Financialisation and the transformation of banking in Brazil

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Introduction

Despite never achieving significant inroads into mainstream economic thought, financialisation has become ubiquitous in heterodox economics and other social sciences, particularly after the 2008-09 Global Financial Crisis (GFC). Reflecting its loose seminal definition (Epstein, 2005), financialisation has been differently conceptualised. Those conceptions go from a microeconomic approach focused on shareholder value, the detrimental effects of financialisation as a new regime of accumulation, to the growing significance of finance in daily life and culture (van der Zwan, 2014).

Faced with the multiple meanings across social sciences, Christophers (2015) is sceptical of the analytical and empirical use of the concept, deeming it 'an increasingly nebulous and even, arguably, unhelpful signifier' (2015: 187). One of the criticisms levelled, namely the 'anaemic geography' of financialisation, highly centred on the Anglo-American world, has been addressed by an emerging literature on subordinated/peripheral financialisation. Grounded in both Post-Keynesian and Marxist political economy, this new literature characterises this specific form of financialisation (Becker et al. 2010; Correa and Vidal, 2012; Lapavitsas, 2013; Bonnizi, 2013; Rodrigues, Santos and Teles, 2016; Bortz and Kaltenbrunner, 2018; Kaltenbrunner and Painceira, 2018; Bonizzi et al., 2020). By not only extending it to new geographies but also by exposing the uneven, hierarchical, and contested international power relations, subordinate financialisation uncovers the path followed by peripheral countries during the last decades as a research agenda that integrates production and the circulation of capital (Alami et al., 2023; Bonizzi et al., 2022). For countries lacking developed capital and debt markets, the growing internationalisation of production coupled with the specific character of their financial integration compelled their major non-financial corporations (NFCs) and financial institutions to access foreign funding in hard currencies, particularly the dollar. Whereas new avenues for the accumulation of financial assets (Karkowsky and Stockhammer, 2017) and for-profit opportunities in speculative trading are opened (Farhi, 2017), peripheral countries are forced into high-interest rates and financial 'investment-friendly' regulatory frameworks to attract short-term foreign capital flows (Panitch and Gindin, 2012).

Subordinate financialisation results in sophisticated and internationalised financial sectors but with the economy subjected to uneven costs in high interest rates and financial volatility. The

international subordinate power dimension is stressed through the role that liquidity and the safe-haven status of core country currencies play in financial markets. Central Bank foreign reserve accumulation results in the drainage of resources through capital outflows from the Global South to the centres of international finance (Kaltenbrunner and Painceira, 2017).

While focusing on specific (external) features, this literature tends to homogenise each country's experience by focusing on external constraints. The combination of the latter and the domestic institutional contexts, arising from specific historical paths, tends to take a back seat in the analysis, failing to identify national variegation. Institutional frameworks and the social forces that shape reproduction in each country are paramount to capturing the specificities of financialisation (Santos and Teles, 2021). In a world where global credit and state-backed money dominate, state mediation between the international and national financial markets is paramount.

The theoretical pitfall is a case in point for one of the peripheral countries to which this literature has paid the most attention: Brazil. The focus on this peripheral country is unsurprising given its size, the pervasiveness of financial income across its economy. Brazilian literature on financialisation covers a wide range of themes, from the rise of rentier financial interests and the decline of investment (Paulani, 2010; Bruno et al., 2011; Araújo et al., 2012; Bresser-Pereira et al., 2019) to the financialisation of social policy (Lavinas, 2017), NFCs (Corrêa et al., 2017), housing provision and real estate (Pereira, 2017). This literature builds upon the structuralist and dependency theory traditions, which focused on the international power of the American dollar during the Brazilian debt crisis of the eighties (Tavares, 2019 [1997]) and the effects of liberalisation and the Real Plan in the nineties (Coutinho and Belluzo, 1996; Filgueiras, 2006). The theoretical proximity of the approaches above to subordinate financialisation is reflected in how research focuses on external constraints, namely the role of high-interest rates and exchange rate volatility.

Analysis of the major institutions of the financial sector in Brazil, banks and their role in money markets, although extensively researched in their domestic evolution during the past decades (e.g. Paula et al., 2009; Paula and Alves Júnior, 2020), is less often engaged with the financialisation literature and its subordinated character. This article aims to fill this gap by focusing on the changing, financialised role of the Brazilian banking sector. We employ the Marxist analysis of credit as a hierarchical sequence that goes from commercial credit to central bank credit (Sekine, 2020), elaborated by Itoh and Lapavitsas (1999) and Lapavitsas (2003, 2011, 2013) to approach financialisation, supplemented by recent post-Keynesian contributions on money markets and the rise of shadow banking from the self-titled Money View (Merhling, 2011, 2013; Poszar, 2013, 2014) and Critical Macro-Finance (Gabor, 2016, 2021, Dutta et al., 2020), to provide a robust theoretical framework for Brazilian bank financialisation over the past two decades and their subordinated specificities.

Brazilian banks show consistently high profitability compared to international counterparts (The Economist, 2018). They have averted the effects of the GFC and, more recently, the extended 2014-16 domestic crisis, aggravated by the pandemic crisis of 2020-21. By analysing changes in balance sheets and income statements of major Brazilian commercial banks, we aim to show the specificities of the sector and the different - though complementary - roles attributed to public and private commercial banks in the new financialised environment. Our empirical analysis starts in 2003 when bank credit to GDP hit a record low, from which it grew until today. 2003 was also the year the left-leaning Worker's Party reached government for the first time, putting in place regulatory changes that fostered a new banking business model.

