Brazilian Monetary Policy Evaluation using Flow of Funds Analysis

Topic: (8.5) Impact Analysis: Multipliers (2)
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This paper presents the Flow-of-Funds Analysis applied to the evaluation of the monetary policy conducted by the Central Bank of Brazil and its effects on the other Institutional Sectors between 2004 and 2009. In this period, the world economy suffered a shock due to the financial crisis that was triggered by the collapse of the U.S. subprime mortgage market and the subsequent bankruptcy of the Lehman Brothers Investment Bank. The Brazilian economy also experienced this effect with a large drop in the growth rate of the economic production and the fixed investments. So we intend to investigate the monetary policy carried out by the Central Bank of Brazil to evaluate its effectiveness. The method used is the Flow-of-Funds approach which is an application of Input-Output approach to an Asset Liability Matrix (ALM). The ALM is a square matrix that shows the flow of funds between institutional sectors in an economy. This paper presents the Flow-of-Funds Accounts of the Brazilian economy in two matrix forms: the Klein formula, which is based on the asset portfolio, and the Stone formula, which is formulated on the liability portfolio of the sectors. Both of them are used to assess the induced demand and supply of funds. Since they represent gross induced saving and investment respectively in the real economy, it is possible to assess the net induced investment, which can be an indicator of the effectiveness of the monetary policy. We expanded the Flow of Funds Accounts in the financial balance sheet format published by the Central Bank of Brazil by subdividing the financial sector using the balance sheets of the financial institutions. The ALM developed have ten (10) institutional sectors: households, enterprises, government, rest of the world, Central Bank of Brazil, Banco do Brasil, Caixa Economica Federal, Banco Nacional de Desenvolvimento Economico e Social (the financial institutions that are financed by the government), Itau (the largest private bank in Brazil) and the others financial institutions. Although the fundamental analytical method is based on Tsujimura and Mizoshita (ESR, 2003), the method has not been applied to Brazil nor any of the countries on the American continents. Since Brazil has not a few special purpose financial institutions as listed above, we are to evaluate the policy-propagation process through the financial system unique to the country.