Journal of
Economics and Political Economy
econsciences.com
Volume 12 December 2025 Issue 4

Systematically investigating the high interest rates of emerging countries

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Abstract. This work aims to investigate interest rates in emerging markets by examining the primary characteristics associated with their high levels in these countries, particularly in Brazil. To this end, a systematic literature review was conducted, encompassing all articles published between 1985 and 2025. Given Brazil's public debate expressed in discussion papers and opinions in the media, a documentary research study on the causes, effects, and remedies for interest rates in the country is also carried out. The results indicate that the increase in studies on interest rates in emerging markets follows the greater relevance of these countries in the global economy, with the most prevalent primary topic being the effects of monetary policy. In the case of Brazil, despite apparent divergences, economists from different schools of thought frequently agree on the role of fiscal policy in interest rates, its negative impacts on investment, and possible solutions such as debt de-indexation and control of public spending. These findings are useful for the scientific literature investigating monetary policy by mapping the work and key evidence in this dense subfield of economics, and for policymakers and other market participants by synthesizing the main opinions on high interest rates that make up the Brazilian public debate.
Keywords. Interest Rates; Emerging Markets; Developing Economies; Brazil.
JEL. E44; E52; E62; G18.

1. Introduction

The basic interest rates of countries are one of the main topics investigated by the scientific literature that shapes economics. Numerous scientific journals specialize in the subject, and there is a prominent place for the publication of articles that present significant and recent advances in the most prestigious journals in the field. For this reason, many academic works are published on the topic every year for over a century, providing important insights into its causes, methods for measuring optimal interest rates for countries, forecasting models, and their consequences for other macroeconomic variables.

The interest rate is the cost of using money for a given period, and as long as it is a price, its effects extend beyond the financial market and influence the entire economy (Omar, 2008). From a practical point of view, interest rates are identified as one of the main drivers of national economies, being an important determinant for household consumption decisions, corporate capital structuring, and investments in projects. Estimating optimal basic interest rates for countries that encourage their economic agents to invest

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Received 20 Nov. 2025; Received in revised from 10 Dec. 2025; Accepted 20 Dec. 2025.
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Crossref https://doi.org/10.1590/xxx-2025-xxx

without excessive expansion of the monetary base that leads to high inflation in subsequent periods is not an easy task.

Similarly, calibrating monetary policy management so as not to discourage these investments and influence future economic stagnation is also important. Decisions about the money supply in circulation will always consider that basic interest rates below the optimal level for the economy will lead to generalized price increases in the near future, while rates above this optimal level will lead to reductions in the level of employment in the economy, harming people's lives. However, raising interest rates requires a greater volume of investment in the economy to maintain fiscal balance (Amorim, 2019), and high interest rates with low savings are a sign that there are profitable areas in the economy because, since savings are low, economic policy tries to prevent a stronger appreciation of the currency, preventing excessive financing by external savings, with raising interest rates being the way to restrict investment and make demand fit the supply (Pessôa, 2012).

Historically, many countries classified as emerging economies maintain basic interest rates considered high, generating additional social debates about what their optimal interest rates would be in relation to what is seen in developed countries. Brazil is one of these countries, which ended the year 2024 with its basic interest rate at 12.25%, with accumulated 12-month inflation at 4.83%, and at the same time saw its GDP grow by about 3.24% in the year.

The analysis by Oreiro et al. (2012) shows that the high bank spread in Brazil stems mainly from high interest rates and an inertial component, which means that reductions in the Selic rate only have a significant effect after a long time. The "interest rate problem" is linked to the loss of effectiveness of monetary policy, resulting from the way the Selic rate is determined and the composition of the internal public debt. The Central Bank's reaction to exchange rate variations, the main factor in the IPCA (Brazilian Consumer Price Index), leads to an increase in the Selic rate to contain cost-push inflation, reducing competitiveness and growth.

Given the large number of scientific papers published on the considered high basic interest rates identified in developing countries, the need arises to verify the empirical evidence present in the literature on the main causes of these high rates, their consequences, and possible actions for their reduction. At the same time, synthesizing the apparent divergences between experts from different schools of economic thought on aspects of the topic can facilitate understanding by society.

Thus, this work seeks to investigate the high basic interest rates of emerging countries by identifying their main causes, consequences for economies, and possible actions to reduce them. To this end, a systematic review of the literature on the subject is carried out, making it possible to quantify the scientific articles published, and, additionally, for Brazil, a documentary research was conducted because economists publish as discussion papers or as opinion articles in media outlets that report on economics. The results indicate that the growth of studies on interest rates in emerging markets follows the increased relevance of these countries in the global economy, with the impact of monetary policy being the most recurring theme.

In Brazil, despite apparent disagreements, economists from different schools of thought tend to agree on the role of fiscal policy in interest rates,

its negative effects on investment, and possible solutions, such as the de-indexation of public debt and the control of government spending. Therefore, the research is justified by the latent need to improve the efficiency in the management of monetary policy. Interest rates influence the entire economic system, from household consumption decisions to the possibilities of structuring capital for investment projects. Mapping the main findings of the scientific literature on high interest rates will contribute to a qualified debate on the subject.

In addition to this introduction, the work has 4 more sections. The second section presents the methodology employed, with the criteria for selecting scientific articles, data source, period considered, and form of analysis. The third section presents the results, including the number of studies, the main findings from the literature, and a summary of the public debate. In section 4, we use the references studied and consolidate them into actions that can be considered by Brazilian authorities. Finally, section 5 concludes the work.

2. Methodology

The methodology employed makes use of systematic literature review methods. This approach allows for the identification, selection, evaluation, and synthesis of available evidence based on a well-defined question, with secondary studies being conducted using sources that are the results of primary studies (Galvão & Pereira, 2014). Stanley (2001) defines meta-analyses for economics as the systematic review and quantitative synthesis of empirical data on a specific phenomenon, summarizing the disparities found in the works. In recent decades, meta-analysis has emerged as a frequent tool for understanding economic research, reporting empirical evidence that diverges from theories with reasonable recurrence (Gechert et al., 2025).

The search for papers is conducted in the free scientific database OpenAlex, considering articles with available abstracts and considering the period from 1985 to 2025 for publications. The terms used as filters in the title and abstract of the works are interest rates and emerging markets, interest rates and the name of each of the 5 countries that initially made up the BRICS bloc – Russia, India, South Africa, China, and Brazil. As there may be a significant number of works in Portuguese for Brazil, additional research is carried out considering its name in the language - Brasil, along with the term Interest Rates – Taxas de Juros.

