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CENTRAL BANK MONITORING – SEPTEMBER

2016

Monetary Department
Monetary Policy and Fiscal Analyses Division

CNB CZECH NATIONAL BANK

In this issue

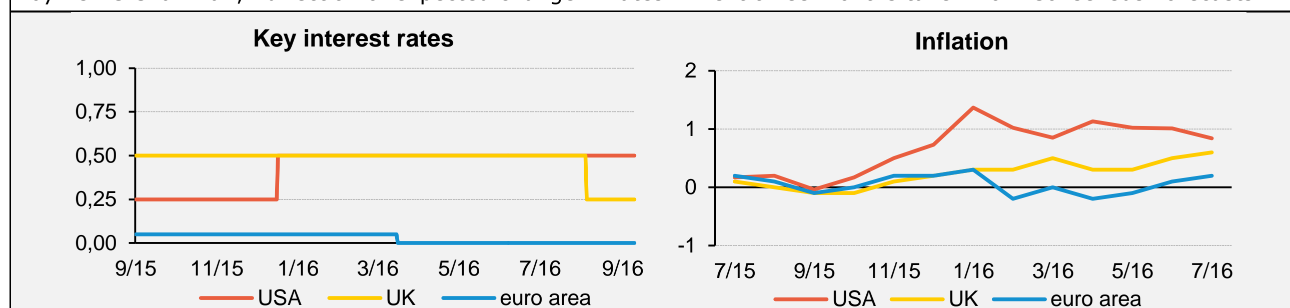
Most of the central banks under review are keeping their interest rates at the current low levels or considering easing monetary policy further. The ECB made no change to its interest rates or the parameters of its bond purchase programme. In reaction to events following the announcement of the Brexit referendum result, the BoE eased monetary policy and provided additional liquidity to British banks. In the case of the Fed, by contrast, the likelihood of an interest rate hike by the end of this year has increased because of sufficiently robust data from the US economy. Spotlight *focuses on economic and monetary developments in Brazil, which hosted this year's Summer Olympic Games but whose economy is going through a deep recession. In our* Selected Speech*, the President and CEO of the St. Louis Fed James Bullard provides a new characterisation of the US economic outlook.*

1. LATEST MONETARY POLICY DEVELOPMENTS AT SELECTED CENTRAL BANKS

Key central banks of the Euro-Atlantic area

	Euro area (ECB)	USA (Fed)	United Kingdom (BoE)
Inflation target	< 2%[1]	2%[2]	2%
MP meetings (rate changes)	21 Jul (0.00) 8 Sep (0.00)	14–15 Jun (0.00) 26–27 Jul (0.00)	16 Jun (0.00) 14 Jul (0.00) 4 Aug (-0.25)
Current basic rate	0.00%; -0.40%[3]	0.25–0.50%	0.25%
Latest inflation	0.2% (Aug 2016)[4]	0.8% (Jul 2016)	0.6% (Jul 2016)
Expected MP meetings	20 Oct 8 Dec	20–21 Sep 1–2 Nov	15 Sep 13 Oct 3 Nov
Other expected events	8 Dec: publication of forecast	19 Oct: publication of Beige Book, Feb: publication of Monetary Policy Report	3 Nov: publication of Inflation Report
Expected rate movements[6]	→	↑	→

[1] ECB definition of price stability "below, but close to 2%"; [2] January 2012 definition of inflation target; [3] deposit rate; [4] flash estimate; [5] meeting associated with summary of FOMC economic forecasts and press conference given by FOMC Chairman; [6] direction of expected change in rates in next three months taken from Consensus Forecasts.



The **ECB** kept key interest rates unchanged at its July and September meetings and confirmed that it expects them to remain at present or lower levels well past the horizon of its security purchases. The ECB also confirmed monthly bond purchases of EUR 80 billion at least until the end of March 2017, or beyond if necessary to hit the inflation target. In June, the ECB started buying corporate bonds under its corporate sector purchase programme (CSPP) and conducted the first auction of targeted four-year refinancing operations under the TLTRO II programme. The ECB expects GDP to increase by 1.7% this year and 1.6% in 2017 and 2018. Inflation will remain very low (0.2%) this year and rise to 1.2% in 2017 and 1.6% in 2018.

