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Opening remarks by Luiz Awazu Pereira da Silva, Deputy Governor, Central Bank of Brazil

Ladies and Gentlemen, Good morning.

It is an honor and a great pleasure for me to make the opening remarks of this meeting at the 60th ISI World Statistical Congress.

I would like to thank Turalay Kenç, chairman of the Irving Fisher Committee on Central Bank Statistics of the BIS and Deputy Governor of the Central Bank of the Republic of Turkey, and Jesus Cervantes González, representative of CEMLA (Real Sector and Program of General Principles Coordinator), for sharing the organization of this important event with the Central Bank of Brazil (BCB).

I also welcome all the lecturers and participants, especially those from abroad, including the members of the Irving Fisher Committee on Central Bank Statistics, representatives from the central banks that participate in CEMLA, officials from the IMF, representatives from the Community of Portuguese Language Countries, researchers, statisticians, and analysts of the private sector.

This seminar is a great opportunity to assess the challenges posed by swings in capital flows and their proper registration, in light of the methodological changes set out in the sixth edition of the Balance of Payments and International Investment Position Manual.

First, I will share with you our views on how the dynamics of capital flows in the aftermath of the global financial crisis (GFC) have evolved. Then I will discuss the Brazilian experience in managing and registering external sector data. And finally I will say a few words on the current situation of the Brazilian economy.

So beginning with the first topic, the conduct of economic policy, especially in emerging market economies (EMEs), always had to address the challenges posed by the behavior of capital flows, particularly in periods of excess liquidity or abrupt reversals, what is called in the literature "sudden stops and sudden floods" or periods of "risk-on and risk-off". The textbook recommendation to sail through these natural periods of mood swings is well- established and that's what we've been using in Brazil.

First, by strengthening a well-tested framework, a macroeconomic tripod consisting of: keeping a flexible exchange rate regime (ERR); ensuring a sound fiscal stance that generates sustainable levels of indebtedness; maintaining low and stable inflation using, for example, an IT framework. Second, to avoid the transmission of external financial instability into our domestic financial markets, keeping a solid financial system in terms of capital, provisions, liquidity and regulations; pairing it with an intrusive supervision capable of using relevant and timely information (a good market infrastructure) to detect vulnerabilities. Third, addressing any surge of financial systemic risk using macro-prudential instruments. Fourth, while keeping the floating ERR as a 1st line of defense, smoothing excessive volatility that can affect financial stability. Finally and fifth, maintaining macroeconomic and financial stability is necessary but working on growth potential through structural reforms is paramount. Not only it strengthens solvency ratios and fundamentals but it also allows more room for maneuver for social improvement which, in turn, obviously affects positively the stability of institutions and social welfare. These are some good and tested policies and rules to face capital flow volatility and to build macro-financial stability.

Let me now discuss the Brazilian experience in managing and registering external sector data. Against this backdrop, naturally, having good quality data on capital flows, available to the policymaker in a timely manner, has become crucial. So this seminar is very important and well-timed.

What's really new? Well, the GFC and especially unprecedented easy monetary conditions, in part associated with unconventional monetary policy in advanced economies, have exacerbated the well-known episodes of capital floods and sudden stops that usually affect emerging markets.

We were naturally used to, and in need of, foreign savings in the form of capital flows. The problem is not capital flows per se, but excessive volume and intensity. Despite sound macroeconomic policies and adequate local financial regulation, too much capital inflows might lead to excessive credit expansion, overheating, financial bubbles, real exchange rate appreciation unwarranted by fundamentals, and rapid current account deterioration. If unaddressed, it might result in financial crises. This is not a problem only for EMEs, but, as we, in EMEs, are more susceptible to larger swing in capital flows, it certainly has shaped our policy responses and experiences.

Most, if not all, EMEs had to use some form of sterilized interventions to accommodate excessive capital inflows in order to safeguard financial stability. In Brazil, interventions were part of a multipronged policy response to intense capital inflows, together with a set of macroprudential measures that helped curtail excessive exuberance in domestic credit markets, driven by the cross-border spillovers from large-scale asset purchases. These interventions were not designed to affect our exchange rate regime but to keep market volatility from feeding self-reinforcing dynamics that could potentially threaten our financial stability.

These interventions also allowed us to accumulate when market conditions warrant, a buffer in international reserves. This buffer has helped us withstand the spillovers from changing global financial conditions and in particular the process of unwinding of unconventional monetary policies in the U.S.

The global excess liquidity has also facilitated an expansion of foreign-currency liabilities of corporates. Brazil was no exception, but the corporate debt-to-GDP ratio is in line with other emerging countries and below the numbers for advanced economies.

The current share of foreign-currency-denominated debt is about 42% of total debt, but most of it is not really exposed to FX risk[1]. Almost all corporate foreign-currency debt is owed by companies hedged against FX risk. They are major exporters, have substantial assets abroad or have hedged their exposures through derivatives. According to assessment of the BCB, the total debt exposed to FX risk is not relevant. The overall debts that are in fact exposed to FX risks amounts to 7% of total corporate debt.

In spite of the variety and complexity of exposure to exchange rate risks, the Central Bank of Brazil (BCB) is capable of detecting excessive risk exposure in a timely manner, leaving enough room for adequate measures. Brazil has a well- developed system for registering financial operations and especially derivatives[2]. This system was improved and broadened after the 2008 financial crisis, and the central bank worked closely together with participants in our market infrastructure in order to make sure data is provided in a useful form for financial stability monitoring purposes. As a result, the central bank is able to identify the strategies in use and to map out potential risks.