The search results are synthesized using the Preferred Reporting for Systematic Reviews and Meta-Analysis (PRISMA) method, presented by Page et al. (2021) and applied in recent years to various economic problems, such as in Gallettta et al. (2024), Gricar (2023), Oláh et al. (2020), Lucas-Noll et al. (2023), Singh et al. (2025), and Bastidas-Orrego et al. (2023). In order to analyze the possible causes, consequences, and remedies for high interest rates in Brazil, documentary research is also conducted. In the country, public debate on this topic is frequently framed through discussion papers and opinion articles published in media outlets that cover the economy.

3. Results

Figures 1, 2, and 3 present, respectively, the PRISMA diagram, the number of papers identified per year, and the main primary topics to which the papers are classified.

As can be seen in Figure 1, the number of studies found relating basic interest rates and emerging markets during the period is immense. However, a relatively small number contain available abstracts, an important factor for analyzing the literature. Figure 2 shows that the number of studies increased as the participation of developing countries in the global economy grew. Furthermore, another reason may be the increase in computational capabilities influencing empirical research, as well as the dissemination of necessary knowledge among economists and researchers in these countries. Figure 3 shows that, in the search, the topic with the highest number of studies is Monetary Policy and Economic Impact, which may indicate the attention given to the effects of monetary policy in the literature.

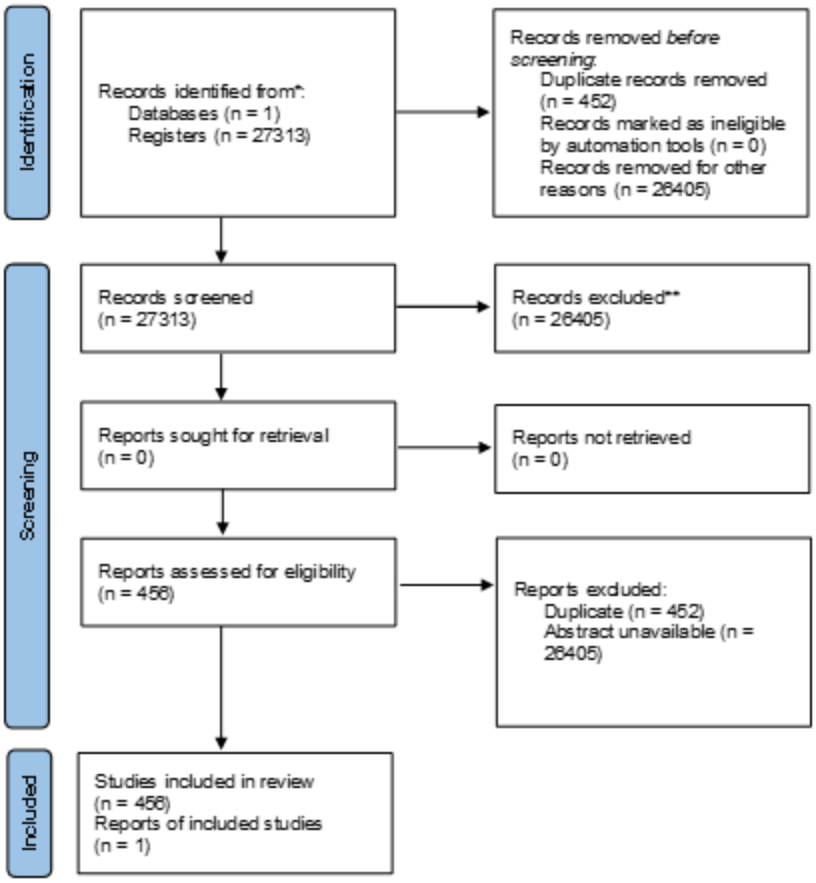

Figure 1. *Prisma*
Source: Elaborated by authors.

Low interest rates are crucial for countries to access low-cost sources of financing and, consequently, sustain their economic development. In this context, emerging countries need, first of all, to determine which factors contribute to the variation in interest rates (Kartal, 2020). Edwards & Khan (1985) modeled the domestic interest rates of developing economies as being influenced by several factors, such as the monetary developments of these countries, expected changes in exchange rates, foreign interest rates, and their speed of adjustment in relation to their variations.

Saxena's (2008) results indicate that, although exchange rates have become more flexible in these economies, they are still not fully floating and, consequently, interest rates still respond to foreign interest rates to some

extent – albeit to a lesser extent compared to the beginning of the century. The implementation of inflation targets, increased financial integration with the global economy, and the dedollarization of these countries' debt increase the effectiveness of monetary policy (Saxena, 2008). The transmission channel of monetary policy in these countries during the second half of the 2000s was investigated by Mohanty & Turner (2008).

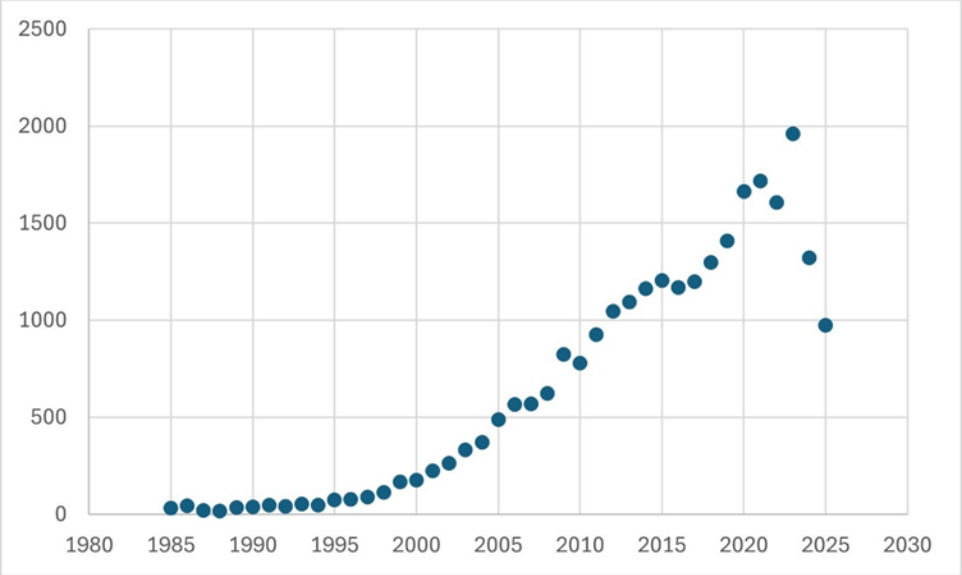

Figure 2. *Number of Publications*
Source: Elaborated by authors.