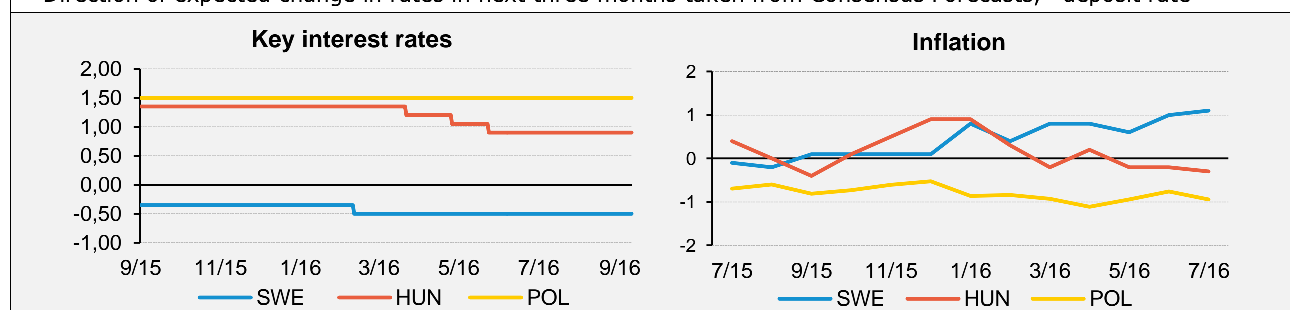
The **Fed** left interest rates in the range of 0.25%–0.50% in June and July. According to the Fed, the likelihood of a rate hike before the end of the year has increased slightly (see *News*), mainly because of sufficiently robust labour market data and weaker near-term risks to the economic outlook, such as Brexit-related uncertainty. According to the FOMC, inflation will remain low. The Fed expects the 2% target to be hit in the medium term. The economy will expand at a moderate pace.

In August, the **BoE** cut its key interest rate by 0.25 pp to 0.25% and announced purchases of corporate bonds of up to GBP 10 billion and an expansion of its purchases of government securities of GBP 60 billion, taking its total government security holdings to GBP 435 billion. Other measures (see *News*) are designed to further ease monetary policy in order to provide additional support to growth and achieve sustainable fulfilment of the inflation target. Inflation reached 0.6% in July. The BoE expects a rise in headline inflation combined with depreciation of sterling and subsequent growth in import prices. According to the BoE, marked movements in the sterling exchange rate have always been associated with substantial changes in core inflation, which can therefore be expected to increase as well.

Selected central banks of inflation-targeting EU countries

	Sweden (Riksbank)	Hungary (MNB)	Poland (NBP)
Inflation target	2%	3%	2.5%
MP meetings (rate changes)	5 Jul (0.00) 6 Sep (0.00)	21 Jun (0.00) 26 Jul (0.00) 23 Aug (0.00)	7–8 Jun (0.00) 5–6 Jul (0.00) 6–7 Sep (0.00)
Current basic rate	-0.50%; -1.25%[2]	0.9%; -0.05%[2]	1.50%
Latest inflation	1.1% (Jul 2016)	-0.3% (Jul 2016)	-0.9% (Jul 2016)
Expected MP meetings	26 Oct 20 Dec	20 Sep 25 Oct 22 Nov	4–5 Oct 8–9 Nov 6–7 Dec
Other expected events	27 Oct: publication of Monetary Policy Report	20 Sep: publication of Inflation Report	14 Nov: publication of Inflation Report
Expected rate movements[1]	→	→	→

[1] Direction of expected change in rates in next three months taken from Consensus Forecasts, [2] deposit rate



The **Riksbank** left its key interest rate at -0.5% in September and confirmed that its government bond purchase programme will continue until it reaches SEK 245 billion in 2016. The main motivation for continued expansionary monetary policy is to reduce the risk of the current upward trend in inflation halting (the CPI and CPIF outlooks for 2016 are 1.1% and 1.5% respectively). The Riksbank is not planning to increase its key rate until 2017 H2, when inflation is expected to be close to the target (CPI at 1.7% and CPIF at 1.9%). In the event of negative international developments (especially as a result of the British referendum) or sharper-than-forecasted appreciation of the Swedish krona, the Riksbank is prepared to make monetary policy even more expansionary, even between monetary policy meetings.

