



## Financialisation and Monetary Policy: The Brazilian experience.

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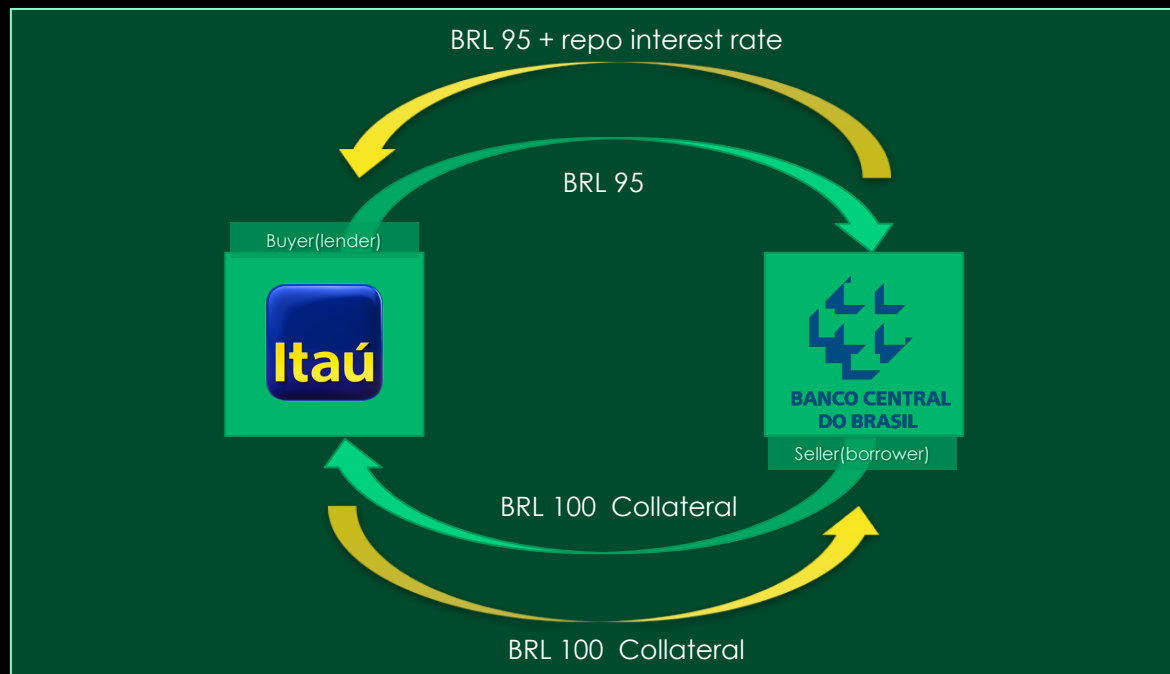
## Statement of the problem



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?

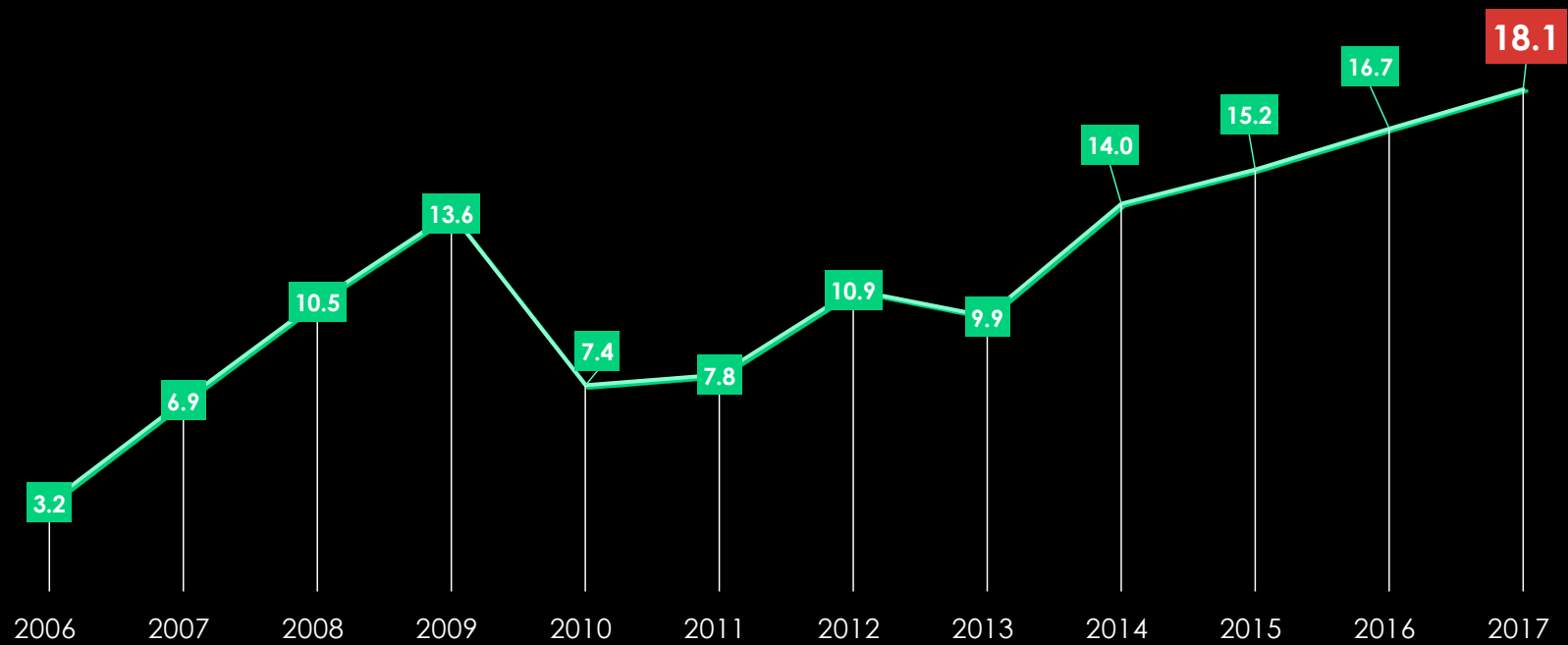
Four main features:

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



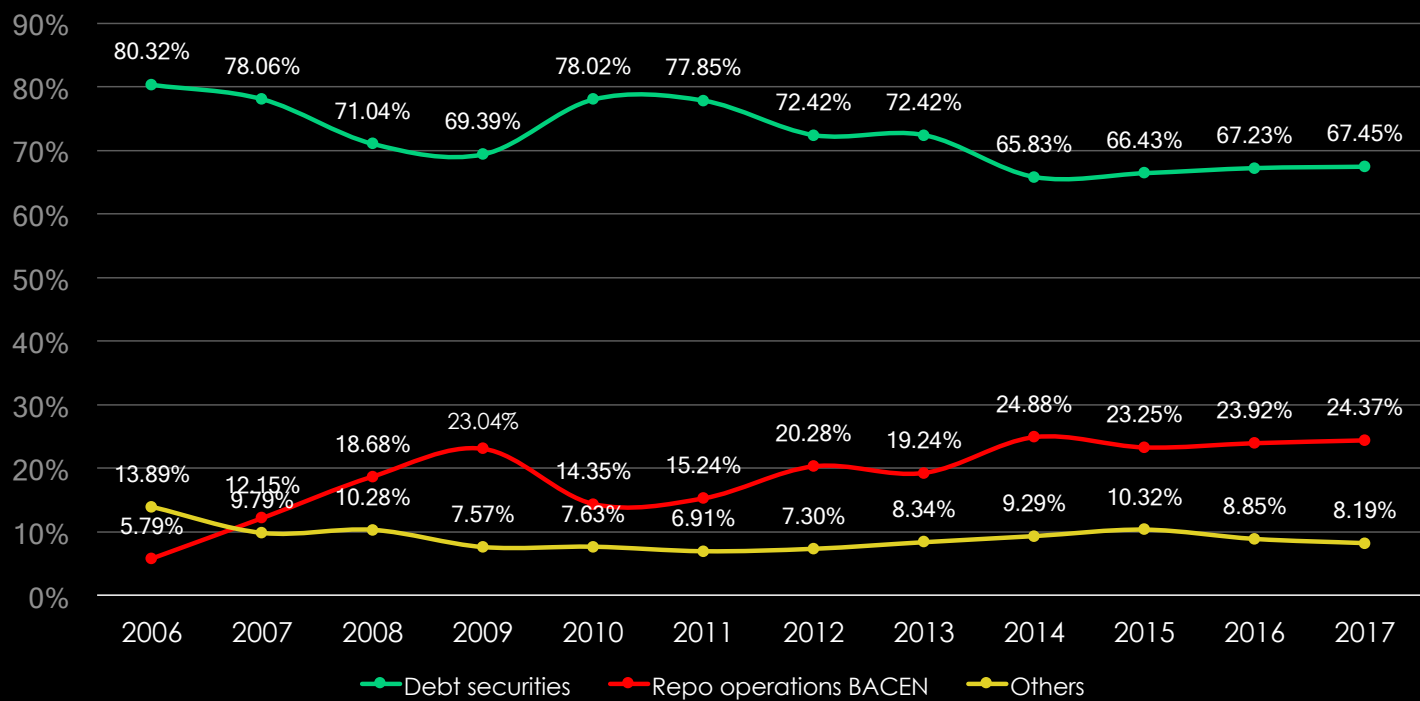
## REPO OPERATIONS - BRAZILIAN CENTRAL BANK 2006 – 2017 (%GDP)

— Repo transactions - Brazilian Central Bank (%GDP)