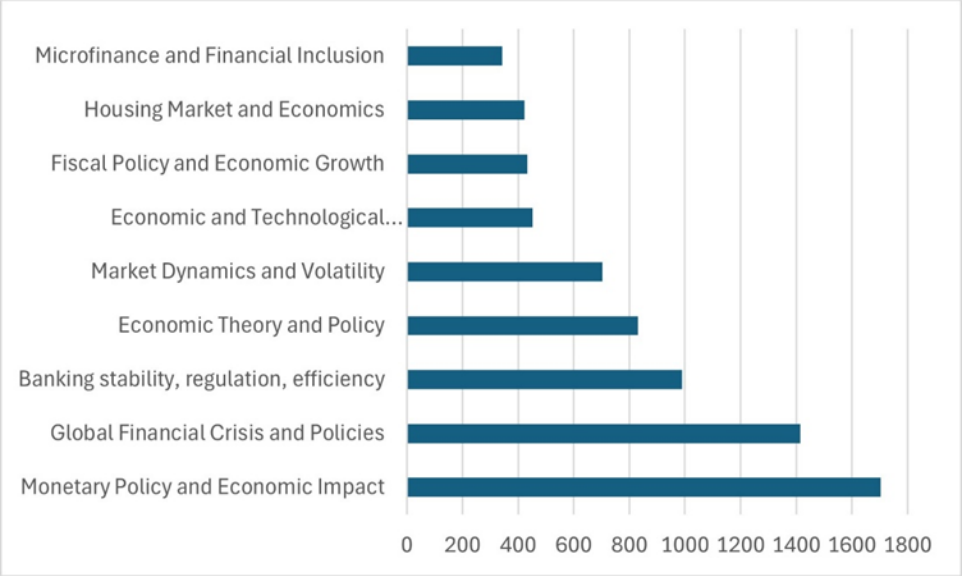

Figure 3. *Principais Tópicos Primários*
Source: Elaborated by authors.

They observed that central banks became more flexible in their operations and more credible, with changes associated with their balance sheets strengthening the interest rate channel to contain inflation, making it lower and less volatile. Furthermore, it was found that fiscal dominance and attempts such as currency devaluation were overcome, suggesting that as transmission channels continue to shift with the evolution of economies,

central banks need to remain attentive to the implications of such changes when calibrating their policy responses to macroeconomic developments (Mohanty & Turner, 2008).

Tiryaki (2012) examined the quantitative role of the interest rate in determining macroeconomic volatility in emerging market economies and found that fluctuations in the country spread account for less than 9% of output volatility, varying significantly with the working capital parameter, the persistence of productivity shocks, and the shares of factors of production. Frankel & Rose (1996) found that factors such as low output growth, high domestic credit growth, and high levels of foreign interest rates can influence exchange rate declines in developing countries, while variables such as the composition and level of public debt did not prove significant.

Mohanty & Klau (2005) suggested that, in some emerging countries, the central bank's response to a negative inflation shock may be stronger than a positive one, that in most of these countries the interest rate responds strongly to the exchange rate, and in some cases, the response is greater in relation to changes in the inflation rate or the output gap. Blumenschein (1998) points out that high inflation rates and nuances in market structure can contribute to monetary neutrality, especially in developing countries; the imperfect and slow adjustment in the interest rate structure, along with the flight of productive real assets, can exert a substantial effect on decreasing long-term investment (Blumenschein, 1998).

The results of Kartal (2020) indicate that economic growth and reserves influence loan (credit) interest rates in China, credit and net exports are the macroeconomic factors that influence loan (credit) interest rates in Brazil, inflation and money supply are the macroeconomic factors that affect loan (credit) interest rates in Turkey, while other macroeconomic indicators do not show influence in these countries.

Drobyschevski et al. (2017) observed that relatively restrictive international monetary policies may not harm economic growth amid low inflation expectations. Even if the central bank's monetary policy is moderately restrictive, the effectiveness of the channels can serve as a precondition to boost economic growth rates in the medium term, as the economic situation stabilizes, the risk premium decreases, and the inflation rate approaches the target.

The findings of Drobyschevski et al. (2017) indicate that increases in effectively realized (ex-post) real interest rates do not have a significant effect on the dynamics of output and its components. Therefore, efforts to stimulate economic growth through expansionary monetary policy would tend to increase inflation rather than produce the desired effect on the real economy.

Klose's (2020) results show significant differences between the real interest rate and the equilibrium rate in BRICS countries, revealing asymmetries in monetary policies. In China and India, monetary policy tends to be looser, stimulating economic growth, while in Brazil, the opposite occurs, especially in the late 1990s and early 2000s, when real interest rates were well above the equilibrium rate, restricting economic activity. In Russia and South Africa, real interest rates remain close to the equilibrium level, indicating more neutral monetary policies.

Furthermore, highly regulated markets tend to reduce aggregate investment, permanently raising the equilibrium interest rate. China and India adopted interest rates below equilibrium, favoring growth and inflation,

while Brazil maintained interest rates above equilibrium, with a restrictive effect. Russia and South Africa, in turn, show greater alignment between real and equilibrium interest rates (Klose, 2020). As influences of monetary policy, the estimates of Araújo & Silva Bastos (2008) indicate that shocks are relevant to the equity markets of Latin America, while revealing low sensitivity of equity returns to macroeconomic variables, although in some cases a weak relationship appears between returns and interest rates.

Specifically for Brazil, the results of Leandro et al. (2021) show that, after the adoption of the inflation targeting regime, monetary policy began to use the interest rate as the main instrument of control. Interest rates are adjusted according to the variation in inflation, increasing when it rises and decreasing when it falls. In addition, the rules of the regime strengthen the confidence of economic agents in the conduct of monetary policy. The findings of Moreira & Rocha (2011) indicate that a fiscal austerity policy can reduce the domestic interest rate, with a 1% increase in the primary surplus decreasing interest rates by between 100 and 550 basis points, highlighting the central role of fiscal policy in defining interest rates and revealing the limitations faced by the Central Bank in conducting monetary policy.

The findings of Akram & Uddin (2021) indicate that a lower (higher) short-term interest rate is associated with lower (higher) government bond yields, with the Central Bank influencing government bond yields due to monetary policy impacting the short-term interest rate through instruments such as swap rates and the Selic rate. Meanwhile, the empirical evidence from Biage et al. (2008) demonstrates that the Selic rate behaves insensitively to capital flows and country risk, denoting a strongly exogenous character.

Muinhos (2006) compared equilibrium interest rates, and his results indicate that institutional quality influences the difference between gross and net returns, being linked to jurisdictional uncertainty - as pointed out by Arida et al. (2004). Although the net marginal productivity of capital explains the level of the real interest rate in Brazil, it does not justify the difference in relation to other countries. This uncertainty raises the country risk premium, as evidenced by its econometric regressions.

But, for Gonçalves et al. (2007), traditional monetary and fiscal conditions better explain the level of short-term interest rates than jurisdictional uncertainty and exchange rate inconvertibility pointed out by Arida et al. (2005), due to the statistically significant correlations of the short-term interest rate with inflation and the debt-to-GDP ratio. Moreira's (2015) empirical findings suggest that monetary authorities during the subprime crisis preferred to stabilize or expand production at the expense of stabilizing inflation, even with the Brazilian inflation targeting regime in effect since 1999.