In Brazil, capital flows have remained strong, reflecting the strong fundamentals of our economy. Direct investment in the country has amounted to USD 81.9 billion over the last twelve months (June 2015), equivalent to 3.8% of GDP, financing most of the current account deficit. In turn, net portfolio investments have reached USD 36 billion.

As you know, Balance of Payments statistics are key for policy making. In Brazil, the regular production of the Balance of Payments statistics dates back to 1947, with a partnership between Banco do Brasil — a public commercial bank — and Getulio Vargas Foundation (FGV). In 1951, Sumoc — the monetary authority of that time — took the responsibility of generating those statistics, a responsibility that was kept by the BCB, which celebrates fifty years of existence this year.

The Brazilian Balance of Payment and other external statistics are compiled by the Balance of Payments Division of our Economics Department (DIPEC). The new Manual’s guidelines were implemented last April. The Balance of Payment figures are

1 Low exposure of domestic firms to FX risk is in part a result of the hedge provided by the BCB through the FX swaps program. With over US$ 370 billion in international reserves, the central bank offered FX swap auctions on a regular and daily basis. The program was adopted in August 2013, and was progressively phased out until March 31st, 2015, when it was no longer extended. Swaps expiring after May 1st 2015 have been rolled over in a proportion consistent with market conditions. The program was successful in preserving financial stability, providing forex hedge to private agents. The outstanding stock reached USD 115 billion and currently is at USD 108 billion. The program was also important to enhance predictability and confidence in the Brazilian economy during the “tapering tantrum”.

2 The BCB is chairing a FSB Peer Review on OTC Derivatives tasked by the G20.

released on a monthly basis, three or four weeks after the end of the reference month, according a schedule announced in the previous year.

Our international transactions reporting system allows generating a broad range of information in a timely manner, including for capital flows, very useful for the policy-making process. It is a very granular system, whose origin goes back to Brazil's history of foreign exchange controls. Controls were lifted years ago, but we have kept the system, mainly for statistical purposes.

Nowadays, in a financially-integrated world, the importance of Balance of Payment statistics has become even greater. However, the increasing international flows and interconnections between firms make the countries' boundaries less distinct. On this matter, one of the issues is the differences between the concepts of residence and nationality, which will be the topic of one of the sessions.

Furthermore, the role played by the Balance of Payment statistics in policy making has broadened with the importance that financial stability has gained in central banks' mandates. In fact, the global financial crisis highlighted the need of broader datasets for policy makers and supervisors to better assess the evolution of the economy, and act in a proper and timely manner, resulting in projects such as the G20 Data Gaps Initiative and the IMF SDDS Plus. More than ever, it is important to get accurate, consolidated, comprehensive and timely information.

Therefore, the demands, and the pressure, on the institutions responsible for those statistics have intensified. The task is not simple. For instance, one issue is how to have access to data outside your own jurisdiction. Another concern is avoiding excessive compliance costs.

Furthermore, the changes brought by the new Manual need to be well understood by the public, at different levels of depth, depending on the group involved. This process usually takes time, since people are used to reading and analyzing the old methodology statistics. As part of our communications strategy to overcome those problems, we have published methodological notes describing the changes.

Finally and third, let me say a few words about the current situation of the Brazilian economy.

Brazil is undertaking in 2015 a necessary and classic adjustment process, tightening fiscal and monetary policies and realigning relative prices (e.g., regulated prices vis-a-vis market prices and foreign vis-a-vis domestic prices). This adjustment process is aiming at reducing macroeconomic imbalances such as our current account deficit, re-building our fiscal space used during our counter- cyclical response to the GFC and re-directing our economy towards a new sustainable growth cycle. Unsurprisingly, the adjustment process is taking a toll on short-term growth. We are carefully observing these developments that derive from our policy stance but have also been compounded by the effect of non- economic events. Like any adjustment process, it carries sacrifices for many but is designed to build a solid base for a new cycle of sustainable growth in Brazil for all. Monetary policy's best contribution for Brazil's growth prospect is to help, by bringing inflation to our target and anchoring it, the consolidation of a stable and favorable macroeconomic scenario in longer term horizons.

Initial results in 2015 show that the adjustment process is working. For example, there has been an improvement in our current account balance. The BCB also has anchored inflation expectations in medium-term horizons, in 2017, 2018 and 2019, right on our 4,5% p.a. target. On the other hand, the recent double relative price adjustment impacted inflation in the first half of 2015, increasing 12-month accumulated inflation. Inflation expectations are still about 90 bps above our target by the end of 2016.

The objective of monetary policy is precisely to avoid this impact of short-term inflationary pressure in 2015 to be transmitted to 2016 and beyond. Monetary policy can and should contain the second-round effects of price hikes and to circumscribe them to this year of 2015. For this reason, monetary policy is and should continue to remain vigilant to ensure the convergence of inflation to the 4.5% target at the end of 2016. Moreover, efforts to strengthen fundamentals should persist, for Brazil to be prepared for a future Fed lift-off benefitting from a strong domestic policy stance.

In addition, despite some undeniable positive results, recent developments show that there are new risks to the inflation outcome for 2016 that might affect longer-term horizons. The BCB evaluates that the scenario of inflation convergence to 4.5% in 2016 has been producing some positive signals showing that we are on the right track. However, progress so far in fighting inflation need to be balanced against more recent risks that threaten our central objective in the relevant horizon for monetary policy. Therefore, we should remain cautious at this particular juncture. It is paramount to be vigilant to make sure that monetary policy reflects the balance of risks as of now and remains adequately calibrated to attain our objective.

To end my opening remarks, let me thank you again for your presence. I am sure that the presentations and discussions that you will have during the day will be very useful for the participants. I wish you a very productive seminar.