The article is organised as follows. The second section is dedicated to a theoretical overview of the role of banks in financialised economies. Particular attention is drawn to the need for a political economy framework that captures banks' evolving and historically embedded nature in specific contexts, going beyond static taxonomies, such as the bank-based vs. market-based financial sector. Section three provides a brief history of the Brazilian banking sector and the role played by policy changes and public banks in shaping this sector since the 1990s, when liberalisation, privatisation and current account opening set the scene for the financialisation of the banking sector throughout the 2000s. The fourth section scrutinieses the changing nature of banks in financialisation through a set of financial criteria on changes in assets, liabilities and income using available data from the Central Bank of Brazil[1] (BCB). On the asset side, we aim to identify the rising importance of household debt and financial securities. On the liability side of balance sheets, we explore the transformations of funding from the traditional deposit base to finance-to-finance funding through securities and repo markets. Finally, the changing source of income, with rising fees and revenue from securities, is examined. Through an empirical analysis of the changing business model of Brazilian banks, we show how bank financialisation in Brazil has followed a unique path. It highlights private and public commercial banks' segmented, but complementary, role of private and public commercial banks. The fifth section concludes, showing convergent and divergent features between Brazilian banks and their financialised counterparts in core countries, stressing the role of the State in shaping financialisation and the challenges ahead.

Approaching financialised banks

Since its earlier incarnations (Epstein, 2005; Krippner, 2005), the study of financialisation has been

[1] Data relates to the five most significant financial conglomerates and independent institutions. Conglomerates are a group of financial entities linked by a majority equity interest by effective operational control or partner rights. Consortium administrators, payment institutions, investment funds, and companies that perform acquisition of credit operations, including real estate or credit rights or other legal entities, are not considered part of the conglomerate (BCB, 2023a).

influenced by the distinction between bank-based and capital market-based financial systems, the latter dominating financialised economies. This distinction was advanced by John Zysman (1983), gaining traction with the rise of the Varieties of Capitalism (VoC) literature (Hall and Soskice, 2001; Amable, 2003). Having its intellectual roots in the work of Rudolf Hilferding (2006 [1910]), the distinction has the advantage of scrutinising different national paths of capitalist accumulation between 'continental' coordinated market economies, such as Germany, and liberal market economies, such as the United Kingdom and the United States, pointing to different institutional arrangements that shape financial systems.

The VoC approach has been criticised for the multiplication of 'varieties' that the effort to expand its geographical reach implies, as well as for the metrics used to encapsulate each variety (Erturk and Solari, 2007; Marois, 2012). Moreover, the bank-based/capital market-based distinction reveals two analytical problems when studying financialised banks: in the case of coordinated economies, domestic banks are taken as passive agents of the slow but steady liberalisation process that turns coordination mechanisms into financialised ones; in the case of liberal market economies, banks are taken as static institutions, embroiled with capital markets, with financialisation regarded as an expansion of their traditional business model rather than a new qualitative structural change. Banks as historically evolving institutions which shape capitalist accumulation appear to take the back seat in the analysis, with agency instead placed on the rising financial markets.

The work of Erturk and Solari (2007) stresses the continuing reinvention of banks, studying how they have turned to new activities and sources of income, becoming more profitable than ever. Banks are taken as pivotal institutions of financialised capitalism, negating the idea of withering banks dissolved into financial markets. The authors point to the transformation of retail banking in its relationship with households, now entangled with multiple banking services rather than being mere depositors. This transformation is coupled with the rise in proprietary trading and investment banking income relative to 'traditional' credit operations. Fee and trading income have thus become a significant source of profit for banks.

The perspective of evolving banks as central institutions of capitalist accumulation finds theoretical support in the Marxist approach of Itoh and Lapavitsas (1999). They develop a historical account of the evolution of credit: from commercial credit and the issuance of bills of exchange at the dawn of capitalist relations to the development of banks as institutions that advance loanable capital as a homogeneous, tradable commodity. The new institutions benefited from collecting information on money dealing across different productive sectors, enhancing the necessary trust and power for credit advances. This crucial historical development for capital accumulation was fostered by the withering away of commodity money (silver and gold), progressively substituted by the issuance of private and public credit money. Such new forms of money fed mounting money markets,

amplified bank liquidity and credit, and eventually enabled the emergence of modern central banks, which regulate the crisis-prone financial sphere. Banks are considered institutions framed by custom and legal apparatus, not least by the State, while closely connected to general capital accumulation, which they foster and are forged by[2]. By positioning banks as institutions with a leading role in the history of capitalism, with its specific institutional, regulation and underlying capital accumulation structures, variegation in time and space of bank financialisation becomes a promising research agenda.

Lapavitsas (2008, 2013) and Dos Santos (2009) locate financialisation as a structural shift in the financial behaviour of NFCs, banks, and households. NFCs, particularly in the US, have become less dependent on banking finance as they can seek direct access to money and capital markets. Financialisation has thus resulted in the shrinking relative importance of NFC credit on banking assets in banks (Dos Santos, 2009; Lapavitsas, 2013). However, a new symbiotic arms-length relation emerges, with banks now profiting from the investment banking fees involved in mediating financial markets. Technological breakthroughs, rising liquidity and public regulation also ease their credit to households, leading to rising debt and increasing weight of household credit in the assets of commercial banks, particularly in the form of mortgages (Barba and Pivetti, 2009). Households found themselves in a vulnerable position in the neoliberal context of public service privatisation, being pushed into the arms of banks as both asset holders (e.g. pension funds) and as debtors (e.g. mortgages, student loans, medical debt), paying not only interest but also mounting fees on their assets (Lapavitsas, 2009).