Estimates by Marques & Fochezatto (2007) indicate that increases in interest rates by the Central Bank tend to raise the risk perception of financial agents - and not the other way around, with causality going from interest rates to the risk premium. Costa (2017) identified that the rates of long-term inflation-indexed bonds are driven by the 10-year interest rates of US inflation-indexed bonds and the risk premium, measured by the 10-year CDS, and are not influenced by the deflated Selic rate, debt levels, and credit market indicators. In Nassif et al. (2010), the differential between Brazilian and foreign interest rates, along with the stock of reserves and the country's risk premium,

is verified as statistically significant in explaining the misalignment of the real exchange rate of the Brazilian currency.

Bonomo et al. (2016) performed simulations with general equilibrium models by reducing Brazilian retirement replacement rates to US levels, resulting in increases in savings rates and reduced interest rates. In addition, a simulated increase in FGTS remuneration would increase forced and total savings, as it is more efficient in wealth accumulation, and would result in lower market interest rates. Marçal & Pereira (2007) tested the expectations hypothesis for the term structure of interest rates in Brazil and perceived the possibility of some type of informational inefficiency in the Brazilian market and/or failures in the expectation formation process (irrationality). Cavalcante et al. (2024) found evidence that monetary policy management adheres to the Taylor Rule, with deviations only observed during the subprime crisis and COVID-19.

Furtado & Barboza (2021) exposed the frequent arguments in the public debate that the BNDES, with its long-term interest rate, would influence the economy's interest rate upwards and make the basic interest rate more volatile. By adding the BNDES to their model, the authors showed that having an exogenous interest rate, such as the TJPL, can exert a positive influence on the economy's interest rate. However, in Furtado & Barboza (2023), it is shown that the impact of the BNDES on the effectiveness of monetary policy is irrelevant; the negative effects would depend on the existence of a benchmark financial cost that is systematically lower than market rates and insensitive to monetary policy, and a significant share of the credit market, even smaller when considering the expanded credit for households and businesses.

There are many economists who point to different causes for the maintenance of high interest rates in the Brazilian economy. Economists considered heterodox or post-Keynesian discuss the importance of exchange rate volatility and the inadequacy of monetary policy to control inflation in Brazil due to exchange rate transmission and indexed prices, while mainstream or orthodox economists highlight strong capital controls, jurisdictional uncertainty, low savings rates, and the country's history of default (Balliester Reis, 2018).

In addition to the discussion about interest rates always being present in scientific journals, due to economic news that brings information on the subject, in the country, arguments debating their different effects on economic activity and the possible causes of their high levels are frequently published as opinion pieces in media outlets or in discussion papers. In an inflation targeting regime, the Central Bank adjusts the nominal interest rate to influence the real rate, but this is defined internally by the dynamics of the economy itself (Lopes, 2011). Omar (2008) points to price stabilization through containment of domestic demand, financing of the current account deficit, and actions to prevent speculative attacks against the exchange rate as factors for maintaining high interest rates in Brazil.

Bresser-Pereira & Nakano (2002) point to three main factors that underpin the current monetary policy, such as the formation of an alliance between rentiers, who receive interest, dividends, and rents, and financial agents, who benefit from high salaries, bonuses, and commissions. Another factor is the contagion effect of public debt between the bank reserves market and the public securities market, where both the conservative actions of the Central Bank and the obstacles faced by the Treasury in issuing debt directly affect the

yields and conditions of operations in these markets. Finally, the authors highlight the use of high interest rates as a mechanism for financing current account deficits, which are interpreted as external savings, although they essentially represent increases in consumer spending.

Coutinho (2017) argues that a large part of Brazil's public debt offered immediate liquidity and high real interest rates, creating an environment favorable to rent-seeking and consolidating a structural dependence on high rates. This regime concentrated savings in short-term investments and distorted the relationship between risk, term, and interest, resulting in a perverse temporal structure. The analysis by Oreiro et al. (2012) points to an explanation based on the loss of effectiveness of monetary policy, caused both by the dynamics of determining the Selic rate and by the composition of public debt, largely composed of LFTs – securities linked to the Selic rate.

For Oreiro & Paula (2010), the persistence of high real interest rates in Brazil is linked to the unique connection between the money market and the public debt market through Treasury Financial Bills (LFTs). As the Selic rate serves simultaneously to control inflation and to remunerate a significant portion of the public debt, its monetary policy function is contaminated by the need to roll over the debt. The fragility of public accounts intensifies this problem, as the market demands very high interest rates to finance the debt, and this cost is transmitted directly to monetary operations.

Oreiro (2024) also points out that Brazilian interest rates remain high due to the high level of price indexation, a result of the incomplete stabilization of the Real Plan, and the rigidity of the inflation targeting regime. This rigidity manifests itself in unrealistic targets and the use of headline inflation instead of core inflation, which creates a bias for the Central Bank to raise interest rates even without consistent inflationary pressures. The use of the global IPCA, instead of core inflation, tends to raise the interest rate, as it does not differentiate the components of inflation that respond to the basic interest rate from those linked to supply conditions such as climate, natural disasters, or geopolitical instability that affect the exchange rate, but are not sensitive to the Selic rate.

Conti et al. (2014) brought a discussion about the hierarchy between currencies, where peripheral countries need monetary authorities to be able to provide the necessary counterpart to agents - maintaining the liquidity of the foreign exchange market without making it vulnerable to speculative and destabilizing movements - through the accumulation of international reserves and the imposition of control modalities over the financial account so that susceptibility to international liquidity cycles is reduced.

However, according to Bresser-Pereira (2017), there is no economic explanation, since the fundamental cause of high interest rates in Brazil is the power of rentiers and financiers, and the argument that Brazil needs to keep rates high to finance its debt is fallacious, since - ultimately - rentiers have no alternative to invest their money. Oreiro (2024) states that the resistance of inflation to the interest rate is due to the maintenance of indexation mechanisms for long-term contracts, making the inflation rate in Brazil more dependent on past inflation than on expectations of future inflation.

Ianonl (2017), based on the analysis of Bresser-Pereira (2007), stated that Brazilian macroeconomic policy reflects the influence of a coalition of rentier and financial interests on the State and regulation. He examines the actions of the investor relations agencies of the Central Bank and the National Treasury,

as well as an investment promotion agency formed by regulators and regulated entities. These institutions strengthen communication between regulators and financial agents, highlight the influence of the financial sector on public policies, and reveal the convergence of interests between the State and investors (Ianonl, 2017).

Bresser-Pereira et al. (2020) argue that the persistence of high interest rates over several decades in Brazil, within a context of marked financialization of the economy, contributed to the emergence of a coalition of interests between rentier and financial agents. It acts in favor of maintaining high interest rates, since this policy favors the appreciation of financial assets, consolidating a financialization regime based on obtaining income through interest.