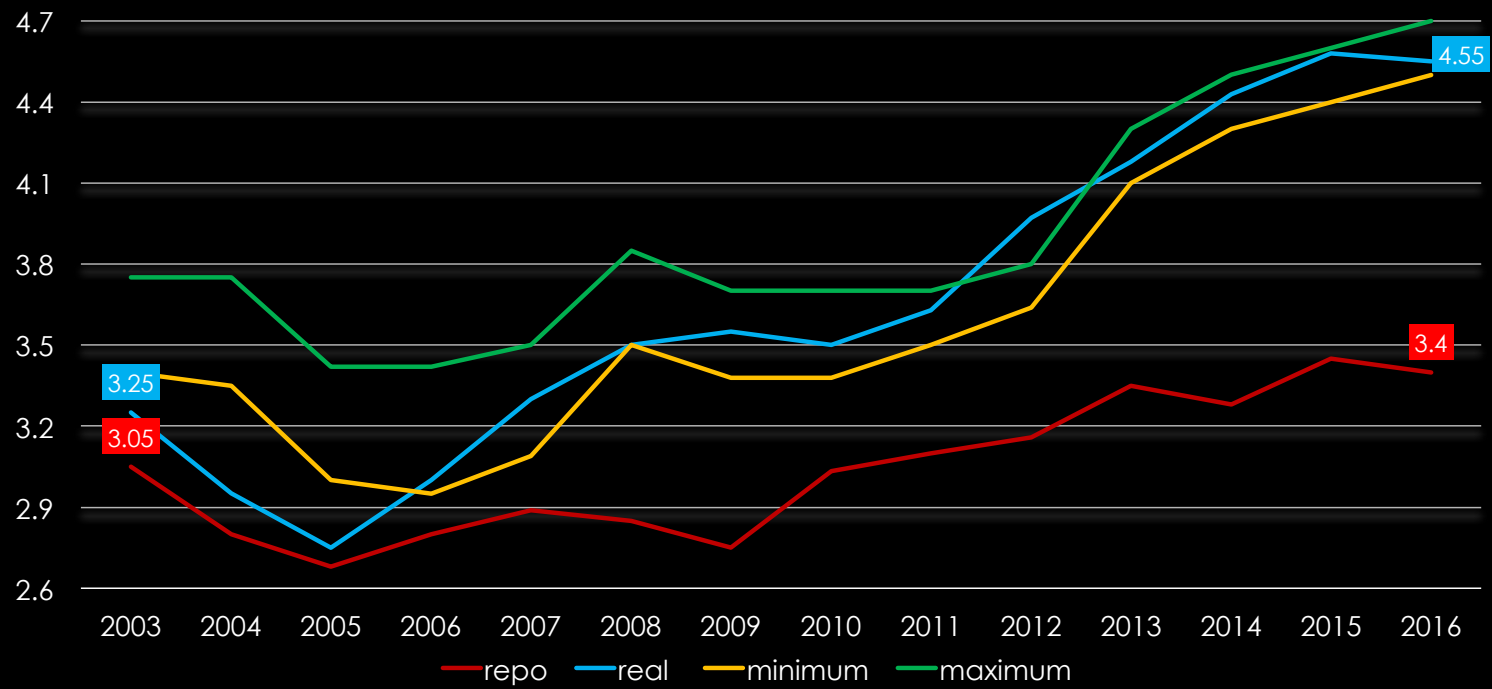
Source: Brazilian Central Bank, 2017

### National Gross Debt Composition, 2006-2017 (%)



Source: Brazilian Central Bank, 2017

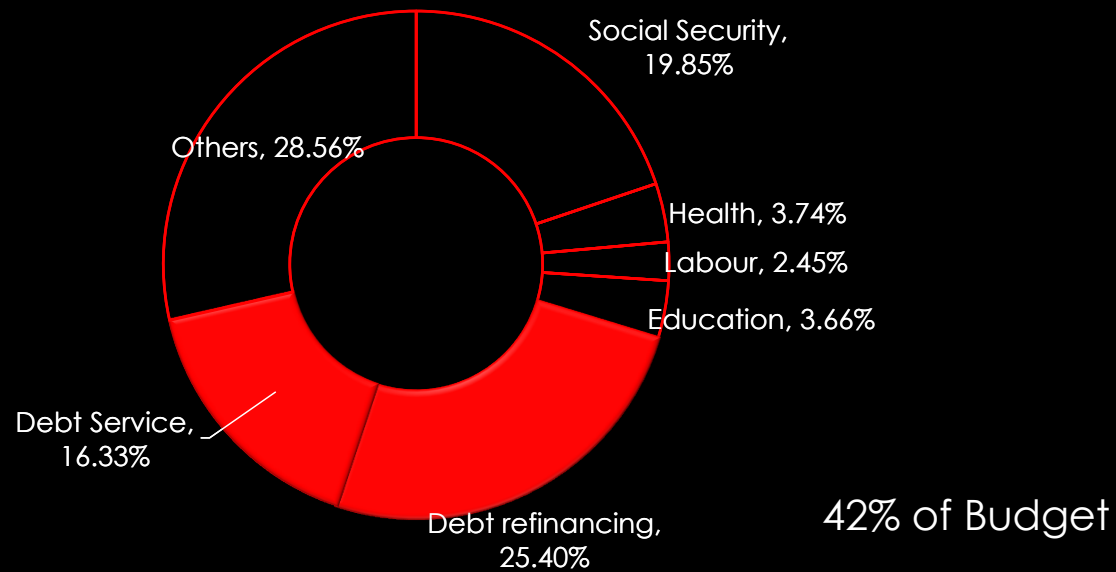
Average term to maturity on debt ABP x Repo, 2003-2016 (years)



Source: Brazilian Central Bank, 2017



## Main public expenses in 2016 (Billions R\$)



Source: Brazilian Central Bank, 2017

Constitutional Amendment 95/2016 – New Fiscal Regime



## The contributions of this research



### 1) Theoretical

What is financialisation?

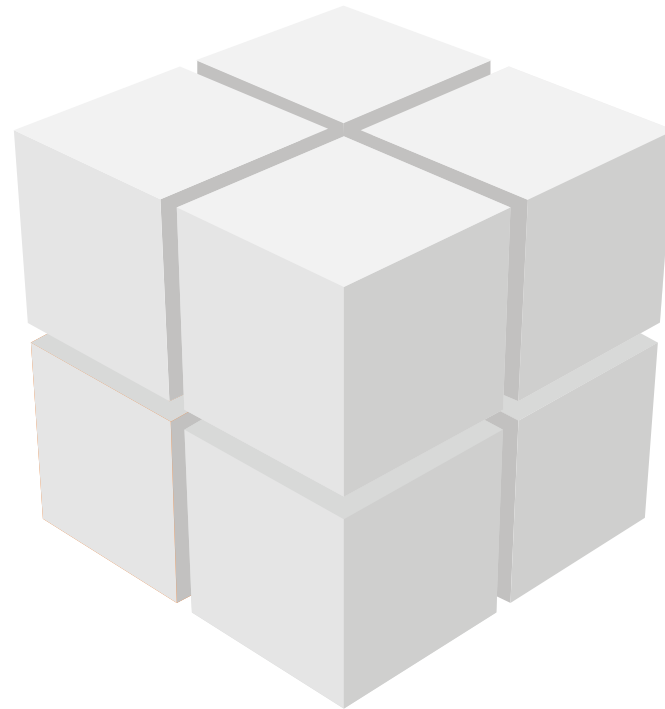
“The increasing role of financial motives, financial markets, financial actors and financial institutions in the operations of the domestic and international economies” (Epstein 2005: 3).



## The contributions of this research



Research on Financialisation (*van der Zwan, 2014*)





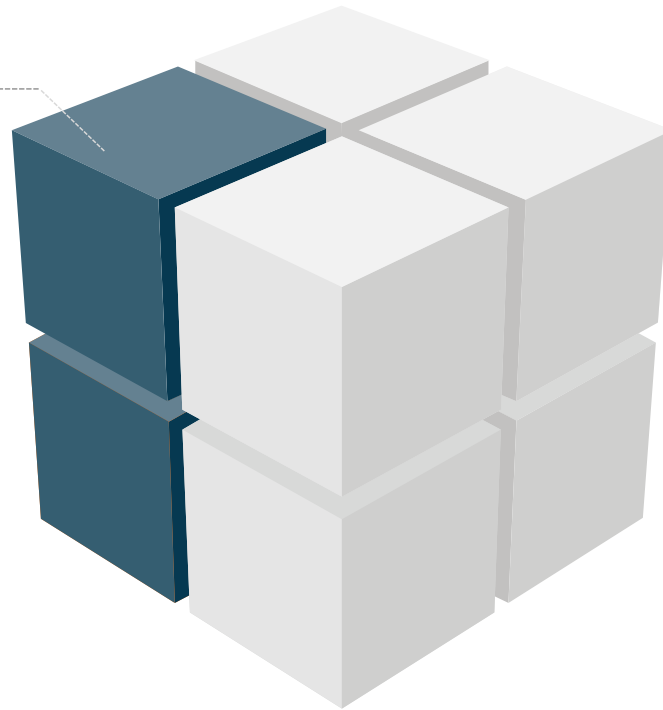
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Research on Financialisation (*van der Zwan, 2014*)

