts to eliminate bottlenecks and foster private sector-led investment.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

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Executive Board Assessment[2]

Executive Directors commended the Brazilian authorities for their decisive policy response to the COVID-19 shock, which significantly reduced the severity of the 2020 recession and cushioned its impact on the poor and vulnerable while setting the stage for a strong recovery in 2021. Directors welcomed the momentum of institutional reforms, despite the pandemic, to create the foundations for a more competitive economy. However, the pandemic has exacerbated long-standing challenges to higher growth and socio-economic inclusion. Further policy efforts are needed to bolster market confidence, foster private-sector-led investment, and strengthen the medium-term outlook.

Directors agreed that fiscal policy should focus on rebuilding buffers and reducing budget rigidities to create space for public investment and a stronger social safety net. The expenditure ceiling has played an important role in maintaining market confidence and continued adherence to the rule is necessary to reduce public debt. Comprehensive tax reform should aim to increase progressivity, simplify the system, and improve resource allocation. The tax reform should include a bold plan to scale back tax expenditures to frontload the benefits to equity and efficiency. Directors encouraged the authorities to adopt a more robust medium-term fiscal framework and strengthen subnational finances. These measures would help enhance fiscal credibility, reduce fiscal risks, and improve the capacity of the government to manage adverse shocks.

Directors supported the ongoing steady tightening of monetary policy to address rising inflation and keep inflation expectations well-anchored. Given the uncertainty around the outlook, policy would need to continue being data dependent, complemented with proactive communication and clear forward guidance. Directors welcomed the authorities' commitment to a flexible exchange rate and to limit intervention to countering disorderly market conditions.

Directors noted that the banking system has been resilient and has supported the recovery. They agreed that a gradual phasing out of crisis-related financial support is appropriate and endorsed the authorities' efforts to enhance financial inclusion and promote competition in the banking system.

Directors welcomed the ambitious supply-side reform agenda aimed at boosting productivity, potential growth, and living standards. Concerted action is needed to liberalize foreign trade and product markets, increase formal labor market flexibility, and improve governance. Strengthening the effectiveness and predictability of the anti-corruption and AML/CFT frameworks remains critical. Steps are also needed to further improve the environment for private sector investment.

Directors welcomed initiatives to foster environmentally sustainable activities in response to climate-related risks. Many Directors encouraged closer collaboration between the authorities

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

and staff to analyze climate-related risks in macroeconomic assessments and evaluations of financial stability.

Table 1. Brazil: Selected Economic Indicators

I. Social and Demographic Indicators

Area (thousands of sq. km)	8,510	Health	
Agricultural land (percent of land area)	30.2	Physician per 1000 people (2018)	2.2
Population		Hospital beds per 1000 people (2018)	2.2
Total (million) (est., 2019)	210.1	Access to safe water (2018)	83.6
Annual rate of growth (percent, 2018)	0.8	Education	
Density (per sq. km.) (2019)	25.3	Adult illiteracy rate (2019)	6.6
Unemployment rate (2019)	11.9	Net enrollment rates, percent in:	
Population characteristics (2018)		Primary education (2019)	98
Life expectancy at birth (years)	76	Secondary education (2019)	85
Infant mortality (per thousand live births)	12	Poverty rate (in percent, 2018) 1/	25.3
Income distribution (2017)		GDP, local currency (2020)	R$7,448 billion
Ratio between average income of top 10 percent of earners over bottom 40 percent	12.4	GDP, dollars (2020)	US$1,445 billion
		GDP per capita (2020)	US$6,875
Gini coefficient (2018)	53.9		

Main export products: airplanes, metallurgical products, soybeans, automobiles, electronic products, iron ore, coffee, and oil.