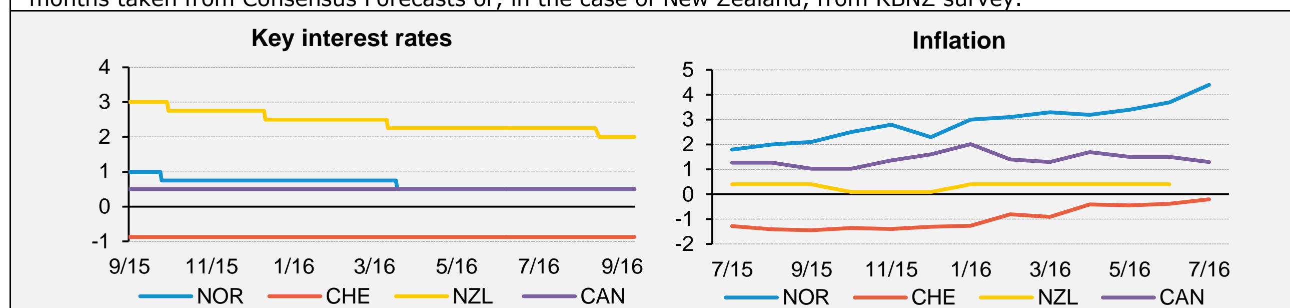
The **MNB** maintained its base rate at 0.9% and its deposit rate at -0.05%. The Hungarian economy exceeded expectations in 2016 Q2, rising by 2.6%. The MNB has adopted further unconventional instruments: from August it will announce its three-month deposit tender only once a month (instead of four times a month) and from October it will limit the amount of money that commercial banks may deposit with it. This should motivate banks to lend more or to invest in domestic government bonds, thereby pushing interest rates down. The MNB expects inflation to remain below the 3% target and approach it only in 2018 H1.

The **NBP** kept its interest rate unchanged at 1.5%, where it has been for one and a half years now. Annual economic growth picked up in Q2, driven mainly by household consumption – supported by a strong labour market – and by a rise in exports. A drop in investment owing to lower EU funds absorption acted in the opposite direction. These main factors will continue to dominate for the rest of this year, with full-year growth of the Polish economy expected to reach 3.2%. Consumer and producer price inflation remain negative and the NBP does not expect them to turn positive again until the end of 2016.

Other selected inflation-targeting countries

	Norway (NB)	Switzerland (SNB)	New Zealand (RBNZ)	Canada (BoC)
Inflation target	2.5%	0–2%	2%	2%
MP meetings (rate changes)	23 Jun (0.00)	16 June	9 Jun (0.00) 11 Aug (-0.25)	13 Jul (0.00) 7 Sep (0.00)
Current basic rate	0.50%; -0.50 reserve rate[1]	from -1.25 to -0,25%[2]; -0.75%[3]	2.00%	0.5%
Latest inflation	4.4% (Jul 2016)	-0.2% (Jul 2016)	0.4% (2016 Q2)	1.3% (Jul 2016)
Expected MP meetings	22 Sep 27 Oct	15 Sep 15 Dec	22 Sep 10 Nov	19 Oct 7 Dec
Other expected events	22 Sep: publication of Monetary Policy Report	21 Sep: publication of Monetary Policy Report	10 Nov: publication of Monetary Policy Statement	19 Oct: publication of Monetary Policy Report
Expected rate movements[4]	↓	→	↓	→

[1] Only on reserves exceeding quota; [2] chart displays centre of band; [3] negative sight deposit rate on account balances held at SNB, graded according to balance amounts; [4] direction of expected change in rates in next three months taken from Consensus Forecasts or, in the case of New Zealand, from RBNZ survey.



The **NB** kept its interest rate unchanged at 0.50% at its June meeting. Governor Olsen mentioned the possibility of a further rate cut but no longer hinted at a possible reduction to negative levels. The growth prospects for the Norwegian economy remain weak despite rising oil prices and the resulting benefits for the Norwegian economy. Inflation has been above the target for almost a year but is expected to decline owing to expected lower wage growth and a stronger Norwegian krone. Should the rapid rise in house prices persist, household vulnerabilities may increase. The countercyclical capital buffer rate is currently 1.5%.

At its June meeting, the **SNB** left the target range for its monetary policy rate (3M LIBOR) at between -1.25% and -0.25%. The interest rate on commercial banks' account balances with the SNB also remained unchanged at -0.75%. The SNB is buying shares in an effort to weaken the Swiss franc (see here). As a result, shares accounted for 20% of the official international reserves in Q2. According to the new forecast, the price level will decline more slowly and then start rising gradually; the SNB expects deflation of 0.4% for 2016 (0.8% in the March forecast) and inflation of 0.3% for 2017 (0.1% in the March forecast).

The **RBNZ** lowered its key rate by 0.25 pp to 2.0% in August to foster a correction of the previous appreciation of the New Zealand dollar and to check the decline in inflation and inflation expectations. The weak global economic conditions are dampening inflation pressures in New Zealand via a high exchange rate, declining import prices and consequently falling prices of tradables. Inflation is therefore low and the RBNZ expects it to sink further in Q3. A further tightening of macroprudential policy has been proposed to enable the RBNZ to continue lowering interest rates (see *News*).

The **BoC** left its key interest rate at 0.5%. Inflation is below the target. It stood at 1.3% year on year in July due to a decline in consumer energy prices. The BoC expects inflation to stay slightly below the target at 1.6% this year. The BoC lowered its GDP growth estimate for this year to 1.3% due to wildfires in Alberta. The growth forecast for 2017 is 2.2%.