But for Gonçalves (2006), the idea that the Central Bank was "captured" by the financial system to maintain high interest rates is mistaken and dangerous. Although the Copom periodically announces the Selic rate, the Central Bank does not define the economy's interest rates alone. Its function, as an independent institution, is to stabilize aggregate demand so that it does not exceed potential GDP. If demand exceeds productive capacity, inflationary pressures arise, followed by adjustments.

Thus, its task is to avoid excessive fluctuations in production and inflation. According to him, the reasons for high interest rates are the political and monopolistic power of banks, high taxes, risks of all kinds for creditors that must be compensated, the scarcity of domestic savings, the government with high debt and budget deficit, and which demands loans to roll over its debt and finance its deficit (Gonçalves, 2006).

There is also no evidence of capture of the Central Bank by financial interests to define the Selic rate, according to Pessôa (2021), with the problem being the high neutral interest rate, which should balance supply and demand. When this rate fell, it was mainly due to the decline in country risk after the elimination of foreign exchange debt and the accumulation of reserves, and stricter fiscal policies could have anticipated the transition to low interest rates.

Pessôa (2012) attributes the reduction in ex-ante real interest rates observed at the end of the 2000s to the decrease in country risk due to a successful political transition by economic agents, who perceived the economy as having a government with fiscal responsibility and respect for contracts. After the EMBI+ fell below 1.5% in 2007, capital flows played a greater role in lower real interest rates, with investment exceeding savings due to the impact of economic liberalization and the prices of internationally tradable goods on the IPCA (Brazilian Consumer Price Index).

Garcia (2015) states that Brazil's real interest rate is high due to the fear of a return to hyperinflation, the fear of expropriation by the government, and the existence of multiple equilibria. Although econometric evidence does not confirm that high interest rates in Brazil are a consequence of public spending, after the end of hyperinflation, there was a continuous fiscal expansion. Garcia & Didier (2003) report that, in addition to exchange rate risk, which is important in developed economies, Brazil risk is very relevant for determining domestic interest rates, with the main factor resisting interest rate cuts being linked to uncertainty about the future profile of the balance of payments, especially trade accounts.

Franco (2011) also cites the concentration of debt in LFTs (Treasury Bills) and the difficulty of the National Treasury in developing long-term curves that

encourage long-term private credit for investments, because with the Treasury borrowing at a high real rate for one day, private companies cannot obtain resources at reasonable costs with longer terms consistent with productive expansion. The same point is made by Holanda Barbosa (2003), where the high real interest rate is explained by the integration of the currency and public debt markets, since the Treasury has been issuing Treasury Financial Bills since 1986 - indexed to the Selic rate, with its price practically not varying when interest rates are changed.

Magalhães & Vieira (2025) argue that the Brazilian fiscal imbalance has a strong financial component, linked to public debt and the basic interest rate, which raises costs and reduces efficiency. The management of debt, liquidity, and exchange rates generates high fiscal spending, especially due to interest servicing. The high participation of Treasury Financial Bills, indexed to the Selic rate, guarantees immediate liquidity, but compromises monetary policy and maintains high interest rates. Overcoming this situation requires institutional reforms and an anti-cyclical fiscal rule, capable of reducing financial costs and expanding space for sustainable public investments. In addition to LFTs, Barboza (2015) identifies transmission failures due to characteristics such as segmentation of the credit market, low penetration of free credit within the income determination process, truncated term structure of interest rates, and the participation of administered prices in the consumer price index.

Furthermore, Franco (2011) attributes interest rate levels to the crowding-out effect. This effect consists of the fact that part of the multiplier effects of a fiscal expansion – especially parts relevant to private sector demand – is consumed by the contractionary effects resulting from debt financing, so that the more sensitive the demand for money is to the nominal interest rate – and it must be quite sensitive in a country with inflationary traumas – the more dampened the effect of a fiscal expansion on aggregate demand will be. At its core is a particularly perverse combination of government deficits and debts, with a series of regulatory measures that impose forced savings to finance the public sector.

There are several motivations pointed out by economists who self-identify – often – within the currents of economic thought, but the texts brought by André Lara Resende from 2017 onwards heated the public debate in the country about interest rates. Resende (2017) shows that the high interest rates in Brazil have multiple explanations, such as the legacy of chronic inflation, price indexation, low savings, and high propensity to consume, in addition to the limited effectiveness of monetary policy.

Traditional models, such as Keynesian and monetarist ones, have been replaced by neo-Keynesian ones, which focus on interest rates as a central mechanism. The Taylor Rule states that, to stabilize inflation, interest rates should react inversely and more than proportionally to price variations. However, recent versions of these models, with rational expectations, show that inflation can be indeterminate and dependent on expectations. Irving Fisher's hypothesis introduces the idea that the equilibrium nominal rate results from the sum of the real rate and the expectation of future inflation (Resende, 2017).

Resende (2017) also explains that the neo-Fisherian approach goes further and suggests that high interest rates signal higher future inflation, reversing the traditional relationship. Thus, in the short term, high interest rates reduce

inflation, but in the long term, they can increase it. The Fiscal Theory of the Price Level (FTPL) reinforces that inflation depends on the credibility of fiscal policy and the sustainable balance of public debt. These new approaches indicate that the separation between monetary and fiscal policy is artificial and that high interest rates can worsen fiscal imbalance, keeping inflation high, as already suggested by the fiscal dominance hypothesis. Both the FTPL and the neo-Fisherian hypothesis conclude that monetary policy can only moderate inflation in the short term. In the long term, stability depends on fiscal balance.

Resende (2019) argues that interest rates in the economy result from multiple factors, such as credit risk, term, and banking structure. The basic rate, which remunerates bank reserves, is defined by the Central Bank and functions as the main instrument of monetary policy. Experiences such as Quantitative Easing have shown that monetary expansion does not automatically generate inflation, as the problem lies in the insufficiency of money, not in its excess. The demand for remunerated reserves is infinitely elastic, allowing the government to finance its debt at the basic rate. The chartalist view, taken up by Modern Money Theory, understands money as an official accounting unit between government and society, created endogenously through spending. Thus, taxes do not finance spending, but free up productive space so that the government does not put pressure on installed capacity.

Resende (2019) goes on to explain that monetary and fiscal policies are interdependent; if demand puts pressure on inflation, the response should be fiscal, not monetary. The interest rate should be set below the growth rate, guaranteeing investment and well-being. Setting interest rates above this level is a mistake, as it compromises growth and does not resolve inflationary pressures linked to expectations. Public debt does not represent a permanent fiscal cost, as long as the primary deficit is controlled. The government can increase well-being by spending or investing, as long as it respects the limits of productive capacity. This approach reinforces that fiscal policy is central to sustaining growth and stability, while monetary policy should support, without replacing, this role.