II. Economic Indicators

	2017	2018	2019	2020	2021 Proj.	2022	2023	2024	2025	2026
					(Percentage change)					
National accounts and prices										
GDP at current prices	5.0	6.4	5.8	0.6	15.0	7.8	6.1	6.4	6.2	6.1
GDP at constant prices	1.3	1.8	1.4	-4.1	5.3	1.9	2.0	2.1	2.1	2.1
Consumption	1.4	2.0	1.6	-5.3	3.5	1.6	1.5	1.5	1.5	1.4
Investment (GFCF)	-2.6	5.2	3.4	-0.8	11.8	4.1	5.0	5.2	4.0	4.0
Consumer prices (IPCA, end of period)	2.9	3.7	4.3	4.5	5.8	3.7	3.3	3.0	3.0	3.0
					(Percent of GDP)					
Gross domestic investment										
Private sector	12.3	13.0	13.3	12.7	14.5	14.6	15.1	15.8	16.2	16.6
Public sector	2.3	2.1	2.1	2.7	2.0	2.3	2.3	2.2	2.2	2.2
Gross national savings										
Private sector	20.1	18.6	17.2	26.6	22.1	21.5	20.6	20.1	19.7	19.6
Public sector	-6.5	-5.9	-4.7	-11.6	-5.2	-5.6	-5.0	-4.5	-4.0	-3.6
Public sector finances										
Central government primary balance 2/	-1.9	-1.8	-1.3	-10.0	-1.9	-0.8	-0.3	0.2	0.7	1.2
NFPS primary balance	-1.8	-1.7	-0.9	-9.2	-1.7	-1.0	-0.3	0.2	0.7	1.2
NFPS cyclically adjusted primary balance (in percent of potential GDP)	-0.9	-1.1	-0.5	-7.7	-1.5	-0.9	-0.3	0.2	0.7	1.2
NFPS overall balance	-7.9	-7.1	-5.9	-13.4	-6.3	-6.9	-6.2	-5.7	-5.2	-4.8
Net public sector debt	51.4	52.8	54.6	62.7	63.9	66.4	69.4	71.8	72.6	74.6
General Government gross debt, Authorities' definition	73.7	75.3	74.3	88.8	82.6	81.8	83.2	84.0	83.6	84.5
NFPS gross debt	83.6	85.6	87.7	98.9	91.6	90.9	91.7	92.0	92.1	92.0
Of which: Foreign currency linked	3.6	4.1	4.2	5.8	5.2	5.0	4.9	4.9	4.8	4.7
Money and credit					(Annual percentage change)					
Base money 3/	9.6	1.6	3.3	8.0	15.0	7.8	6.1	6.4	6.2	6.1
Broad money 4/	4.6	8.1	8.6	18.6	13.9	10.1	8.1	7.9	8.0	7.8
Bank loans to the private sector	0.0	7.7	5.9	16.4	10.0	9.0	9.0	8.0	8.0	8.0
					(Billions of U.S. dollars, unless otherwise specified)					
Balance of payments										
Trade balance	57.3	43.4	26.5	32.4	76.1	63.4	55.9	49.7	50.0	50.8
Exports	218.0	239.5	225.8	210.7	281.2	280.4	279.9	283.6	294.0	304.4
Imports	160.7	196.1	199.3	178.3	205.2	217.0	224.1	234.0	244.0	253.6
Current account	-22.0	-51.5	-65.0	-25.9	7.1	-19.1	-38.3	-54.1	-64.5	-74.2
Capital account and financial account	17.5	52.8	64.7	22.8	-7.1	19.1	38.3	54.1	64.5	74.2
Foreign direct investment (net inflows)	47.5	76.1	46.4	48.1	57.9	64.8	69.5	72.8	75.9	74.3
Terms of trade (percentage change)	15.6	-2.2	0.6	-7.0	15.1	-3.9	-1.6	-1.3	-1.1	-0.9
Merchandise exports (in US$, annual percentage change)	18.3	9.9	-5.7	-6.7	33.5	-0.3	-0.2	1.3	3.6	7.3
Merchandise imports (in US$, annual percentage change)	15.0	22.1	1.6	-10.5	15.0	5.8	3.2	4.4	4.3	8.4
Total external debt (in percent of GDP)	32.3	34.7	36.0	44.3	37.7	31.8	29.3	27.5	26.3	25.8
Memorandum items:										
Output Gap	-2.9	-1.9	-1.3	-4.0	-0.7	-0.4	-0.2	0.0	0.0	0.0
Current account (in percent of GDP)	-1.1	-2.7	-3.5	-1.8	0.4	-1.0	-1.8	-2.3	-2.6	-2.8
Unemployment rate	12.7	12.3	11.9	13.5	13.7	12.9	11.7	10.9	10.2	9.8
Gross official reserves	374	375	357	356	353	353	353	353	353	353
REER (annual average in percent; appreciation +)	8.5	-10.4	-1.8	-20.6	…	…	…	…	…	…

Sources: Central Bank of Brazil; Ministry of Finance; IBGE; IPEA; and Fund staff estimates.

1/ Computed by IBGE using the World Bank threshold for upper-middle income countries of U$5.5/day. This number is not comparable to the estimates provided by IPEA in previous years due to methodological differences.