2. NEWS

Main topic of 2016 Jackson Hole symposium was "Designing Resilient Monetary Policy Frameworks for the Future"

The annual economic symposium of central bankers and academics organised by the Federal Reserve Bank of Kansas City discussed the creation of sufficiently resilient and flexible monetary policy frameworks in a situation of low nominal interest rates and changes in financial markets, and also covered the role of central bank balance sheets. Opening remarks were given by Fed Chair Janet Yellen (see below). The other speakers included Agustín Carstens, Governor of the Bank of Mexico, Haruhiko Kuroda, Governor of the BoJ, Benoít Coeuré from the ECB, Minouche Shafik from the BoE, Marianne Nessén from the Riksbank, Christopher A. Sims from Princeton University and Marvin Goodfriend from Carnegie Mellon University.

In her Jackson Hole speech Janet Yellen hints at rate hike this year and mentions possible new policy tools

Janet Yellen said that thanks to positive signs in the labour market and the outlook for growth, the case for an increase in the federal funds rate this year had strengthened, but the decision depended on further data. In addition to adjusting the federal funds rate and forward guidance, she spoke about a possible need to widen the spectrum of monetary policy tools in the future – for example by purchasing a broader range of assets – to support economic growth. She also mentioned the suggestions of some observers to raise the inflation objective or to implement policy through alternative monetary policy frameworks, such as price-level or nominal GDP targeting, but she stressed that the FOMC was not actively considering these additional regimes and policy frameworks. She also emphasised the important stabilisation role of fiscal policy. She did not mention the possibility of introducing negative interest rates.

BoE eases monetary policy in response to Brexit

In reaction to the UK's decision to leave the EU, the BoE decided to provide banks with additional liquidity by offering three Indexed Long-Term Repo operations (ILTR, see the last CBM), and the BoE governor in a speech given at the end of June hinted at a probable additional easing in the near future. At the beginning of July the BoE reduced the UK countercyclical capital buffer rate from 0.5% to 0% with immediate effect. In August, the BoE approved a package of measures designed to provide additional support to growth and to achieve a sustainable return of inflation to the target. The package comprises (i) a 25 bp cut in the Bank Rate to 0.25%; (ii) a new Term Funding Scheme to reinforce the pass-through of the cut in the Bank Rate; (iii) the purchase of up to GBP 10 billion of UK corporate bonds; and (iv) an expansion of the asset purchase scheme for UK government bonds of GBP 60 billion, taking the total stock of these asset purchases to GBP 435 billion.

RBNZ proposes tightening of macroprudential policy in field of property market lending across New Zealand

In July the RBNZ published a consultation paper proposing a tightening of loan-to-value restrictions (LVRs) on the property market as from September 2016. The proposed changes would simplify the LVR policy by removing the current distinction between lending in Auckland (see the June 2015 CBM) and the rest of the country. The tightening of LVR restrictions should allow the RBNZ to cut interest rates and thereby weaken the still relatively strong New Zealand dollar without fuelling a house price bubble by easing monetary policy further. Under the proposed new restrictions, no more than 5% of bank lending to residential property investors would be permitted with an LVR of greater than 60% and no more than 10% of lending to owner-occupiers would be permitted with an LVR of greater than 80%. All loans that are

exempt from the existing LVR restrictions, including loans to construct new dwellings, would continue to be exempt. Following consultations with banks, the RBNZ deferred the start of the proposed changes to investor LVRs nationwide from 1 September to 1 October 2016. The RBNZ added that further adjustments to the proposals are still possible.

St. Louis Fed president proposes new approach to forecasting

St. Louis Fed President James Bullard presented a new characterisation of the US macroeconomic outlook and proposed a new approach to forecasting consisting in the concept of economic regimes. Our *Selected Speech* covers this approach.

SNB releases info portal, application and brochure

The SNB released a new website, a tablet app and a brochure containing information about the SNB and its monetary policy, price stability, the history of the minimum exchange rate, the property market and much more besides. The information is aimed at schools and the general public and is available currently in German and French, with Italian and English versions due in autumn 2016.

3. SPOTLIGHT: BRAZIL'S WAYS OUT OF CRISIS

Brazil, the seventh largest economy in the world, hosted the Summer Olympic Games this year and the FIFA World Cup two years ago. The hosting of large sporting events was intended to celebrate this rapidly growing economy, the largest in Latin America. However, Brazil has been experiencing a deep recession and political turmoil in recent years. Nonetheless, it traditionally ranks among the major world markets and has overcome many trials in its history. There is therefore hope that the Brazilian central bank, together with the government's economic team, will again find suitable solutions to help the economy rebound.

