Financialisation and Monetary Policy: The Brazilian experience.

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The high levels of repurchase agreements carried out by the Brazilian Central Bank.
1) What is a repurchase agreements (repo)?

Source: Adapted from Gabor (2016)
2) Why governments use repos?

1) Sterilization instrument

2) Steer short-term interest rates

3) Signal the monetary policy stance

4) The role of repos in periods of stress can be enhanced by central banks implementing, as part of their operations to support financial stability, specific repo operations in order to allow banks to monetise liquid assets.
Statement of the problem

Why should we care about Brazilian Central Bank Repos?

Four main features:

1. Size (%GDP / %Gross national debt)
2. Linked to Selic (Interest rate)
3. Short-maturity
4. Nature of public indebtedness
National Gross Debt Composition, 2006-2017 (%)

Debt securities: 80.32%, 78.06%, 71.04%, 69.39%, 78.02%, 77.85%, 72.42%, 72.42%, 65.83%, 66.43%, 67.23%, 67.45%
Others: 5.79%, 7.75%, 10.28%, 7.57%, 7.83%, 6.91%, 7.30%, 8.34%, 9.29%, 10.32%, 8.85%, 8.19%

Source: Brazilian Central Bank, 2017
Average term to maturity on debt ABP x Repo, 2003-2016 (years)

Source: Brazilian Central Bank, 2017
Main public expenses in 2016 (Billons R$)

- Social Security, 19.85%
- Debt refinancing, 25.40%
- Debt Service, 16.33%
- Education, 3.66%
- Health, 3.74%
- Labour, 2.45%
- Others, 28.56%

42% of Budget

Source: Brazilian Central Bank, 2017

Constitutional Amendement 95/2016 – New Fiscal Regime
The contributions of this research

1) Theoretical

What is financialisation?

“The increasing role of financial motives, financial markets, financial actors and financial institutions in the operations of the domestic and international economies” (Epstein 2005: 3).
The contributions of this research

Research on Financialisation (van der Zwan, 2014)
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REGIME OF ACCUMULATION

SHAREHOLDER VALUE

EVERYDAY LIFE
The contributions of this research

Research on Financialisation (van der Zwan, 2014)
The contributions of this research

1) Theoretical

Introduce the concept of “Financialisation of Monetary Policy”.

“A monetary policy oriented towards high yields in sterilization instruments that highly contributes to the Shadow Banking expansion”.
The contributions of this research

2) Methodological

- Economic Efficiency
- Social justice
- Individual liberty

Brazilian Central Bank x National Treasury (DMO) x Financial Institutions (DB + IF)
Relation to the literature

The results of this paper fit with what is already known in Hyman Minsky:
- Financial Fragility
- Endogenous Money

The results of this research intend to expand previous contributions on the spillovers of Repurchase Agreements:
- Gorton and Metrick (2012)
- Gabor (2016)
Methodology

- Public data from BCB, Anbima, IMF, BIS, IPEA, TN, ICMA.
- Data received from Investment Fund managers and the Federal Senate of Brazil
- In-depth interviews (Kothari, 2004; Boyce and Neale, 2006)

Public managers in key positions at the Brazilian government
  - Ministry of Industry
  - National Treasury (Brazilian DMO)
  - Ministry of Economy
  - Brazilian Central Bank
  - Ministry of Foreign Affairs
  - Court of National Accounting

Financial Asset Managers
Main Results

- Relation DMO x BCB
  - Competition (Two different goals)
  - Inefficiency (Budget going to finance financial expenses/Trade-off between lending to companies or households or going to the central bank for the good remuneration ...put credit more expensive). Liquidity preference.

- O Tesouro Nacional emitiu hoje (04/01) R$ 40 bilhões em títulos da União, sem contrapartida financeira, para o Banco Central do Brasil (BCB). A emissão foi realizada em conformidade com o art. 3º da Lei nº 10.179, de 6 de fevereiro de 2001, e com a Portaria nº 241, de 4 de junho de 2009, que autorizam a emissão de títulos ao BCB com o objetivo de manter a carteira daquela autarquia em dimensões adequadas para a condução da política monetária.

- Segundo o chefe do Departamento de Contabilidade e Execução Financeira, a importância de tal mecanismo está no fato de a Lei de Responsabilidade Fiscal proibir o BC de emitir títulos próprios. “Assim, além de se evitar que os fluxos financeiros interfiram indiretamente no volume de recursos da economia e na gestão da dívida pública, o projeto resguarda a manutenção de níveis adequados dos instrumentos.
Main Results

1) DMO and BCB relationship: Potential conflict of interest with impact on the cost of credit.

Lengthening the average maturity of outstanding debt
Provide federal government borrowing requirements at the lowest long-term cost (yield curve)

Inflation Target
Provide a low-risk option for cash investment
Supporting cash market efficiency and liquidity
Main Results

**Evidence:** National Treasury and the Brazilian Central Bank are competitors.

When central banks issue large amounts of shorter-term debt, they crowd out governments from this market, forcing them to seek additional long-term financing, possibly at higher cost.
Main Results

When the yield curve is steep, banks are able to borrow money at lower interest rates and lend at higher interest rates.

So…
When the yield curve is steep, banks are able to borrow money at lower interest rates and lend at higher interest rates.
Main Results

- Relation DMO x BCB
  - Competition (Two different goals)

- To provide federal government borrowing requirements at the lowest long-term cost. (yield curve)

- Lengthening the average maturity of outstanding debt

Inflation Target

Providing a low-risk option for cash investment.

Supporting cash market efficiency and liquidity.
Main Results

2) Expansion of Shadow Banking

Brazilian Central Bank Repurchase Agreements are highly contributing to Shadow Banking expansion.
Growth of Shadow Banking in Brazil (2003-2018)
Investment Funds Net Worth (2002=zero)

Source: Anbima, 2018
Government Bonds 50%

Repos with Federal Govt. Bonds 23%

Private Equities 9%

Letras Financeiras 7%

Others 6%

Debêntures 3%

Certificate of deposit 2%

Debêntures 3%

Certificate of deposit 2%

Source: Anbima, 2018
Interconnectedness and financial sector investments - December 2017 (BRL Billions)

Source: Brazilian Central Bank, 2018
Conclusions

• Financialisation of MP is (1) changing the nature of Public indebtedness in Brazil, (2) exacerbating liquidity preference, (3) crowding out productive investment and (4) is a main driver for shadow banking expansion in Brazil.
Future research

• Is the BCB repo framework compromising the self-asset status of Sovereign Bonds in Brazil?

• How resilient the Brazilian Financial system is to support a sharp increase in the yield spreads of sovereign bonds?