On the liability side of funding, banks have been less dependent on traditional deposits as sources of liquidity, instead relying on money markets lending, namely through repurchase agreements (repo) (Lapavitsas, 2009). Repo operations rose to prominence in American and European money markets in the late 1980s and the early 1990s. By the 2000s, they had changed how monetary policy was implemented in core countries. This market has been subjected to a rising interest after the GFC in understanding modern finance in the emerging literature of Money view and Critical Macro-Finance (Merhing, 2011; Pozsar, 2014; Gabor, 2016; 2021). Their role in providing liquidity to markets and potential volatility through mark-to-market collateral valuations and subsequent margin calls, is spotted as a potential source of financial market stress (Sissoko, 2020). Attention has been drawn to the mounting relevance of non-monetary agents in these markets, such as money-market, pension and investment funds, known as shadow banks (Ban and Gabor, 2016). Although

[2] This Marxist historical account of banks and money (and its endogeneity in capitalism) finds adherence in recent historical work on credit relations in England and France in the seventeenth and eighteenth centuries (Wennerlind, 2011; Jackson, 2022).

lacking access to central bank reserves and unable to create through credit, shadow banks supply liquidity or high-quality collateral to banks through repo and reverse repo operations, thus playing an increasingly relevant role in money markets (Pozsar, 2014; Gabor, 2016).

Finally, transformations on both assets and liabilities of financialised banks have resulted in changing sources of income for banks away from interest rate spreads to banking fees from households and securities income (Erturk and Solari, 2007; Lapavitsas, 2013).

The changing landscape for banks in Brazil

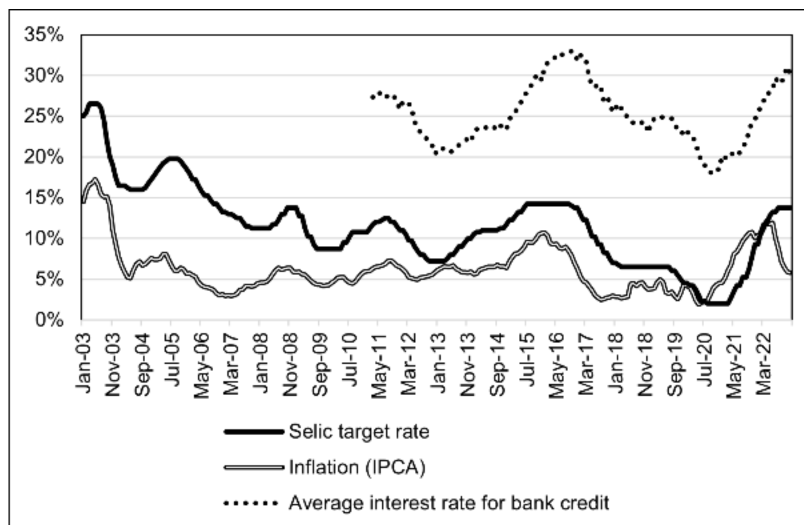
Since the eighties' debt crisis and ensuing fiscal and monetary crisis, Brazilian banks have been extraordinarily profitable, a feature that still prevails today. The Brazilian financial sector escaped the ‘big-bang’ liberalisation of other peripheral economies (Stallings, 2006). Current account liberalisation started during the right-wing leaning Collor de Mello's presidency (1990-92) when barriers to foreign investors' access to financial markets were eased. This slow process was only completed in the 2000s.

Seeking to tackle inflation, a new currency pegged to the dollar, the Real, was introduced in 1994. This move implied high-interest rates to attract capital inflows, a condition for the desired exchange rate stability (Prates and Paula, 2017). Despite providing one of their primary lasting sources of income – high-interest rates of the expanding public debt securities market (Carvalho and De Oliveira, 2002) – the Real plan had dire consequences for banks. Deprived of some of their previous ‘inflationary gains’ and facing soaring non-performing loans, smaller banks started to fail. This scenario led to a significant reduction in the number of commercial banks, increasingly centralised around private domestic-owned banks Bradesco, Itaú and Unibanco, the (new) foreign-controlled Santander and ABN-Amro and the public-controlled Banco do Brasil (BB) and Caixa Econômica (CEF). This process would continue throughout the 2000s – the number of banks having retreated from 203 in 1998 to 159 in 2008 (Sobreira and Paula, 2010).

Bank credit relative to GDP, which had been dropping since 1995, reached a record low of 21.8 per cent in 2003, the year of the inauguration of the left-wing leaning Lula da Silva (Prates and Biancareli, 2009). The market-friendly policies of previous administrations continued to be the foundation of the macroeconomic regime during Lula's government. However, the new government was now invested in easing credit. New forms of credit were legally introduced, such as payroll credit (crédito consignado) for public sector and unionised workers, allowing wages to be posted as collateral (Mora, 2014). Car loans were also boosted by a new ‘fiduciary’ law in 2004 that eased banks' re-selling of repossessed cars and homes (Assunção et al., 2013).

The new government tried to partially deprive banks of one of their primary sources of income: public debt securities. From 2006, the Brazilian treasury tried to recompose the profile of its public debt, reducing the importance of floating-rate securities, such as Letra Financeira do Tesouro (LFTs) indexed to the central bank target rate (Selic), and of dollar-denominated debt (Paim, 2016). Given the downward trend of the Selic rate at the time, the falling yield of public debt further encouraged bank credit to non-government sectors. According to the Treasury calculations, average yields on public debt securities went from 18-17 per cent annual gains in 2005-06 to an average of 12 per cent in the following years before the GFC (Secretaria Nacional do Tesouro, 2021). The fundamental characteristic of Brazilian public bonds that separates them from their counterparts is how it is structured around floating-rate securities. Unlike other economies, where a surge in interest rates generally leads to a drop in bond prices, the prominence of floating rate bonds – mainly LFTs – means that bond prices remain stable even when the BCB raises interest rates, thus contributing to the enduring high yields of public bonds, even in times of financial turmoil (Pelegrini, 2017). The guaranteed profitability of public debt securities partially explains why average interest spreads for the rest of the economy have remained well above the Selic rate (Figure 1) and the subsumed character of the private debt securities market (Paula et al., 2009). Since 2006, they have become the bedrock collateral of funding for financial institutions through repurchase agreements. These contracts are the main instrument the BCB uses for liquidity management, surpassing reserve requirements and other types of open market operations (Pereira *et al*., 2020).