The Brazilian economy in brief

Brazil is the fifth largest and fifth most populous country in the world and the largest and most populous country in South America. Its economy is the seventh largest in the world as measured by total GDP (in PPP). The country is rich in mineral resources, and the oil industry (dominated by the state-run Petrobras, currently embroiled in a corruption scandal) is a key sector. The engineering and chemical industries are also significant. Brazil is the world's largest sugar and coffee exporter, the second largest soybean and meat exporter, and also one of the largest exporters of iron ore. Given the high share of mineral commodities in Brazilian exports (about 60%), the country is strongly affected by changes in their global prices. Brazil's main export partners are the EU (about 19% of exports), China (18%), the USA (12%) and Argentina (6%). Although Brazilian exports account for only 13% of GDP, they are a significant source of external income for the economy.

At the start of the millennium Brazil was one of the world's fastest growing economies, and in 2001 it was ranked among the four most important up-and-coming world economies, for which the joint name BRIC (Brazil, Russia, India and China) was coined. In 2013, however, its economy began to slow, mainly because of a drop in world commodity prices and slower growth of China, the key buyer of Brazilian commodities. External factors were exacerbated by imbalanced domestic macroeconomic policy with high government spending and interventions in the economy. Since the second quarter of 2014, the Brazilian economy has been in recession. Its decline has been accompanied by corruption scandals and a political crisis culminating in the ousting of the Brazilian president from office this year.

The historical trials of Banco Central do Brasil and the choice of inflation targeting

Brazil has successfully overcome many economic crises in the past. In the 1980s and 1990s it grappled with hyperinflation,[1] and in the late 1990s it overcame a financial crisis[2] which led to the adoption of inflation targeting. Alongside the government's economic team, the Brazilian central bank has always played an important role in stabilising Brazil's economy.

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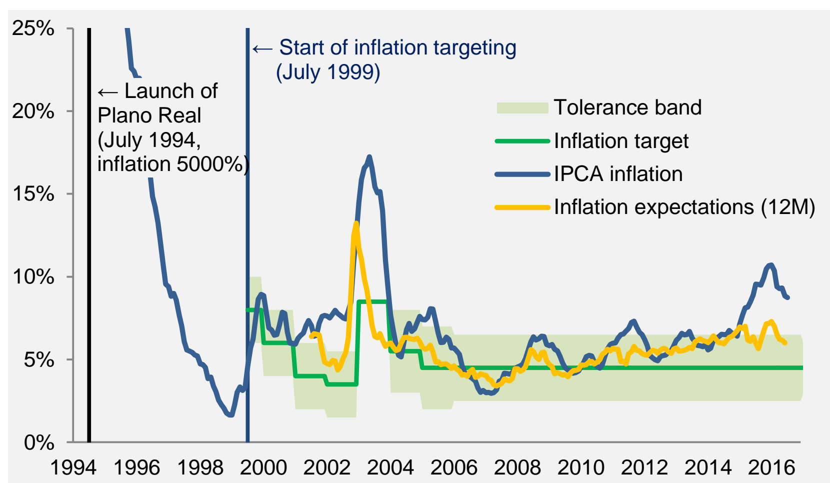
[1] The hyperinflation period, when annual inflation soared above 5,000% in several episodes, was a legacy of the military regime of 1964–1985. Under this regime, the country enjoyed strong economic growth in the 1970s, but at a cost of rising foreign debt and the deferral of vital structural reforms. Since 1986, a series of economic plans have been implemented to curb inflation, but it was not until July 2014 that the "Plano Real" finally succeeded. This involved introducing a "new" real (the ninth currency in Brazil's independent history) and fixing its exchange rate against the dollar. The rate thus became a nominal anchor for the economy. In addition, wage and price indexation was abolished, fiscal and monetary policies were tightened, the public sector was downsized and foreign trade was liberalised. (For a short time, the BRL/USD exchange rate was fixed at 1:1. As from March 1995 it was gradually devalued by 8% a year in a crawling peg system, with the central bank intervening on the foreign exchange market when the rate deviated from the set parity.) Inflation was reduced to single figures in less than three years.

[2] The financial crisis was caused by a strong outflow of foreign capital connected with the Russian financial crisis in 1998 and the related drop in investor confidence in emerging economies. Brazil raised short-term interest rates (above 40%) and the government agreed a financial aid package with the IMF. In January 1999, Brazil was forced to switch to a floating exchange rate due to heavy pressure on its foreign exchange reserves. The real fell sharply over the next two months (from USD 1.2/BRL at the end of January to USD 2.2/BRL at the start of March 1999) and the central bank had to find a new nominal anchor for the economy to prevent instability and growth in inflation after exiting the fixed exchange rate regime. That anchor was the inflation target.