For Resende (2022), the sustainability of public debt depends on the relationship between interest rates and economic growth. If the interest rate is lower than growth, the debt/GDP does not follow an explosive trajectory and tends to fall, even after crises such as 2008 or the pandemic. Inflation can be understood as the discount in the currency over time, defined by the central bank when setting the interest rate and the yield curve. Thus, the central bank determines the temporal structure of prices. Unlike conventional theory, inflation is not negatively correlated with interest rates, because according to the neo-Fisherian hypothesis – defended by John Cochrane – higher interest rates tend to generate higher inflation.

Financial accounting should serve the collective well-being and not be captured by corporate interests or delegated solely to the financial system. Credit, in volume and direction, is a more powerful instrument than the basic interest rate. The traditional view, which associates investment only with savings and considers interest rates as the equilibrium between the two, ignores the state origin of credit. The State can control both its expansion and its allocation, in addition to the interest rate. However, state intervention can

also reinforce the inflation of financial assets, resulting from the expansion of bank credit supported by public debt (Resende, 2022).

But, Deos et al. (2021) explain that - for Minsky and MMT - the Central Bank is not limited to setting the basic interest rate, but should also continuously regulate the financial system to reduce instabilities, including those caused by speculative movements of foreign capital. However, this expanded role, although essential, is considered insufficient to fully address economic challenges. By assuming that mere clarification and persuasion would suffice to overcome the dogma of the balanced budget, Resende (2019) ignored the political aspects of Modern Money Theory and its main proposal that it is the Employer of Last Resort, a legacy of Minsky, that puts the fight against unemployment back as a priority. The central idea of MMT is that the government should guarantee work for all those who are able and available but cannot find employment in the market, especially in peripheral economies marked by instability (Deos et al., 2021).

As effects of high interest rates on the economy, Omar (2008) points to them as the main obstacle to economic growth in relation to the productive sector, and Mattei (2024) highlights that maintaining a high Selic rate increases interest expenses and intensifies the risks to the balance of public accounts. This makes it contradictory to advocate spending cuts to reduce debt when the biggest problem is the increasing cost caused by interest. The main beneficiaries of this scenario are financial institutions, which hold about 29% of the public sector's net debt. Next are pension funds (24%), investment funds (23%), and foreign investors, who accounted for 11% in October 2024. In total, almost 90% of the debt is concentrated in this restricted group of investors.

Omar (2008) found that one of its serious consequences is the increase in public debt, since, as public debt results from the budget deficit, the interest burden is the main component responsible for the budget deficit, with the deficit not being caused by excess spending on infrastructure or other social spending, but having a purely financial origin. Feijó & Araújo (2024) state that economies that liberalize their external accounts and maintain a high interest rate differential tend to have an appreciated real exchange rate, lose competitiveness in international trade, increase external vulnerability, and intensify the effects of the so-called Dutch disease.

Kanczuk's (2022) model findings demonstrate that working capital constraints cause interest rate increases to function as negative technological shocks. If interest rates rise temporarily, there is greater intertemporal substitution, and agents take advantage of the moment, but permanent shocks reduce this effect and make monetary policy less effective. Dos Santos Calvetti (2024) explains that high interest rates make mortgage financing more expensive, reduce demand for real estate, and slow property appreciation, negatively affecting the urban economy and the construction industry, a sector relevant to job creation.

Lower interest rates, on the other hand, stimulate consumption and investment, but can increase household debt. Urban infrastructure projects also suffer from these variations, where high rates increase costs and can cause delays or cancellations in necessary investments (dos Santos Calvetti, 2024). In Oreiro et al. (2020), it is presented that the history of inflation and the exchange rate explain current inflation better than expectations. The relationship between exchange rates and inflation indicates that the fall in

inflation during periods of rising Selic interest rates occurs due to currency appreciation, which reduces the competitiveness of the Brazilian industry and reinforces the debate about the premature deindustrialization of the country.

Guerra (2016) argues that the Brazilian institutional scenario, marked by strong indexation, means that part of the inflation of one year is automatically transferred to the next. Government, companies, unions, and owners use this mechanism to protect purchasing power, readjusting tariffs, rents, prices, and wages based on past inflation, a practice reinforced by the tolerance of the authorities. When the Central Bank raises the Selic rate, the effect is twofold: it reduces economic activity, decreasing tax revenue, and increases the cost of public debt, since 23% of it is linked to the Selic rate itself.

According to Pochmann (2017), the high interest rate has functioned as compensation for financial gains in the face of low economic dynamism, without stimulating productive investment. In the IPCA (Brazilian Consumer Price Index), 23.3% corresponds to administered prices and 32.9% to products quoted externally, such as soybeans and corn. Non-tradable free prices, which represent 43.8%, are more sensitive to interest rates. Thus, more than 56% of the items surveyed by IBGE suffer little or no impact, revealing that high interest rates favor elites more than they combat inflation. A policy of progressively reducing the interest rate would reduce the market's perception of risk and increase the rate of economic growth, improving the solvency of public accounts without compromising price stability (Marques & Fochezatto, 2007).

Linked to interest rates is the bank spread, which has been much investigated and discussed in the country. Oreiro et al. (2012) identified a strong inertial component in the formation of the bank spread in Brazil, so that a broader and more lasting drop in the basic interest rate only significantly affects the spread after a considerable period. Quatrochi et al. (2021) state that the entry of fintechs into the Brazilian banking sector has the potential to reduce the cost of credit and the bank spread, increase the efficiency of intermediation, and better serve micro and small entrepreneurs, who are traditionally underserved by banks. Because they are digital and less bureaucratic, these companies increase competition and challenge the large incumbents.

Advances are already visible with the growth of fintechs in credit, financial management, and digital banks, and Quatrochi et al. (2021) emphasize that, among the proposals to strengthen this movement, are the creation of a specific guarantee fund for fintechs, the reduction of capital requirements for their recognition as financial institutions, and the use of regulatory sandboxes and LIFT, which allow testing and maturing new business models under the supervision of the Central Bank.

De Jesus & da Nóbrega Bezarria (2021) realized that the default rate is the main factor that makes the bank spread high in Brazil, making it important for policymakers to focus on measures aimed at reducing this component. To this end, the authors reiterate the suggestions of Febraban (2018) such as improving the positive credit registry, expanding access to information on income, revenue and existing employment in public bodies, improving the Bankruptcy and Judicial Reorganization Law, allowing the extrajudicial search and seizure of movable property subject to fiduciary alienation, and altering the tax treatment of provisions for doubtful debtors.