Figure 1. Brazilian Annual Interest Rates and Inflation



Source: BCB (2023a)

A more favourable international scenario compounded the domestic changes. During 2005-07, high commodity prices and current account surpluses coincided with a surge in global market liquidity. Brazilian banks and NFCs benefited from this abundant funding, now gaining access to

foreign debt and derivatives securities markets, further contributing to the burgeoning dynamism of domestic credit markets (Prates and Biancareli, 2009).

Although, with hindsight, the GFC had few effects on the Brazilian economy, capital flight led to Real devaluation and a rise of interest rates, putting the domestic banking sector in peril. A banking crisis was precluded by the activist stance of the State, which used all the instruments at its disposal (fiscal, monetary, regulatory and state-owned companies). The BCB reduced their (high) legal reserve ratios on deposits held in the form of public debt securities, fostering liquidity (Sobreira and Paula, 2010). Public banks – state-owned CEF, the state-controlled BB and the development bank Banco Nacional de Desenvolvimento (BNDES) – provided crucial anti-cyclical policy instruments. These banks gained new government-sponsored and earmarked credit[3] lines, and purchased other banks' troubled portfolios, alleviating systemic liquidity constraints (Prates and Biancareli, 2009). BNDES increased its credit supply, growing 52.2 per cent between 2008 and 2009 (Paula *et al.*, 2013). Meanwhile, the retreat of foreign banks during the GFC years paved the way for a new wave of mergers and acquisitions, further centralising the banking sector (Sobreira and Paula, 2010).

The aftermath of the GFC proved favourable to the Brazilian economy. Thanks to the expansionary monetary policy of the core countries (low-interest rates and 'Quantitative Easing'), capital flight from the precarious Eurozone and a new commodity price boom, financial inflows to peripheral countries resumed, with Brazil being one of the primary recipients (Alami, 2019). The current account reversal from a surplus to a deficit was more than offset by these inflows, driven by high Brazilian interest rates (Biancareli et al., 2017). The years following the GFC saw a record-breaking foreign reserve accumulation (from 85 billion in 2006 to 378 billion dollars in 2012), sterilisation operations by the BCB and rising repo markets (Kaltenbrunner and Painceira, 2017).

In 2013, the external context changed yet again. The American Federal Reserve announced the 'tapering' of its expansionary monetary policy. This reversal had a double impact on the Brazilian economy: highly financialised commodity markets started to deflate, affecting Brazilian exports, and short-term capital flows began to flee the country, renewing pressure on the Real exchange rate. Brazilian monetary authorities then decided to scale back previously stabilisation measures, such as the taxation of derivatives (Alami, 2019) and raise the Selic rate, further demonstrating the subordinated character of the Brazilian economy.

The economic crisis naturally affected Brazilian banks through higher debt rollover costs and rising non-performing loans. Still, public banks were the ones who bore the brunt of the recession, seeing a significant decline in profitability due to their higher risk exposure. Furthermore, the

[3] Earmarked credit has been one of the Brazilian bank credit idiosyncrasies. Credit to specific sectors and activities (for example, agriculture, housing, microcredit), corresponding to a fixed share of the deposits, has been an important policy tool of the Brazilian State (Prates and Biancareli, 2009). If still significant, such forms of credit have been retreating, with Brazilian banks choosing other funding instruments than deposits to circumvent this regulation (see next section).

impeachment of President Dilma Rousseff inhibited the political return to the countercyclical role of public banks. Profits in dealing with high-interest rate public securities soared, particularly at the height of the crisis in 2015 when interest rates peaked. In the aftermath of the domestic turmoil, private commercial banks reinforced their domestic position, buying foreign bank branches, such as Citibank (Itaú) and HSBC (Bradesco) (BCB, 2017).

The COVID-19 pandemic exposed Brazil to external vulnerability yet again, leading to capital flight amounting to a quarter of all outflows from peripheral economies (Schipani and Wheatley, 2020). Aligned with the international trend of cutting interest rates to mitigate the impact of the pandemic crisis, the BCB lowered the legal reserve rate on deposits and set the Selic rate to 2 per cent, an all-time low. A legislative package greenlighted a massive fiscal stimulus, reaching 8.8 per cent of GDP (IMF, 2020). Thanks to the scale of public spending, Brazil had one of the mildest drops in GDP among peripheral economies (-4.1 per cent in 2020). Contrary to their expectations, the mildness of the recession and the swift rebound of GDP led to a decline in non-performing loans resulting in a sharp drop in provisions and renewed profitability.

Brazilian Banks' financialised model

Brazilian banks endured a long period of restructuring, leading to the centralisation and concentration of banking capital around the five commercial banks - Itaú, Bradesco, Santander and BB and CEF - which now hold 61 per cent of this sector's total assets (BCB, 2023b). Throughout the period in question (2003-22), they have shown themselves more profitable than most of their international core country counterparts, even during the economic downturn. Their Return on Equity has remained well above favourable terrain during the covered period and throughout the economic crisis that has afflicted Brazil since 2014 (BCB, 2023a).

Through the analysis of the balance sheet and income statements for each of the leading five financial conglomerates, the changing trends and patterns of bank funding, lending, and income are scrutinised to capture the context-specific financialised path. The period here considered can be divided into three different phases: the years of the resurgence of private-led bank credit and economic growth from 2003 to 2007, the period between the GFC and the domestic crisis of 2014-16, and the subsequent years of credit and economic stagnation until the 2020 pandemic.