The Brazilian central bank (Banco Central do Brasil, BCB) was founded in 1964. Until then, the usual central bank powers had been exercised by three different federal institutions: the Currency and Credit Superintendence (Superintendência da Moeda e do Crédito, SUMOC, which closed down after the BCB was established), the Bank of Brazil (Banco do Brasil, BB) and several departments of the Ministry of Finance (the current National Treasury, or Tesouro Nacional). However, the fiscal and monetary policy competences of these institutions were not definitively clarified until the constitution came into effect in 1988.

The BCB's primary objective is to ensure the stability of the Brazilian currency's purchasing power and the stability of the Brazilian financial system. However, it does not set Brazil's monetary and financial policy, which is formulated by the government-run National Monetary Council (Conselho Monetário Nacional, CMN),[3] of which the central bank is an executive body. The BCB thus cannot be said to be fully independent. The fact that the BCB governor and vice-governors do not have mandates for a fixed period and can be removed from their posts at any time by the president also contributes to the BCB's insufficient statutory independence. The BCB only has operational independence, that is, the option to choose the instruments needed to achieve the objectives set by the CMN, and currently only informally.[4]

Inflation targeting (IT) has been the monetary policy regime in Brazil since the exit from the dollar peg, i.e. since 1999. It was proposed by BCB representatives as the best regime for achieving economic stabilisation with a free floating exchange rate. The IT regime was formally adopted by presidential decree at the end of June 1999. At the same time, the CMN issued a resolution setting gradually decreasing inflation targets for the end of 1999 and the following two years (8% for 1999, 6% for 2000 and 4% for 2001), defining a tolerance band of ±2% and setting the IPCA consumer price index as the reference price index.[5]



Source: Datastream, BCB

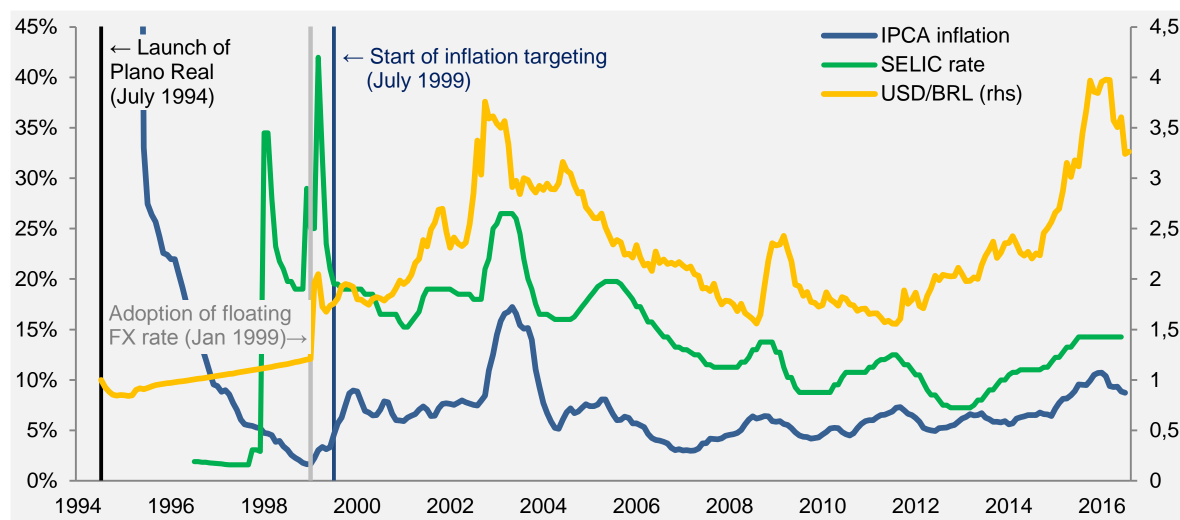
Brazilian inflation stabilised in the tolerance band after the adoption of IT. The exceptions were a period around 2002 characterised by temporary capital outflows and sharp depreciation of the real, and a recent episode of high inflation. The rise in inflation in 2015 was due in part to government austerity measures, including a hike in administered prices. Inflation pressures were also fostered by a weakening real due to economic difficulties, the country's poor fiscal position and investor distrust. Inflation has been falling moderately since the start of 2016, but remains outside the tolerance band and currently stands at 8.7% (July 2016). The real is strengthening thanks to better macroeconomic data and improved market sentiment regarding the new economic team (see below). At its latest meeting (July 2016), the BCB trimmed its

[3] Two of the three CMN members are members of the government (the Minister of Finance and the Minister of Planning and Budget). The third member is the BCB Governor.

[4] Operational independence might be enshrined in the Brazilian constitution this year if the relevant government-sponsored amendment is approved.