As recommendations for reducing interest rates in the country, Bresser-Pereira & Nakano (2002) argue that after the persistent maintenance of the interest rate at a very high level, it is natural that fear of reduction arises and that this level becomes a convention, and that to get out of this trap we could think about improving the inflation targeting policy using core inflation - eliminating the transitory components of inflation - and reducing or eliminating the exchange rate from the measurement of inflation, since with the interest rate reacting to the output gap and the inflation target there is already an important indirect reaction to the exchange rate.

Luperi (2024) states that it is necessary to change the sampling of the Focus survey to meet the interests of society, as well as to have changes in the understanding of seasonal impacts and the overestimation of the IPCA, in addition to changes in the composition of the Copom that bring greater representativeness of Brazilian society. The fall in interest rates resulting from greater regulation and rule changes, in addition to saving financially spent resources and contributing to greater investments, reduces the impact on the exchange rate, which is important to contain the deindustrialization process of the Brazilian economy (Luperi, 2024).

Omar (2008) recommends decreasing the public debt/GDP ratio, an expansionary and responsible monetary policy, and attacking the high spreads charged by banks through greater oversight of competition policy in the financial sector and the monopoly power of banks to charge interest rates that penalize consumption and investment and, consequently, the GDP growth rate. Nassif et al. (2010) emphasize that high domestic interest rates and low international interest rates contribute to appreciating the Brazilian currency in real terms and suggest a modification in the inflation targeting regime in Brazil so that monetary authorities have more room to reduce the basic SELIC interest rate, in addition to - as in Oreiro et al. (2009) - considering an 18-month calendar year to manage the inflation target.

Marconi (2025) argues that the inflation target, considered unattainable, supports a strongly contractionary monetary policy, while the government adopts an expansionary fiscal policy to compensate for the effects of high interest rates and stimulate growth. The result is the worst of all worlds, where there is an increase in public debt, deteriorated expectations, room for speculation, pressure on exchange rates, inflation, and interest rates. This incoherence between fiscal and monetary policies is recurrent in the Brazilian economy.

For Marconi (2025), an alternative would be to adopt more realistic inflation targets, reduce the interest rate and, consequently, financial expenses, in addition to decreasing the dependence on compensatory policies. This would open up space for greater dynamism in private and public investment. The necessary adjustment involves increasing revenue from the wealthiest, cutting tax breaks, subsidies, and parliamentary amendments, better controlling spending, reforming the pension system, and recovering formal jobs to strengthen tax collection, thus creating a less expansionary fiscal policy and a less contractionary monetary policy.

Salto (2025) argues that the Central Bank should indicate, through the members of the Copom (Monetary Policy Committee), the interest rate curves for the relevant period, instead of focusing only on short-term interest rates and their expectations. Furthermore, the low inflation target forces the maintenance of high interest rates for longer. To reduce the Selic rate in a

lasting way, it is essential to control the deficit and public debt and overcome the vicious circle of short-termism and unconditional liquidity, creating long-term funding mechanisms for the financial system and the capital market (Coutinho, 2017). This involves Oreiro & Paula (2010), who state that the reduction of the real short-term interest rate in Brazil depends on the elimination of LFTs (Treasury Bills), a fiscal adjustment that eliminates the nominal deficit of the public sector, and more efficient management of monetary policy by the Central Bank.

Lopes (2014) highlights measures aimed at reducing the fiscal deficit, stimulating private savings, decreasing the tax burden, mitigating inflationary pressures, limiting subsidized credit, allowing the free floating of the exchange rate, and structural reforms with initiatives such as increasing the flexibility of the Long-Term Interest Rate (TJLP) and eliminating public bonds indexed to the Selic rate (LFTs). The indexing of domestic public debt by LFTs dilutes the wealth effect of monetary policy, concentrates financial gains in the short term, and limits the capital market, making it difficult for interest rates to fall. To address this situation, Oreiro et al. (2012) suggest three measures: reducing exchange rate volatility, de-indexing administered prices, and eliminating LFTs, strengthening the effectiveness of monetary policy, and favoring economic growth. Holanda Barbosa (2003) also recommends withdrawing LFTs from circulation and prohibiting the Treasury from issuing bonds indexed to the Selic rate.

Franco (2011) proposes measures to reduce interest rates in Brazil. In public debt policy, he suggests replacing LFTs (Treasury Bills) with pre-fixed bonds, making them a low-risk benchmark and avoiding high transition costs. He advocates expanding the issuance and average maturity of securities indexed to the IPCA (Broad Consumer Price Index), IGPM (General Market Price Index), and exchange rates, creating long-term benchmarks and stimulating private markets and hedging instruments. Regarding funds, he recommends limiting or taxing those with daily liquidity, encouraging alternatives with longer maturities, to reduce distortions similar to those of indexation.

In directed credit, Franco (2011) criticizes reserve requirements and demands on savings deposits, which function as a "tax on credit" and increase the bank spread. Finally, he points out that forced savings mechanisms, such as FGTS (Employee Severance Indemnity Fund) and FAT (Workers' Assistance Fund), capture private resources with low returns and reinforce crowding out, restricting the capital market and harming productive financing.

Garcia (2015) afirma precisar ser contida a expansão dos gastos públicos, impulsionado o alongamento do crédito, principalmente para investimentos, pois o crédito de longo prazo é amplamente subsidiado, e permitir a conversibilidade da moeda para que o real seja negociado livremente no mercado internacional, enquanto Moreira (2015) propôs a calibração da política monetária brasileira para uma política mais ativista e menos gradual, com respostas mais expressivas da taxa Selic às mudanças na inflação esperada e aos hiatos do produto.

And to overcome low funding for long-term financing, Giambiagi (2022) proposes the creation of a long-term nominal interest rate that encourages a financing model in which real interest rates can vary over time. Thus, the cost to the borrower would be adjusted annually according to prevailing long-term conditions, instead of remaining fixed at the conditions existing at the time the loan was contracted.

Given the discussion presented, our findings are consistent with the bibliometric investigation by Da Silva Santos & Neto (2021), which highlighted the need for a coordinated strategy involving macroeconomic, fiscal, and monetary policies, as well as structural reforms to strengthen credibility and the domestic environment. Inflation control is central, but factors such as high public debt, the level of domestic savings, fiscal stability, and institutional uncertainty also influence interest rates.

4. Possible strategies for reducing interest rates in Brazil

Maintaining the Selic rate at a high level is justified by the Central Bank (BC) as a necessary action to ensure that inflation converges to the target, combating unanchored inflation expectations. Additionally, the BC frequently emphasizes that fiscal policy, considered expansionary, limits the effectiveness of monetary policy. This occurs because high indebtedness and government deficits increase the risk premium perceived by the market, raising the neutral real interest rate of the economy and requiring the Central Bank to keep the Selic rate even higher to compensate for the risk and obtain the desired disinflationary effect, intensifying the need for contractionary perseverance.