Assets

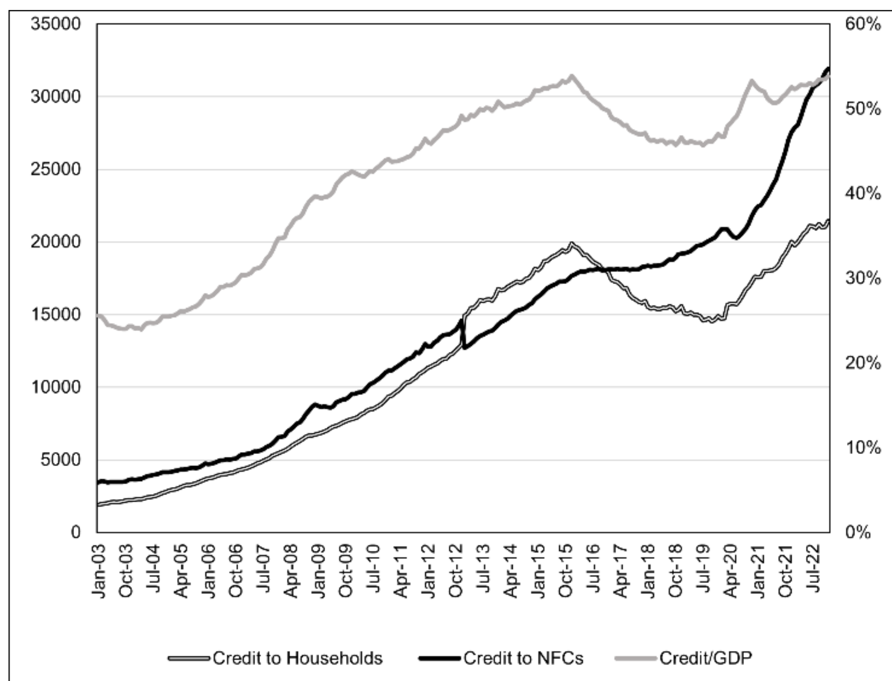
On the asset side, bank financialisation (Dos Santos, 2009; Lapavitsas, 2013) points to a change from lending to NFCs to households as a core component of financialised bank assets. The peripheral subordination aspect supplements this hypothesis. Banks' liquidity, strongly influenced by

international short-term capital flows and accommodating behaviour by the BCB, would bias credit towards shorter maturities (Kaltenbrunner and Painceira, 2017).

The evolution of credit operations from 2003 to 2014 shows both credit to NFCs and households steadily rising in absolute and relative (to GDP) terms. However, since the 2014-16 crisis, a clear divergence can be spotted, with the downward trend of credit to NFCs reflecting the overall economic crisis and stagnation. This trend was reversed in 2020 due to the emergency credit lines created to mitigate the economic effects of the pandemic.

Notwithstanding a fall in the turbulent 2014-16 period, credit to households has resumed its growth, surpassing NFC credit in absolute terms in 2016 (Figure 2). The declining interest rates between 2015 and 2021 may explain this divergent path. On the one hand, household debt became less costly. On the other hand, the interest rate decline was insufficient to sustain NFC credit, given the collapse of public investment and credit availability from commercial public banks and the development bank BNDES.

Figure 2. Total value of new Credit operations to Households and NFCs (R$ Billion)[4] and credit relative to GDP



Source: BCB (2023a)

The market share of household credit changed within commercial banks. Despite the seemingly convergent path of Brazilian and core country banks, a closer look at the balance sheets shows divergence regarding the content of credit growth. Contrary to what happened in core and other peripheral countries, mortgage credit has been residual for private commercial banks and BB. Even

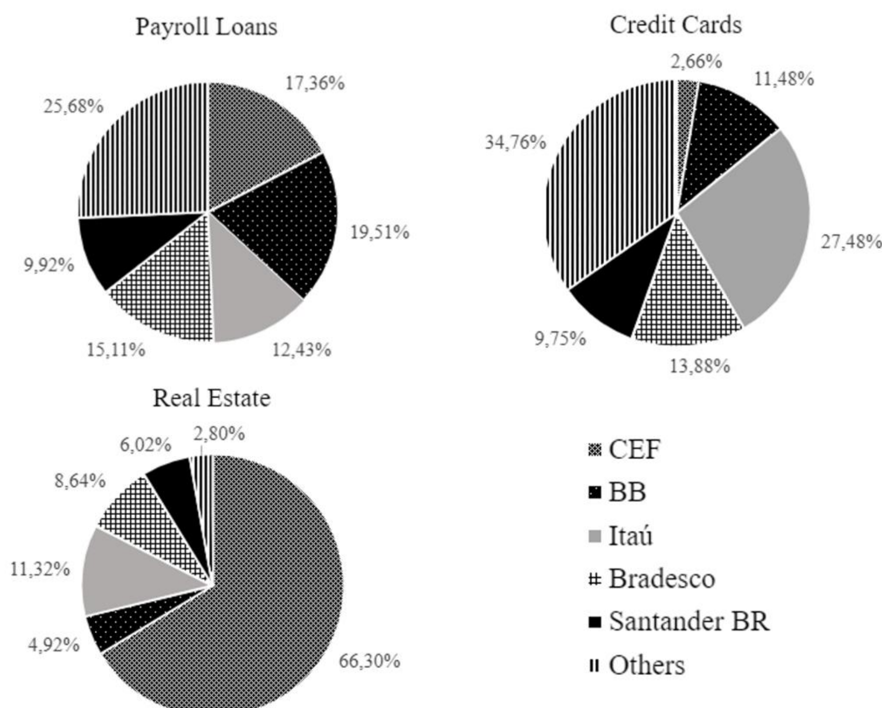
[4] Constant 2023 prices. Deflated through the IPCA inflation index.

though mortgage credit reached around 30 per cent of all household credit, it is overwhelmingly concentrated in state-owned CEF, holding 66 per cent of real estate credit as of 2022 (Figure 3).

The role of public policy and specific mandates given to public banks becomes evident. CEF has been the vehicle for public-sponsored and earmarked housing credit programmes[5] – most notoriously, the 2009 program that targeted the lower middle class, Minha Casa, Minha Vida. CEF's mortgage credit has stagnated since the 2014-16 crisis following the new political environment of fiscal austerity. With its long-term profile, household mortgage lending is far from being the engine of overall bank credit expansion and household debt, whose growth is explained by short-term consumer credit, partially explaining the absence of any housing price boom in Brazil (Pereira, 2017; Aalbers, 2017).