2/ Includes the federal government, the central bank, and the social security system (INSS). Based on the 2017 draft budget, recent announcements by the authorities, and staff projections.

3/ Currency issued, required deposits held at the Central Bank plus other Central Bank liabilities to other depository corporations

4/ Currency outside depository corporations, transferable deposits, other deposits and securities other than shares

INTERNATIONAL MONETARY FUND

BRAZIL

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

August 20, 2021

KEY ISSUES

Context. Economic performance has been much better than expected, in part due to the authorities' forceful policy response. Nevertheless, Brazil's long-standing challenges of low growth, high debt, and elevated levels of poverty and inequality have been exacerbated by the pandemic. Tragically, more than 550,000 Brazilians have died from COVID-19.

Recent Developments. Brazil is past the peak of a severe second wave of the pandemic and, after a slow start, vaccinations are progressing well. GDP regained its pre-pandemic level in 2021 Q1 and momentum continues to be favorable, supported by booming terms of trade and robust private sector credit growth. The surge in commodity prices and a weaker currency compared with pre-crisis levels has fed into headline inflation and inflation expectations, leading the Central Bank to initiate a tightening cycle. The labor market is lagging the recovery in output, and the unemployment rate remains high, especially among the young, women, and afro-Brazilians.

Outlook and Risks. Real GDP is projected to grow by 5.3 percent in 2021. Inflation is forecast to fall steadily from the July peak toward the mid-point of the target range by end-2022. After jumping to 99 percent of GDP in 2020, public debt is expected to drop sharply in 2021 and remain around 92 percent of GDP over the medium-term. Uncertainty around the outlook is exceptionally high but risks to growth are viewed as being broadly balanced.

Policy Recommendations. Despite the strong cyclical recovery, monetary and fiscal policy face difficult choices and further institutional reforms—to improve the composition of tax and spending, strengthen governance, and raise labor productivity growth—remain critical to strengthen the medium-term outlook.

- **Fiscal policy**: The 2021 round of targeted COVID-19 spending will protect the most vulnerable and support the recovery. Medium-term consolidation is appropriately guided by the constitutional expenditure ceiling. Reducing budget rigidities and mandatory outlays will be key to create the fiscal space needed for high priority programs and to increase the flexibility in responding to shocks. Tax expenditures should be scaled back alongside a broader tax reform that increases progressivity, reduces the misallocation of resources, and raises potential growth. Developing a full-

fledged medium-term fiscal framework at the federal level and imposing credible hard budget constraints at the subnational level will further support fiscal credibility.

- **Monetary and exchange rate policy**. A steady upward path for the policy rate should ensure inflation returns to the mid-point of the target band by end-2022. Given the uncertainty around the outlook, policy will need to be data dependent and be particularly cognizant of shifts in inflation expectations. Continued clear forward guidance that is linked to economic outcomes and articulates the timeline and pace at which the BCB's inflation goal is expected to be reached will be important. Foreign exchange (FX) intervention should be limited to countering dysfunctions in FX markets.

- **Financial sector.** The banking system remains resilient. Careful supervisory oversight should continue while a gradual withdrawal of extraordinary crisis support measures is appropriate. Promising efforts to improve financial sector competition, expand financial inclusion, and promote green financing should be deepened.

- **Institutional reforms**. Despite the pandemic, important market-oriented measures have been taken to create the foundations for a more competitive economy. Additional decisive steps are needed, including a comprehensive tax reform that simplifies the system and reduces the cost of tax compliance, further easing the stringency and complexity of market regulations, reducing barriers to entry in network sectors, liberalizing trade, and improving governance.

Approved By
Nigel Chalk (WHD) and Bikas Joshi (SPR)

Team: C.H., Lim (Head), V. Flamini and F. Toscani (all WHD), F. J. Boumediene (MCM), S. Hassan (SPR), R. Perrelli and M. Coelho (FAD), I. Rossi (LEG) and C. Kolerus (RES), assisted by J. Pereira (Resident Representative) and D. Cunha (Local Economist). Discussions took place virtually during June 21–July 5, 2021. The team met Minister Guedes and Central Bank President Campos Neto and other senior officials, financial sector analysts, think-tanks, academics, and representatives of the private sector. A. Bevilaqua (Executive Director), B. Saraiva, J. Barroso and R. Velloso (all OEDBR) participated in some of the meetings. N. Chalk and J. Morsink (WHDAI) participated in the concluding meetings.

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