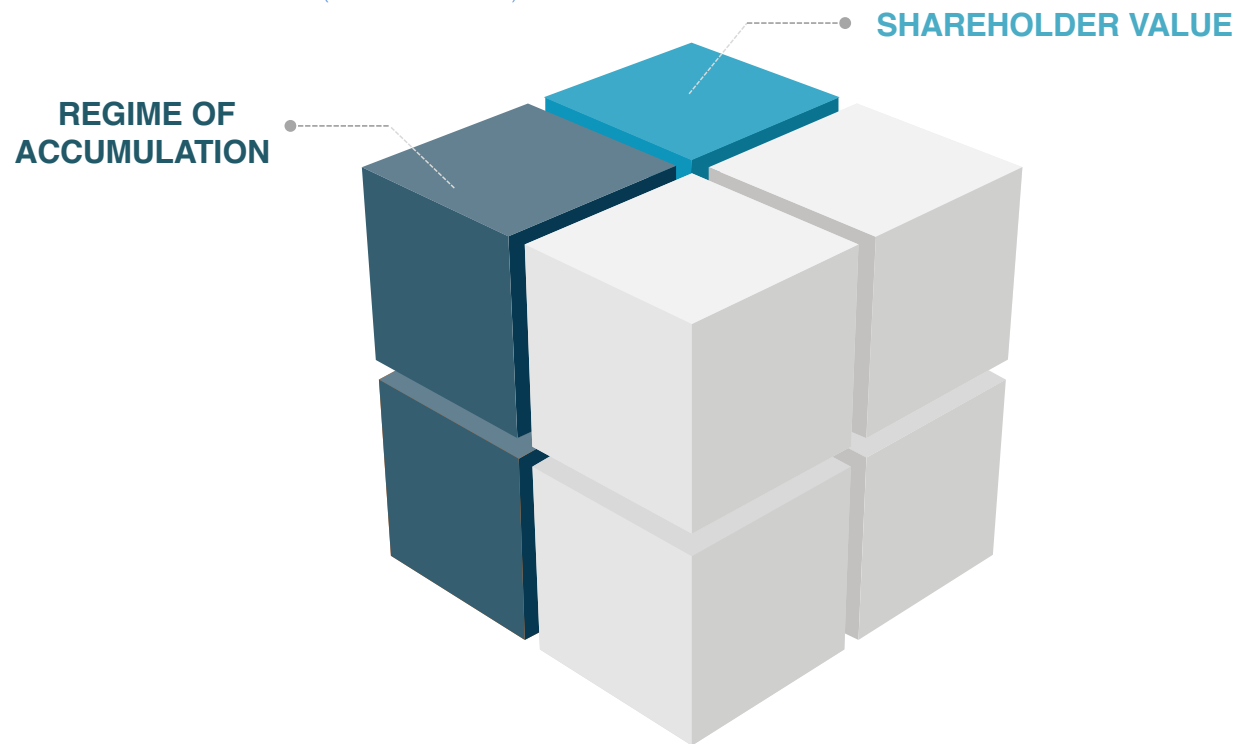


**REGIME OF ACCUMULATION**



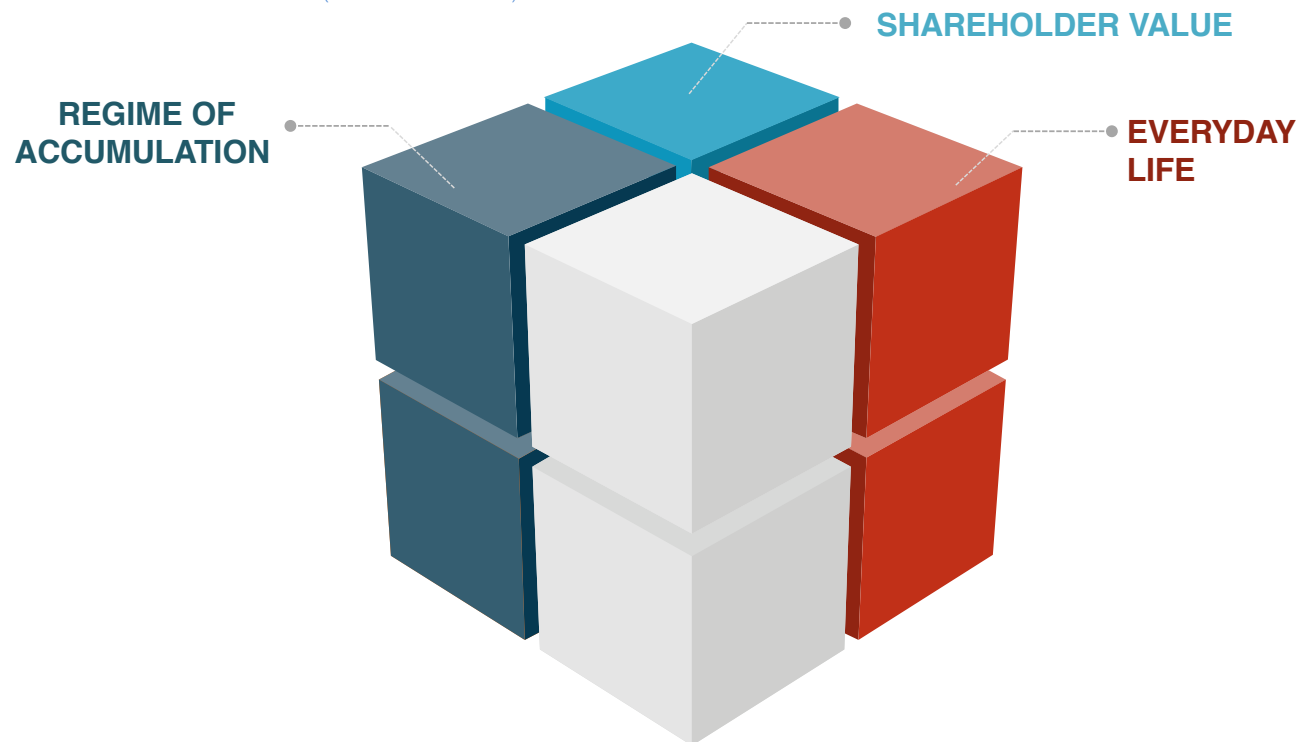
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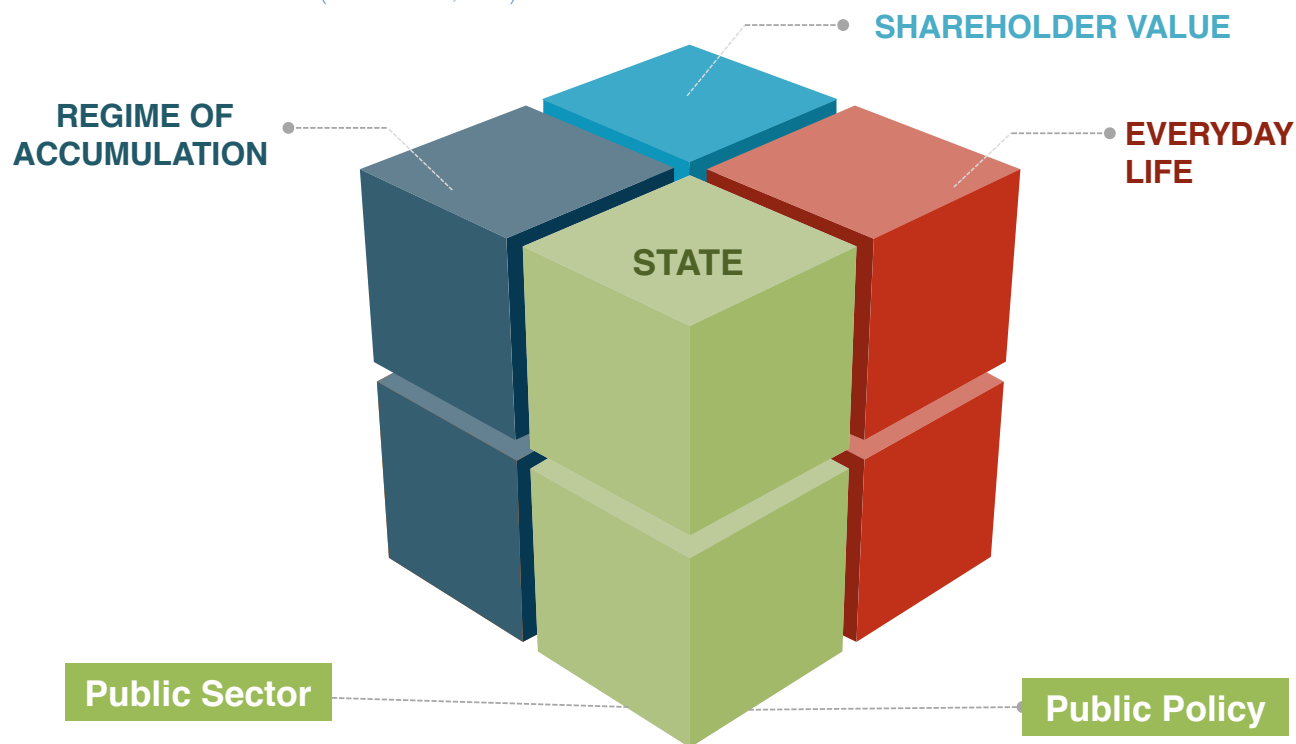
# The contributions of this research

Research on Financialisation (*van der Zwan, 2014*)



# 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”.

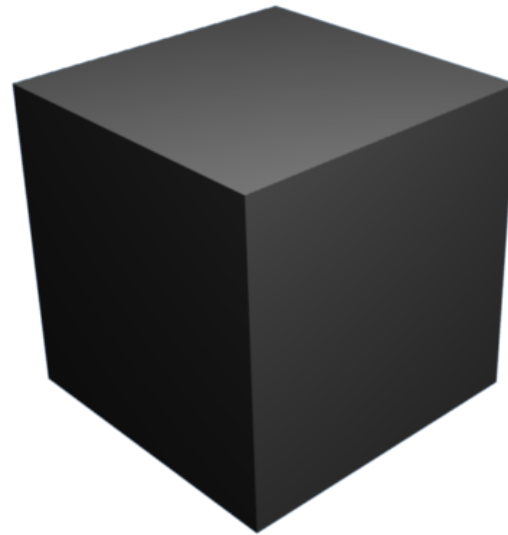
“A monetary policy oriented towards high yields in sterilization instruments that highly contributes to the Shadow Banking expansion”.



## 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)
- BIS (1999, 2017)
- 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