The different business models of Brazilian banks when it comes to credit to households are not restricted to mortgage lending. Other categories are dominated by public banks, such as Payroll credit, with lower interest rates due to the direct debit on the payroll. The opposite outlook is found, for instance, in credit card credit that are led by private banks (Figure 3). This credit, which benefits from skyrocketing interest rates, is concentrated in Itaú (around 35 per cent market share) and Bradesco (around 15-16 per cent market share). This divergence conforms with the subordinated financialisation hypothesis, whereby short-term funding structures are to be matched with shorter maturity assets (Kaltenbrunner and Painceira, 2017).

Figure 3 – Share of Selected Categories of Bank Credit to Households in 2022



[5] These programs are funded by allocated resources either by the earmarked credit Sistema Brasileiro de Poupança e Empréstimo and the FGTS, a publicly managed Severance Indemnity Fund (Royer, 2014).

Source: BCB (2023b)

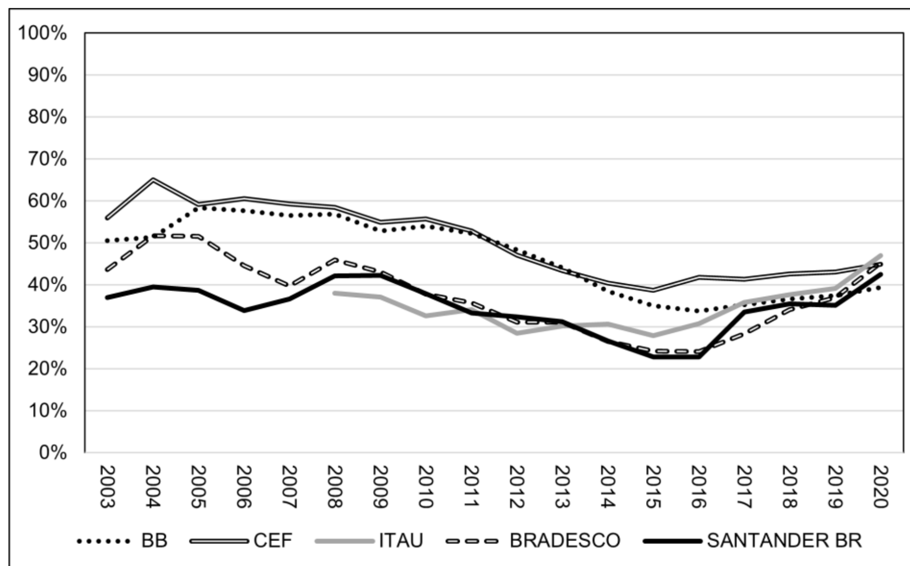
Bank credit to NFCs relative to bank assets has been declining. However, one must be cautious of 'crowding-out' or 'substitution' arguments, as bank credit to NFCs did grow significantly from 2003 to 2014 in both public and private banks. The relative decline is explained by the rising proportion of household debt and financial securities in expanding balance sheets. Securities and derivatives are one of the key assets for the major Brazilian commercial banks, surpassed only by credit operations. In 2022, they ranged from 15.06 per cent (CEF) to 28.07 per cent (Itaú). Although securities and derivatives lost relevance in the public banks' balance sheets from 2003 to 2022, they have consistently grown relative to assets in private banks (BCB, 2023b).

Liabilities

The bank financialisation hypothesis is to be confirmed by the rise of finance-to-finance funding. Money markets have become a relevant short-term funding source for banks, increasingly relying on liquidity created by non-bank financial institutions (Mehrling, 2011; Pozsar, 2014). Capital inflows and subsequent sterilisation operations in Brazil were decisive in expanding non-deposit liabilities, favouring short-term securities and repos, and, within the deposit category, time deposits that banks can issue and trade.

Despite lower rates of legal reserves, deposits have been declining relative to total bank liabilities (Figure 4). Differences between public and private banks are again visible, with the former maintaining higher relative shares of deposits until the 2014-16 crisis, although this seems to be changing over the past few years since the COVID-19 pandemic. The relevance of tradable time deposits within the whole category is a significant feature of banks' liabilities, rising during the GFC in 2008 and, more recently, since the 2014-16 economic crisis, reaching in 2022, 28, 29 and 32 per cent of all liabilities for Itaú, Bradesco and Santander, respectively, and 22 and 12 per cent for the publicly controlled BB and CEF, denoting a more persistent funding model (BCB, 2023b).

Figure 4. Deposits Relative to Total Bank Liabilities

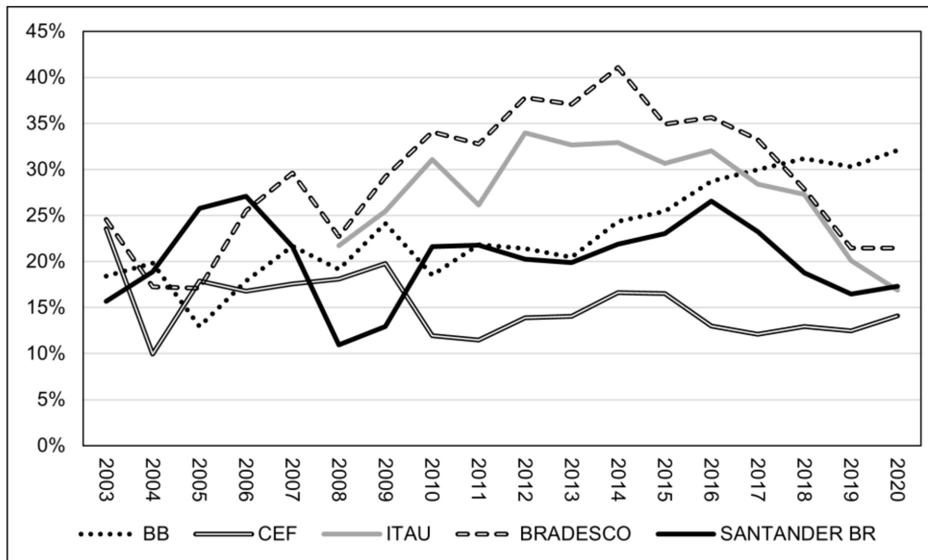


Source: BCB (2023b).