[5] The IPCA was selected ahead of the other Brazilian national consumer price index, the INPC, as it covers a larger proportion of the population (families with income of 1–40 times the minimum wage, as compared to 1–5 times in the case of the INPC).

inflation estimates for this year and the next and expects inflation to return to the tolerance band in 2017 (the inflation estimates for 2016 and 2017 are 6.8% and 5.3% respectively).



Source: Datastream, BCB

The CMN sets the inflation target and the width of the tolerance band every June for two years ahead. At present (since 2005) the inflation target is 4.5% with a tolerance band of ±2.0%; the tolerance band for 2017 and 2018 has been narrowed to ±1.5%.

The definition of fulfilment of the inflation target in Brazil differs slightly from that in other countries. The inflation target is hit if cumulative month-on-month inflation for the calendar year (January–December) is in the tolerance band. If inflation misses the target, the BCB Governor is required to write an open letter to the Minister of Finance explaining the reasons why the target was missed, as well as the measures required to bring inflation back to the target and the time period over which these measures are expected to take effect.

The central bank's monetary policy decision-making body is the nine-member Monetary Policy Committee (Comite de Politica Monetaria, COPOM), established in 1996. The COPOM holds eight regular meetings a year and sets the main SELIC monetary policy rate (the overnight interbank market rate). At present (since July 2015) the SELIC rate is 14.25%.

In addition to the above rates, the COPOM may declare an "interest rate bias". The BCB Governor is authorised to change rates in the direction of the bias at any time between regular COPOM meetings.[6]

The COPOM releases minutes of its policy meetings with a one-week delay (in Portuguese and, several days later, in English). Four times a year (in March, June, September and December) it publishes an Inflation Report (Relatório de Inflação) in Portuguese and English containing a description of the internal and external environment as well as inflation and GDP forecasts.[7]

[6] The interest rate bias (*viés de taxa de juros*) can be set in either the upward or downward direction and indicates the likely monetary policy outlook. The BCB used the opportunity to change rates between its meetings in 1999 and 2000. The measure was last declared (but not applied) in 2003. (A brief indication of the most likely monetary policy outlook was used, for example, by the US Fed until January 2000, which then replaced it with a detailed accompanying statement about the inflation and economic growth outlooks.)

[7] The Inflation Report contains the forecast in the form of fan charts in two scenarios. The baseline scenario assumes a constant exchange rate and SELIC rate at the level as of the current COPOM meeting date for the whole two-year forecast horizon; the second, market scenario uses analyst survey data for the exchange rate and SELIC rate paths.

Current situation

GDP 2016 Q1	-5.4%
Inflation Jul 2016	8.7%
Inflation target	4.5% ± 2%
SELIC rate	14.25%

Source: BCB, IBGE

The economic and political crisis in the country failed to calm after President Dilma Rousseff's narrow re-election in October 2014. Nationwide protests – mainly against corruption and the still worsening economic situation – broke out again in 2015 and there were calls for Rousseff to resign. The country's economic situation was not helped by repeated reshuffles of the government's economic team,[8] during which the approach to implementing the structural reforms needed to restart economic growth was partially changed. International agencies downgraded Brazil's rating to speculative grade at the start of this year. The economic contraction eased from 5.9% in 2015 Q4 to 5.4% in 2016 Q1, but economic activity is still falling. According to forecasts by international institutions, GDP will shrink by 3.0%–3.3% this year. The BCB projects a decline of 3.3%.

The political crisis in the country is being exacerbated by a high-level corruption scandal around the state-owned oil giant Petrobras, which is aggravating the political discord. In March 2016, the Congress decided to open a process to impeach[9] President Rousseff for manipulating budget accounts to secure her re-election in 2014.

The latest efforts to kick-start the economy were made in June 2016 by Vice-President Michel Temer, who replaced the President during the impeachment process and who reshuffled the government's economic team to fast-track the necessary reforms. Henrique Meirelles (the BCB Governor in 2003–2011) was appointed Minister of Finance and Ilan Goldfajn was named the new BCB Governor (replacing Alexandre Tombini, who had headed the BCB since 2011). According to the first signs on the markets, this change and the promised return to reforms are causing confidence in the Brazilian economy to grow.

Conclusion

At the FIFA World Cup hosted by Brazil in 2014, the Brazilian national team suffered an embarrassing defeat against Germany, which gave a rather bitter aftertaste to an otherwise quite well-organised event. Moreover, the high spending linked with the World Cup failed to generate the expected returns for the Brazilian economy. The economic benefits of the recently ended Olympic Games are just as uncertain. Sales in transport, accommodation and services rose temporarily, but many of the sports venues will probably be under-used – as was the case after the World Cup. However, the football-crazy Brazilians can draw comfort from the fact that their team beat Germany to win their longed-for Olympic gold medal. Perhaps this is a sign that things will also finally change for the better in the Brazilian economy and that the saying that Brazil is a country of the future will at last be proved right – even though Brazilians themselves half-jokingly add that Brazil will forever remain a country of the future.

