The role of banks in building the economy



Murilo Portugal

President of the Brazilian Federation of Banks

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Lawyer and economist Murilo Portugal, president of the Brazilian Federation of Banks (Febraban), jokes that he is more of a bank clerk than a banker. He has never been associated with any Febraban member — or any other private company — yet his new job launches a major change in how Febraban is managed. However, he has had a long and successful career in public service. Portugal was Secretary of the National Treasury during the time (1992–96) when the Real Plan was introduced, then executive director of the International Monetary Fund (IMF), where he represented Latin American countries (1998–2005). He came home to serve as deputy finance minister (2005–2006) but was then appointed deputy managing director of the IMF (2006–2011). Now he takes charge of the organization that represents one of Brazil's fastest-growing sectors.

***The Brazilian Economy* — What do you think should be the mission of banks in this phase of economic stabilization and growth in Brazil?**

Murilo Portugal — At every stage of development, banks have three important roles: First, they must run the payment system safely and efficiently. Second, they must mobilize, protect, and adequately remunerate the savings of firms and individuals. Third, they must allocate these savings effectively to finance production, consumption, and investment. Depending on the specific circumstances, there may at times be more or less emphasis on one or another role. Brazil's banking sector has always handled the first two roles well. But because of high inflation and the fiscal indiscipline that characterized Brazil until the economic stabilization phase that started with the Real Plan, banks focused mainly on government funding. This has begun to change in

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recent years with accelerated expansion of credit to the private sector. In this scenario, banks increasingly will be financing investment, which in Brazil still depends heavily on compulsory savings mechanisms led by the government. These mechanisms seem to be reaching their limits. They need to be complemented by funding from private banks and the domestic capital market.

At the moment, in addition to creating new types of long-term loans and complying with the new Basel rules, Febraban has been analyzing the rapid rise in the number of users of banking services. According to the Getulio Vargas Foundation study of the new middle class, between 2003 and 2009, 35.7 million consumers were added to the middle and upper classes. These are people who consume more and therefore need to better understand the financial products banks offer and the basics of how to handle money, credit, and savings. Another challenge is to keep credit expanding at a higher rate than GDP, but without degrading its quality or endangering the financial system.

How do we overcome this challenge? By offering cheaper credit with longer maturities?

The high rate of interest paid on government debt makes it less attractive to invest in long-term private paper, whose quality by definition is lower than that of government bonds. Part of the solution is for government to give corporate bonds a tax advantage, as was done last year. Private long-term bonds must also be of high credit quality; their risk should be classified by rating agencies. We also need a deep and liquid secondary market for private bonds as well as public bonds. This requires a small number of high-quality bonds, large trading volumes, regularity and predictability in their issuance, and market makers to keep the secondary market functioning. We are still discussing how to create those conditions.

Strictly speaking, the cost of credit has been declining for the past year as Brazil's macroeconomic fundamentals improve. But it is necessary to reinforce this process by reducing both the basic interest rate and spreads. For the former, the most important factor is a continued fall in expected inflation and reducing the gross financing needs of the public sector — Brazil's is the highest among emerging economies. At the same time, it is necessary to reduce subsidized credit because it increases the basic interest rate on nonsubsidized credit. As for spreads, it is necessary to reduce delinquency, especially the costs of collecting on collateral; lower the tax rates on financial interme-

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diation, which are also higher in Brazil than elsewhere; reduce bank administrative costs; and promote further competition in the financial sector. The agenda is challenging. We not only need more progress in macroeconomic fundamentals, we need microeconomic reforms to break with the culture of the short-term, overnight markets, and certificates of deposit with daily liquidity. This may be the single most difficult task for government, banks, and society.

In countries with higher living standards, the services sector is usually the main generator of income and jobs.

The service sector has been growing fast in recent years. Why do you think that is happening?

This is normal when there is an improvement in per capita income. A person who has more resources does not necessarily consume much more food, clothing, or other manufactures. The additional demand ends up being channeled to services. In countries with higher living standards, this sector is usually the main generator of income and jobs.

Is this growth in line with Brazil's current stage of development or might it indicate problems in the structure of the economy?