The decline in deposits has been offset by the rising importance of repo operations, particularly for the three private banks since the GFC (Figure 5). The apparent decline in repurchase agreements as a source of funding for most banks since 2016 does not seem to be the result of capital outflows and the end of sterilisation operations by the BCB but likely due to regulatory changes: a decision by the National Monetary Council of the BCB barred financial institutions from engaging in repo with institutions of the same conglomerate. In fact, repo markets have shifted from being fueled by BCB operations to the new role of Brazilian investment funds as an alternative source of short-term funding, assuming the role of shadow banks (Pozsar, 2014). As the repo market grew, the scope of its participants became broader with the rising involvement of shadow banks: repos collateralised by sovereign debt securities rose from roughly 8 per cent of funds' assets in 2006 to 21 per cent in 2022 (ANBIMA, 2023a).

The size of such funds has grown from a net worth of 51 per cent of GDP in 2012 to 74.7 per cent in 2022 (ANBIMA, 2023b). Demand for these funds has been growing due to tax benefits and successive pension system reforms (the latest being in 2019), which have eroded future public pensions. National, peripheral specificities also apply. Eight of the ten major investment funds are owned by the five commercial banks here considered. They have mainly invested in public debt securities and the repo as mentioned above instruments - 67 per cent of all assets as of 2023 (ANBIMA, 2023c)- denoting three specific elements: the secondary role of private capital and debt markets; the financial appeal of high yielding (mainly floating rate) public securities; and the specific role of shadow banks in supplying liquidity to their traditional bank owners.

Figure 5. Repurchase Agreements Relative to Total Bank Liabilities

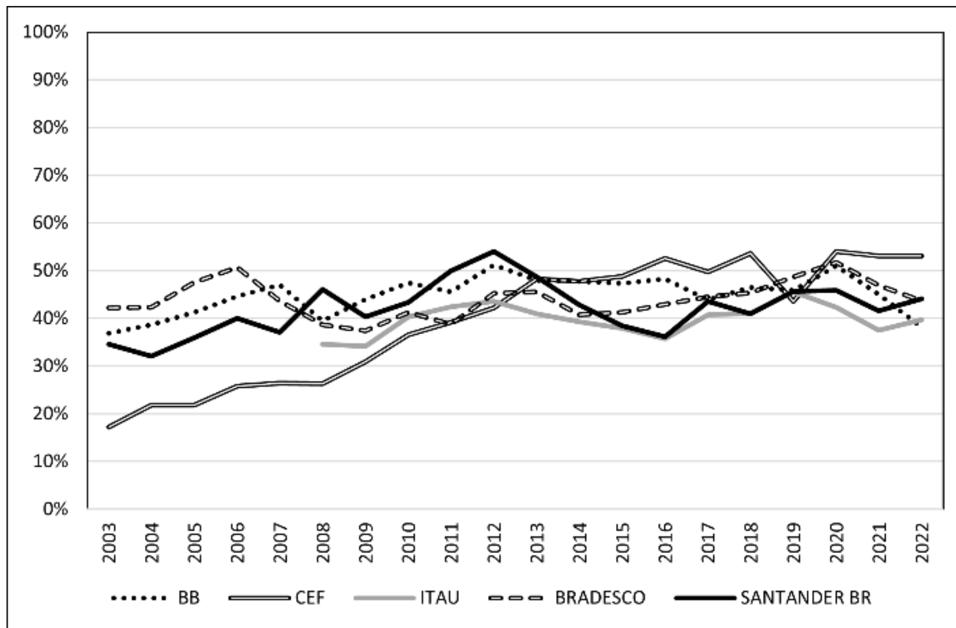


Source: BCB (2023b).

Income

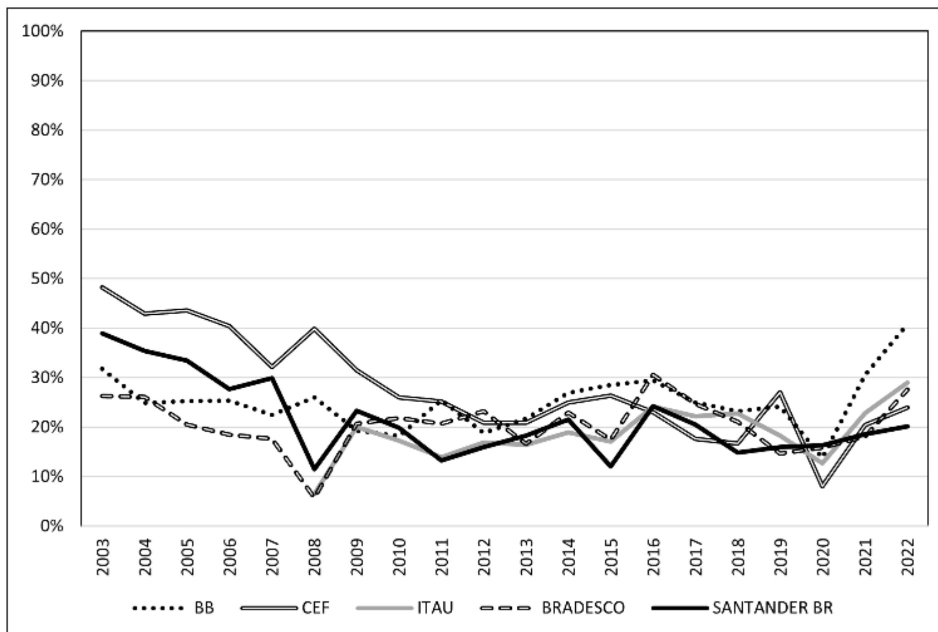
The income sources of financialised banks, the initial hypothesis pointed to a rise in financial securities trading relative to credit in core-country banks, reflecting the growing relevance of financial markets and investment banking (Dos Santos, 2009). That was not the case for Brazilian banks (Figure 6). Echoing the overall structure of assets, income continued to be driven by credit operations until the 2014-16 crisis. Income accruing from financial securities is significant, but peaking in periods of capital outflows and declining stock prices, as in 2003, 2015-16 and 2022 (Figure 7). Such a paradox is explained by the record interest rates on public debt securities in these years. Income from financial securities does not result from growing securities market involvement in general. Instead, it is heavily influenced by high-yield public debt that structures these markets in Brazil.