[8] Following her narrow victory against more conservative candidates in October 2014, President Rousseff could not continue her previous policy of high government spending and appointed fiscal conservative Joaquim Levy as Minister of Finance. His goal was to achieve a balanced budget and implement radical structural reforms (such as reforms of the pension system and social benefits, a review of tax breaks and a hike in administered prices). However, the reforms were not fully supported even by the President's economic team and also met with resistance in the Congress. Levy resigned from his post in December 2015. The President appointed Nelson Barbosa, a proponent of expansionary fiscal policy, to the post. It was decided to continue only stepwise with the proposed reforms. The markets have not viewed the change positively and analysts have expressed concerns that the central bank's independence will be further restricted, as it will be pressured by the government to cut interest rates regardless of the inflation target.

[9] The impeachment process was opened on 17 April 2016, when the Parliament approved a constitutional petition to impeach the President with the required two-thirds majority. On 12 May, the motion was approved by the Senate by the required simple majority and the President was temporarily suspended (until the final verdict was issued, but for 180 days at the most). Rousseff was replaced by Vice-President Michel Temer. Led by the Chairman of the Supreme Court, the Senate then considered whether the constitutional petition was justified, and on 31 August it voted by a two-thirds majority to impeach the President. The country will be led by Temer until the 2018 elections.

4. SELECTED SPEECH: A NEW CHARACTERISATION OF THE US MACROECONOMIC AND MONETARY POLICY OUTLOOK

An important change in the St. Louis Fed's characterisation of the US macroeconomic outlook was announced by its President and CEO James Bullard on 17 June. Bullard described the change in a speech in London on 30 June and discussed it again in St. Louis in July.

President Bullard presented a new approach in which the concept of a single, long-run steady state to which the economy is converging is abandoned and is replaced by a set of possible regimes that the economy may visit. Regimes are viewed as persistent and optimal monetary policy as regime dependent. Switches between regimes are viewed as not forecastable.

According to Bullard, we can no longer count on the usual cyclical dynamics. It no longer makes sense to submit a forecast of output growing above trend, unemployment continuing to decline, inflation rising above target, and the policy rate increasing at a fairly steep pace. These variables appear to be near values that are likely to persist over the forecast horizon. Any further cyclical adjustment is likely to be relatively minor. There will be a switch to a new regime in the future, which will probably affect all variables, but how and when that happens is difficult to predict. Therefore, the best that we can do today is to forecast that the current regime will persist and set policy appropriately. Consistent with this concept, the new approach does not contain a long-run outlook. The forecast simply stops at two and a half years.

Fundamental factors determine the nature of the regimes in play. One of them is productivity growth. The productivity growth rate has been low in the USA in recent years. Bullard terms this a low productivity growth regime (and hence a low output growth regime). Because this regime is viewed as very persistent, the new forecast assumes that the economy will remain in the low productivity growth regime through the forecast horizon. The idea that productivity may switch to a high-growth regime is not incorporated in the forecast directly, but it is an upside risk to the forecast. The switch is viewed as possible, but not forecastable.

Another important fundamental is the real rate of return on short-term government debt, which is very low today. This is interpreted not as reflecting low real returns throughout the economy, but instead as reflecting an abnormally large liquidity premium on government debt. It is this liquidity premium which is the fundamental factor. This low real rate regime is also viewed as very persistent and so it is assumed to remain through the forecast horizon. The possibility of a switch to the higher real rate regime is a risk to the forecast.

The third important fundamental is the state of the business cycle, or the possibility of recession. The US economy is currently in a no-recession state. Although Bullard views a switch to a recession state as possible, there is no reason to forecast a recession given the data available today. The possibility of recession is instead a risk to the forecast.

According to this concept, Bullard evaluates the current state of the US economy as the following configuration of factors: low growth, low real rate and no recession. There are risks to this forecast in the sense that any of these fundamental factors could switch to alternative values, thus knocking the system out of the current regime. Policy would then have to react.

Bullard sums up by saying that uncertainty about possible medium- and longer-run outcomes is more explicitly taken into account in this new concept. The economy does not necessarily converge to a single steady state, but instead may visit many possible regimes. The timing of a switch to an alternative regime is viewed as not forecastable, and so the forecast expects the current regime to persist and does not attempt to produce a long-run outlook. Policy is regime dependent, leading to a recommended policy rate path which is essentially flat over the forecast horizon. If a switch to another regime occurs, then policy would have to react and the policy rate would have to change appropriately.

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