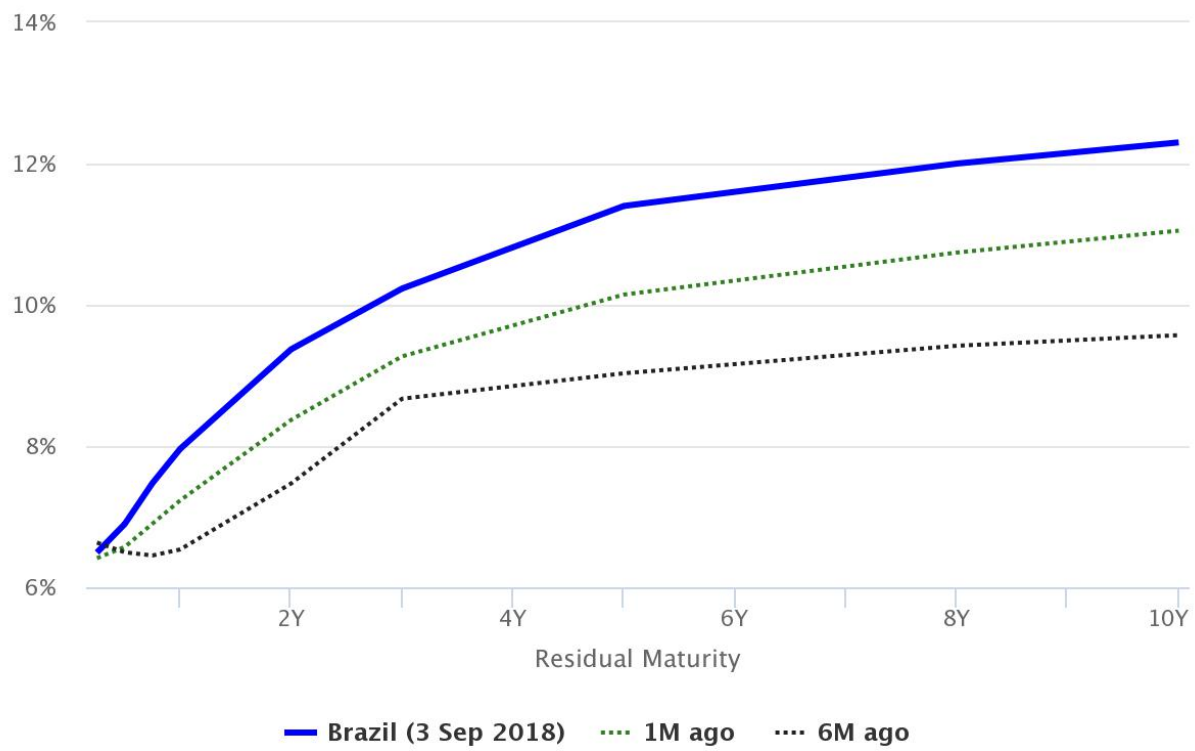


**Evidence:** National Treasury and the Brazilian Central Bank are competitors.

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.

# Brazil Yield Curve – 3 Sep 2018

Brazil Government Bonds





## Main Results

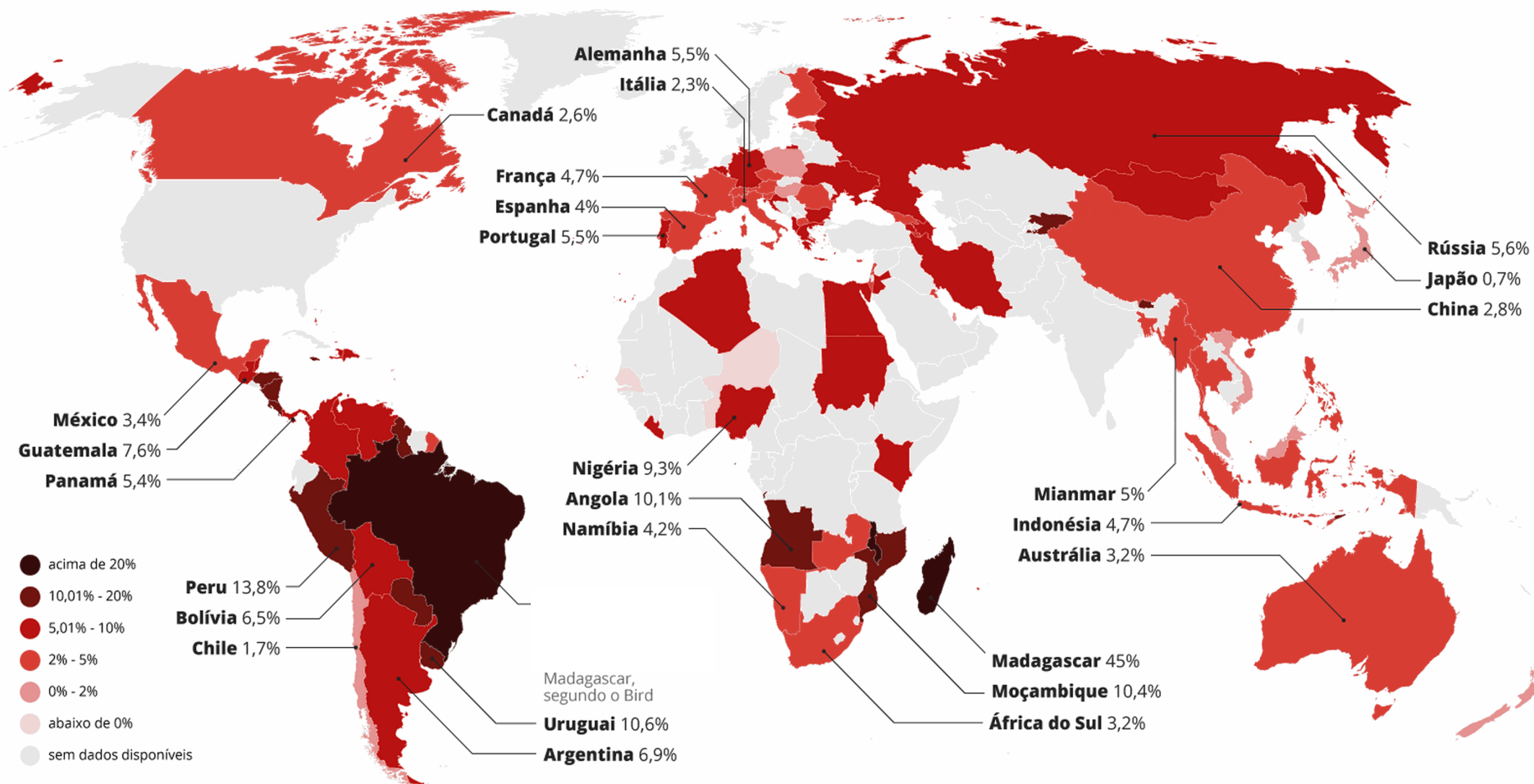


When the yield curve is steep, banks are able to borrow money at lower interest rates and lend at higher interest rates.

So...