Despite the Central Bank's diagnosis, based on national and international references, we proactively highlight some actions that can be considered to combat high interest rates in Brazil. These actions reside in a set of institutional reforms, changes in the management of monetary policy, and actions focused on the financial system and public debt.

4.1. Reforms in public debt management

One of the most cited structural causes of high interest rates, which is directly connected to monetary policy, is the composition of public debt and the inflation targeting regime. Suggestions in this area could include the elimination and replacement of LFTs (Treasury Financial Bills), where the large participation of LFTs - securities indexed to the Selic rate - is pointed out as a mechanism that "perversely" links the monetary and public debt markets (Oreiro & Paula, 2010; Holanda Barbosa, 2003).

One action could be the withdrawal of LFTs from circulation and the prohibition of the Treasury from issuing securities indexed to the Selic rate (Holanda Barbosa, 2003), replacing them - as in Franco (2011) - with pre-fixed securities that would become low-risk benchmarks; another action would be to expand the issuance and average maturity of securities indexed to inflation indices such as IPCA, IGPM and exchange rates, creating long-term benchmarks for the private sector. This could help develop a longer-term structure of interest rates (Marçal & Pereira, 2007; Franco, 2011).

Another suggestion would be to reform the inflation targeting regime, as the rigidity and method of calculating the inflation target lead the Central Bank to raise the Selic rate even without consistent inflationary pressures, impacting growth and competitiveness (Oreiro, 2024; Marconi, 2025). One way to implement this would be to adopt more realistic inflation targets (Marconi, 2025) and modify the regime so that monetary authorities have more room to reduce the Selic rate (Nassif et al., 2010). Improving the inflation targeting regime by changing the way inflation is measured, using core inflation, which eliminates transitory components (Bresser-Pereira & Nakano,

2002; Oreiro, 2024), and considering a longer time horizon for the target (18 months) (Oreiro et al., 2009) could also contribute.

4.2. Actions in the financial and credit system

The high bank spread in Brazil, which is the final cost of credit, stems from high interest rates, but also from factors such as high default rates and low competition (Oreiro et al., 2012). One way to overcome this scenario could be through increased banking competition, attacking the monopoly power of banks and the high spreads charged (Omar, 2008). To this end, the movement of credit fintechs and digital banks could be strengthened to increase competition and efficiency in financial intermediation (Quatrochi et al., 2021).

Another way could be to reduce default rates, which are identified as the main factor that makes the bank spread high in Brazil (De Jesus & da Nóbrega Bezarria, 2021). The positive credit registry, the Judicial Recovery and Bankruptcy Law, and the extrajudicial search and seizure of movable property alienated in trust could be improved. Finally, the reform of directed credit and forced savings can be highlighted, since subsidized credit and forced savings mechanisms (e.g., FGTS, FAT) are seen as "taxes on credit" that widen the spread and reinforce crowding out (Franco, 2011). This could occur by limiting subsidized credit (Lopes, 2014) and reviewing forced savings mechanisms that restrict the capital market and productive financing (Franco, 2011).

4.3 Risk and uncertainty mitigation

High interest rates also reflect the risk premium demanded by the market, linked to jurisdictional uncertainty, fear of a return to hyperinflation, and the perception of country risk (Muinhos, 2006; Garcia, 2015). To mitigate these risks, aspects such as reducing jurisdictional uncertainty could be pointed out, since institutional quality is cited as a factor that increases the risk premium, influencing the difference between gross and net returns (Muinhos, 2006; Arida et al., 2004).

Furthermore, factors such as controlling exchange rate volatility can be cited, as it is a factor that puts pressure on inflation and the Selic rate, generating a loss of competitiveness (Oreiro et al., 2012; Feijó & Araújo, 2024), with the containment of volatility being suggested as a remedy. Improving expectations and credibility can also be cited, where a policy of progressively reducing interest rates would reduce the market's perception of risk and increase the economic growth rate (Marques & Fochezatto, 2007; Pessôa, 2012), but this requires changes in institutional quality and the confidence of economic agents.

4.4 Stimulating savings and growth

Although this work does not disregard fiscal control, it points to low domestic savings as a structural factor that raises interest rates. Points such as the incentive for private savings (Lopes, 2014) are highlighted, as the exercise by Bonomo et al. (2016) shows that increasing the remuneration of funds such as the FGTS, or reducing retirement replacement rates (to US levels), would increase forced and total savings, resulting in lower market interest rates.

In addition, attention should be paid to economic growth, as Resende (2022) argues that the debt/GDP ratio tends to fall if the interest rate is lower than economic growth, and setting the interest rate below the growth rate is

seen as fundamental to guaranteeing investment and well-being (Resende, 2019).

5. Conclusion

This work sought to investigate the high basic interest rates observed in emerging countries. To this end, a systematic review of the scientific literature on developing economies, especially Brazil, was carried out. As there is a great deal of public debate on the subject in the country, with economists' opinions expressed in discussion papers and published as opinion articles in media outlets that cover economics, documentary research was also conducted.

The results indicate that the amount of work on interest rates in emerging markets is positively correlated with the growth of evidence of these countries in the global economy, with a peak after the COVID-19 pandemic, and with the increased availability of data and computational tools necessary for conducting empirical research. The primary topic – classified in each work – most present in this literature is that which seeks to understand the effects of monetary policy.

The discrepancies in views on the causes, consequences, and remedies for high interest rates in Brazil among different groups of economists are smaller than might be assumed. Nevertheless, we synthesized the analytical findings from the literature review and developed a list of structured actions for policymakers to consider.

As a suggestion for future research, some of the main causes identified for high interest rates could be empirically tested – using data from Brazil, such as the decreased effectiveness of monetary policy due to the various types of subsidized credit practiced in the country.

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Author(s) Statements:
Acknowledgements: Not applicable.
Author contributions: The contribution of the authors is equal.
Funding: No funding was received for this study.
Availability of data and materials: Not applicable.
Ethics Declarations:
Ethics approval and consent to participate: Not applicable.
Consent for publication: Not applicable.
Consent to participate: Not applicable.
Competing interests: The authors declare that they have no competing interests.
Informed consent: Not applicable.
Consent for publication: All authors agreed with the content and gave explicit consent to submit the manuscript to *Journal of Economics and Political Economy*
Data Availability Statement: Not applicable.

CRediT Author(s) Statements:

Contribution	MS Tessmann	FB Meneguin	GFO de Silva	
Conceptualization	X	X	X	
Methodology	X	X	X	
Software	X	X	X	
Validation	X	X	X	
Formal analysis	X	X	X	
Investigation	X	X	X	
Resources	X	X	X	
Data curation	X	X	X	
Writing –original draft	X	X	X	
Writing –review & editing	X	X	X	
Visualization	X	X	X	
Supervision	X	X	X	
Project administration	X	X	X	
Funding acquisition	X	X	X	

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