This is a normal process. Like all large economies, Brazil depends mainly on its domestic market. As a result, a rise in incomes affects the domestic market, particularly growth in services. In exporter countries that depend on external demand, growth in other sectors becomes more evident. We will see this happen in Brazil because of our great wealth of natural resources available for export. We are world leaders in exporting agricultural commodities and have significant participation in mineral commodities, like iron. Now, we have these great oil and gas discoveries. Production will grow faster in these areas than in the rest of the economy.

Historically, financial intermediation has been among the segments with the greatest weight and growth in the services sector. In the first quarter, financial intermediation grew 6.4% over the same period last year but recorded a small decrease of 0.4% from the previous quarter, for the first time since 2008. Should we worry about this?

The setback is temporary and is normal. It responds to the Central Bank's tightening of monetary policy over time. But I think the factors that contributed to that faster growth in the past will continue to allow faster growth in the future. The financial sector has good levels of capital and liquidity, considerable technological sophistication, and a more active and innovative approach to offering its customers new products. Of course the

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level of credit to the private sector as a proportion of GDP, though it has lately increased greatly, is low compared with other countries. My view is that, if we sustain this macroeconomic scenario, credit to the private sector will continue growing faster than GDP, especially when monetary policy becomes more neutral.

A large numbers of complaints are related to bank fees, which are high compared to the rest of the world. How do you respond to these criticisms?

It is always important to reduce costs. Febraban has made a significant effort to make fees more transparent. Our website has an online tool that makes it possible to compare bank fees for different types of services, so there has been progress. A recent survey by the Consumer Defense Institute (IDEC), which was often only partially reported, shows that some banks did not increase their fees during the period evaluated and some even lowered them, especially public banks. Just one bank pushed one particular fee up by 124%. But the headlines said, "Bank fees increased 124%."

All complaints should always be looked into very carefully because they help to improve services. Yet the number of complaints is relatively small considering that in Brazil there are 141 million accounts and about 55 billion of transactions a year. As a proportion of total services provided, complaints, which are in the thousands, can be considered low.

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The IBRE Outlook released in June cites inflation control and fiscal policy as major challenges for 2011 and 2012. How should these issues be addressed?

The Central Bank should continue to manage the benchmark interest rate to ensure a reasonable probability that inflation will converge to the official target by 2012. As for fiscal policy, the principal challenge is to keep current government spending below the rate of GDP growth. We need to take advantage of rising tax revenues to save more. I see no conflict between medium- and long-term growth and keeping inflation low and predictable, or keeping fiscal policy prudent and counter-cyclical. These are necessary conditions for sustained growth.

Inflation is more widespread in the services sector because it has been overheating and it is less sensitive to the effects of interest rate increases. How can we change this situation?

This, too, is normal, because prices in the service sector are stickier than in other sectors. After all, in most cases people cannot cut their hair or seek medical attention abroad. The point is that there is still a reasonable degree of indexation in the Brazilian economy, in wages or contracts, and because the government administers many of these prices,

they do not respond immediately to changes in interest rates.

The main external risk for 2012, according to the IBRE Outlook, is the possibility of a sharp contraction in global economic growth that could trigger a wave of pessimism that could affect asset prices and commodities. What do you think of this worst-case scenario?

The international outlook for the next year is for gradual recovery but with significant uncertainties. In particular, some countries on the periphery of the euro area are facing a difficult debt crisis, which might cause some imbalance in the European financial system. But there is also uncertainty about the fiscal position of most advanced countries, whose debt has grown significantly — Japan's is 200% of GDP. Germany, the United Kingdom, France, and Spain, among others, have adopted policies to address such problems. But the United States and Japan have not yet come up with plans.

For Brazil the important thing is that demand and commodities prices remain reasonably steady. Of course prices are always volatile, but the prospect of new consumers in China and other emerging markets helps to maintain demand. Brazil is also experiencing great financial inflows, which create short-term difficulties for managing economic policy. However, these flows are essentially good. We must organize ourselves to use them better, not only to build reserves but also to meet the great needs we have in infrastructure and other areas. In short, the external scenario is complex and uncertain but offers opportunities, such as high commodity prices, low interest rates, and large capital inflows. It is up to us to take advantage of these opportunities to increase production capacity and reduce vulnerabilities. ■

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