## Bank Spread around the world (2016)



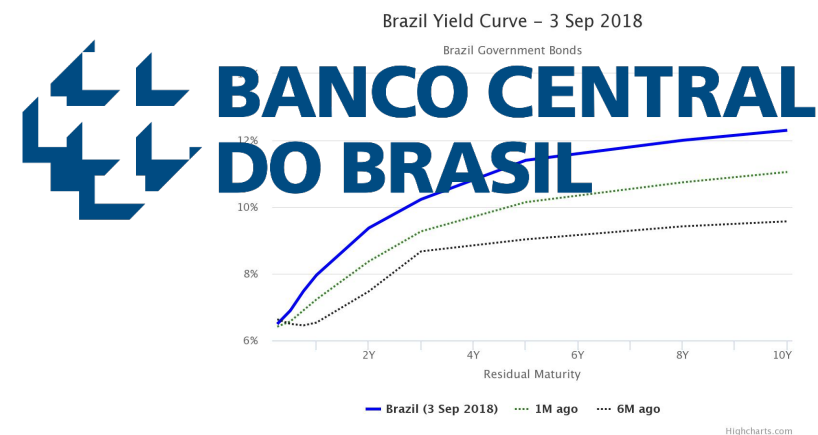
Fonte: Banco Mundial

## 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.



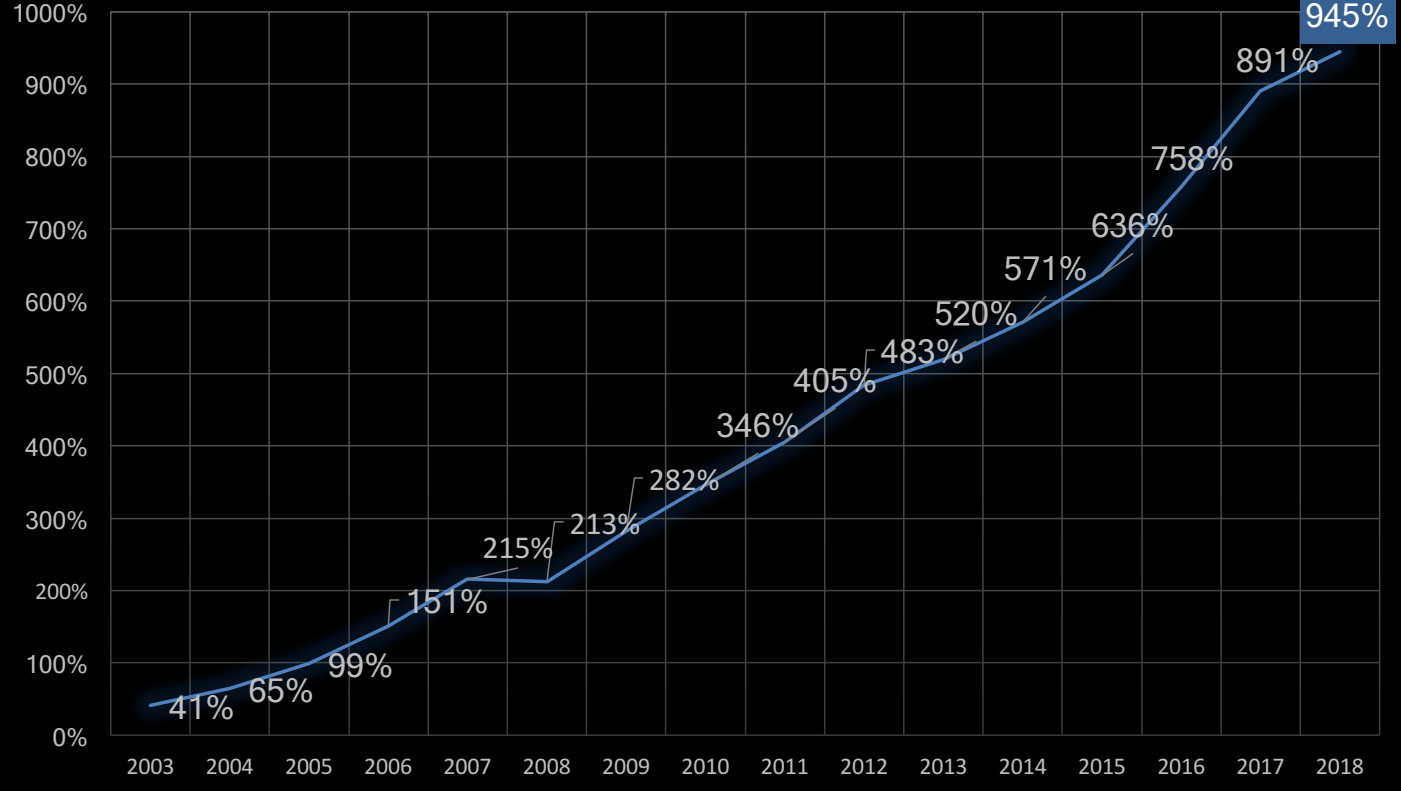
## Main Results



### 2) Expansion of Shadow Banking

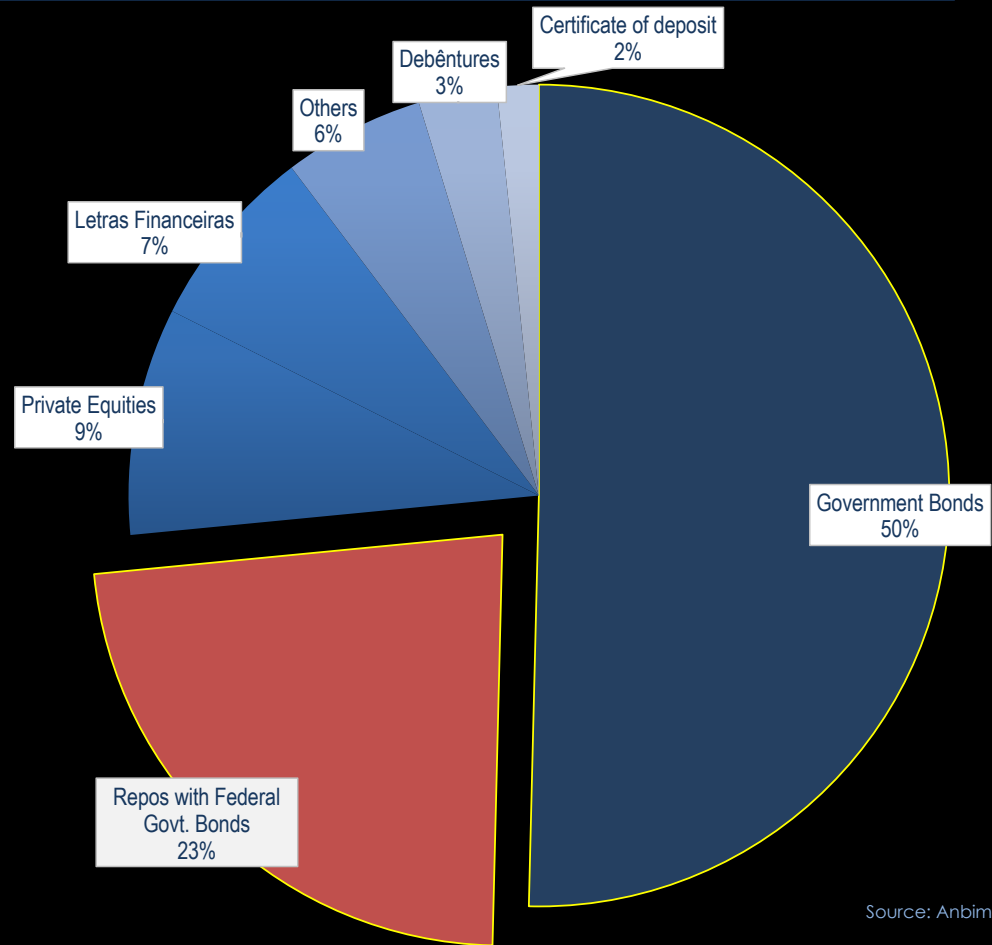