Figure 6. Revenue from Credit Operations Relative to Total Revenue



Source: BCB (2023b)

Figure 7. Revenue from Financial Securities Relative to Total Revenue



Source: BCB (2023b)

Convergence with financialised core country banks is found in two other income sources: banking and financial market mediation fees. These alternative income sources have gained importance in times of crisis and stagnation. Banking fees are overwhelmingly paid by households, denoting their embroilment with finance. Having just available data until 2019, households paid 38 billion Real, rising from 27 billion in 2015 (BCB, 2019). Brazilian banking fees are among the highest in the world when disposable income and inequality are considered, disproportionately affecting the most vulnerable (Goldman Sachs, 2017). This source of income has been immune to the 2014-16 crisis, partially compensating for the loss of interest income of the ensuing period. Income deriving from financial market mediation follows the same trend. Despite encompassing vastly different

services, the rise in investment fund administration fees in the years following the crisis has been remarkable, going from 10.3 billion in 2015 to 14.7 in 2022 (BCB, 2023b), reflecting the growing investment funds which orbit the big domestic financial conglomerates.

Conclusion

This article scrutinised the context-specific path of the financialised banks in Brazil in the past two decades. Critically building on a Marxist political economy framework, we assume a pivotal role for banks in financialisation to integrate the burgeoning literature on subordinate financialisation and the transformations of money markets, namely the rise of repo operations and new agents, the shadow banks. It showed how financialisation is a variegated phenomenon in subordinated environments, influenced by each country's specific institutional and political economy (Santos and Teles, 2021).

From an analysis of the leading Brazilian banks over the past two decades, a picture emerged in which banks are far from being withering institutions substituted by rising securities markets. In the context of financial liberalisation, the growing importance of international financial flows, and market-conforming monetary policy, Brazilian commercial banks have reinvented themselves, showing financialised features that converge and diverge from core-country counterparts. While they followed the international trend of households as a rising source of income (both as recipients of credit and sources of financial services fees), this shift is not motivated by the increasing involvement of NFCs with securities markets. On the contrary, benefiting from the substantial capital accumulation dynamic from 2003 to 2014, NFC bank credit, while heavily influenced by the role of the BNDES development bank, grew in absolute and relative terms to GDP. Additionally, the embroilment of finance with households assumed a different aspect in Brazil, geared not so much to mortgage debt, concentrated in the public bank CEF, but to high-interest short-term consumer lending. Such finding counters other studies for peripheral and semi-peripheral markets where household credit mainly comprises middle-class, low-interest mortgage credit (Rodrigues *et al.*, 2016).

The 'subordinated' insertion in the international financial hierarchy partially explains the specificities of Brazilian credit markets. The dependence on short-term foreign flows and accommodative domestic monetary policy, where repo operations played a central role, transformed bank funding. Commercial banks prioritised money market short-term securities funding as a source of added liquidity, reflecting their focus on short-term lending, particularly for households. However, one should be careful with identifying any deterministic causation between capital flows, sterilisation operations and the transformation of bank funding. Recent years of capital flight and end of repo sterilisations by the BCB did not change banks' funding structure. Repo securities were shifted from the central bank to private sources, namely the growing, bank-owned investment funds. In this context, the role of the Brazilian State as a supplier of high-yielding safe collateral in the form of

floating-rate debt securities has been paramount in de-risking domestic money markets from volatility, albeit at a high fiscal cost (Gabor, 2021).

Public policy was crucial in building and sustaining this new financialised model. Monetary policy and regulatory measures created and fostered new credit markets. Commercial public banks played a central role, serving as instruments of countercyclical public action and expanding financial services and mortgage debt. Indeed, the apparent success of Brazilian financialisation can be attributed to a segmentation of the banking market, where public banks served as both expansionary forces of finance, catering to a segment previously excluded from formal banking and as stabilisers of the economy in periods of financial turmoil, opening the road for the expansion of private banks and associated shadow banks.

From the integrating external and domestic dimensions in this analysis, it seems that any attempt at a robust and enduring economic recovery from the lasting economic crisis started in 2014, aggravated by the Covid-19 pandemic, has to redefine the role of its domestic banks coupled with the rethinking of international financial integration. The retreating public banks (commercial and developmental) should recover and reinforce their role as economic policy instruments in financing long–term investment. Yet, growing household debt should be of concern for the current government. New protective regulatory measures and public provision expansion should lessen the financial vulnerability of households. Moreover, the (de)financialisation of Brazilian banks and the economy would be needed to decrease its external vulnerability, effectively using central bank instruments to reduce public (and private) debt interest rates, which, coupled with the re-establishment of capital controls would limit the detrimental impact of volatile financial capital flows. While granting more funding stability, low-interest rates would force them to comply with their supposed role of investment funding, if at the cost of lower profits for banks.

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