Brazilian Central Bank Repurchase Agreements are highly contributing to Shadow Banking expansion.

### Growth of Shadow Banking in Brazil (2003-2018) Investment Funds Net Worth (2002=zero)



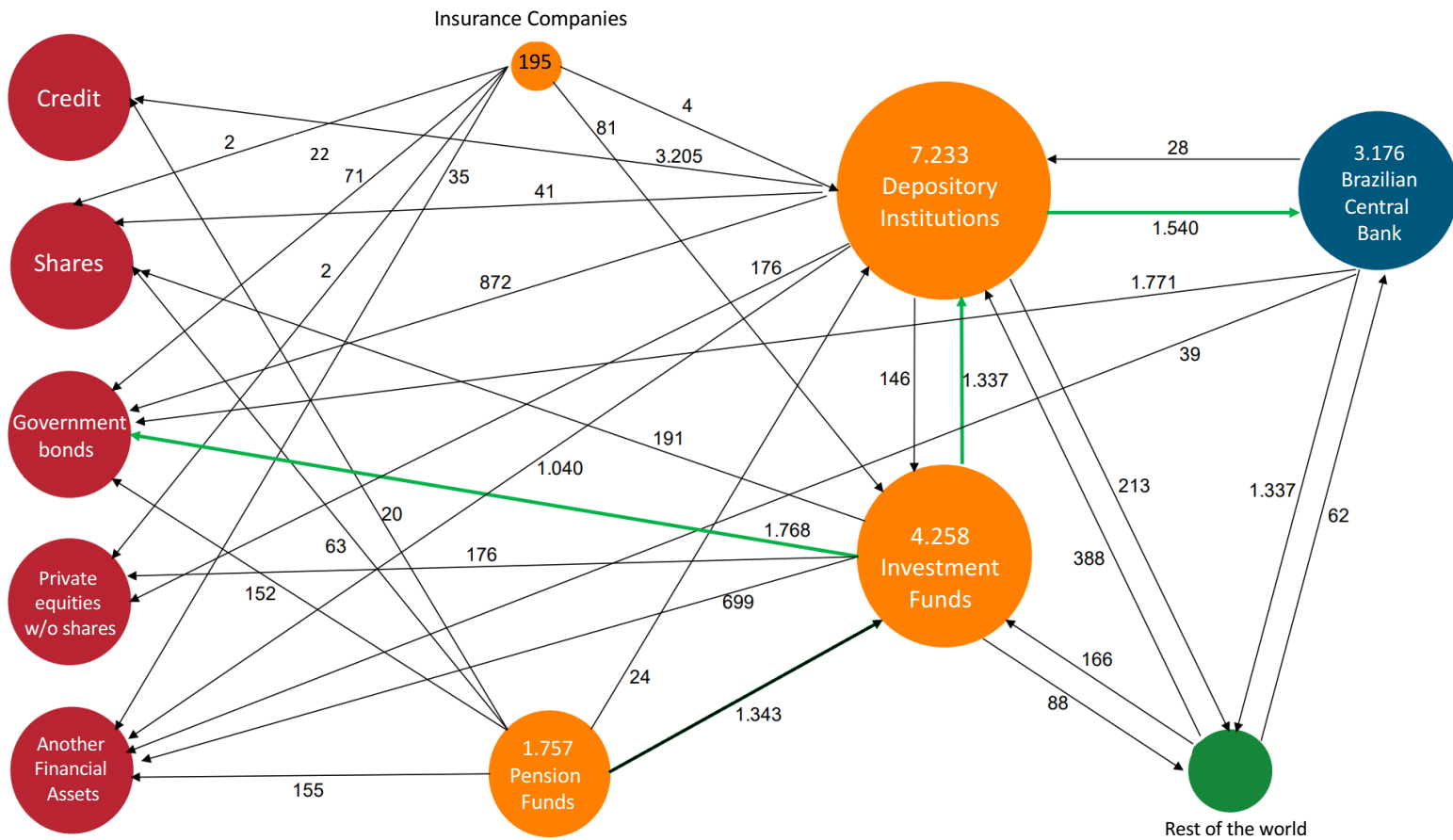
Source: Anbima, 2018

## Net Worth of Investment Funds in Brazil (assets) December 2017



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?