FOR AGENDA

EBS/84/84

CONFIDENTIAL

April 11, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Brazil - Staff Report for the 1984 Article IV Consultation and Review Under Extended Arrangement

Attached for consideration by the Executive Directors is the staff report for the 1984 Article IV consultation with Brazil and a review under the extended arrangement. The letter of intent pertaining to the second year of the extended arrangement was circulated as EBS/84/61 (3/19/84). Draft decisions appear on pages 40-45.

This subject will be brought to the agenda for discussion on a date to be announced.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Reichmann (ext. (5)8610).

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

BRAZIL

Staff Report for the 1984 Article IV Consultation and Review Under Extended Arrangement

Prepared by the Western Hemisphere and Exchange and Trade Relations Departments

(In consultation with the Fiscal, Legal, and Treasurer's Departments)

Approved by E. Wiesner and W. A. Beveridge

April 11, 1984

I. Introduction

The 1984 Article IV consultation discussions with Brazil were held in Rio de Janeiro and Brasilia during February 13-27, 1984.1/ At the same time, the mission conducted the review called for under the extended arrangement with Brazil and negotiated specific performance clauses for the period April through September 1984 in the framework of this arrangement. The mission also assessed whether a basis existed for waiver and modification of the program, a subject which was dealt with in EBS/84/39 (3/2/84). The representatives of the Brazilian Government included the Ministers of Planning, Finance, and Industry and Commerce, the President of the Central Bank, and other senior officials of various ministries, agencies, banks, and corporations of the public sector. The staff mission consisted of Thomas Reichmann (Head-WHD), Ana Maria Jul (WHD), John Lipsky (ETR), Aarno Liuksila (LEG), Henri Ghesquiere and Joris Buyse (both WHD), and Joan Hewitt (Secretary-WHD). Mr. W.A. Beveridge (ETR) joined the mission for the policy discussions. Mr. Alexandre Kafka, Executive Director for Brazil, participated in the discussions.

The extended arrangement for Brazil (EBS/83/33, 2/11/83; and Sup. 4, 3/3/83), was approved by the Executive Board on February 28, 1983, and is for SDR 4,239.4 million (290 percent of Brazil's quota). Of this amount, up to SDR 2,743.1 million would be available to Brazil through the second year of the arrangement. Through March 31, 1984 Brazil had purchased SDR 1,620.9 million, and further purchases during the second year of the arrangement will be such that cumulative purchases do not exceed that amount until May 20, 1984, SDR 1,949.9 million until August 20, 1984, and SDR 2,368.9 million until November 20, 1984 (Table 1). The Brazilian authorities are expected to request a purchase under the Fund's compensatory financing facility which will be dealt with in a separate document.

1/ The last consultation discussions were concluded by the Executive Board on February 28, 1983. Brazil continues to avail itself of the transitional arrangements of Article XIV.

Table 1. Brazil: IMF Position 1/

(December 31, 1982 - February 28, 1986)

	Outstanding Dec. 31, 1982	Transactions in March 1983-Feb. 1984	Transactions in March 1984-February 1985: Mar.-May	June-Aug.	Sept.-Nov.	Dec.-Feb.	Total	Trans-actions March 1985-Feb. 1986
			(In millions of SDRs)					
Purchases	498.8	2,027.1	621.9	374.0	374.0	374.3	1,744.2	1,496.3
First credit tranche	--	249.4	--	--	--	--	--	--
EFF	--	1,246.9	374.0	374.0	374.0	374.3	1,496.3	1,496.3
Ordinary resources	(--)	(623.4)	(187.0)	(187.0)	(187.0)	(187.1)	(748.1)	(25.0)
Enlarged access	(--)	(623.4)	(187.0)	(187.0)	(187.0)	(187.1)	(748.1)	(1,471.3)
Compensatory financing	498.8	466.3	247.9	--	--	--	247.9	--
Buffer stock financing	--	64.5	--	--	--	--	--	--
Repurchases	--	--	--	--	--	--	--	--
Use of Fund credit	498.8	2,525.9	3,147.8	3,521.8	3,895.8	4,270.1		5,766.4
Excluding CFF and buffer stock	--	1,496.3	1,870.3	2,244.3	2,618.3	2,992.6		4,488.9
			(In percent of new quota)					
Purchases	34.1	138.7	42.6	25.6	25.6	25.6	119.4	102.4
Use of Fund credit	34.1	172.9	215.5	241.1	266.7	292.3		394.7
Excluding CFF and buffer stock	--	102.4	128.0	153.6	179.2	204.8		307.3

Source: International Monetary Fund.

1/ Partials may not add up to totals because of rounding.

In the letter dated March 15, 1984 1/ signed by the Minister of Planning, the Minister of Finance, and the President of the Central Bank, the Brazilian authorities provide a description of their policy intentions for 1984. These policies are consistent with the basic thrust of the medium-term economic program supported by the extended arrangement, and with the policies for 1984 the authorities specified during the discussions that led to the modifications of the program approved by the Executive Board (EBS/83/227, 10/19/83, and Sup. 4, 11/23/83) on November 22, 1983.

II. Performance Under the Extended Arrangement

1. Background

Over the past two decades, Brazil was one of the most rapidly growing economies in the world. In the mid-1960s Brazil launched an export-led growth process that relied increasingly on foreign borrowing to supplement domestic savings. From 1963 to 1981 the country's real gross national product grew at an average annual rate in excess of 8 percent, with the U.S. dollar value of exports growing at an average annual rate of 17 percent. Even the two oil shocks of the 1970s, although they had far-reaching consequences for the ultimate viability of the process, did little to change this growth cum debt strategy.

By 1982, however, Brazil found itself in a fundamentally different situation. Externally, it faced a more difficult environment characterized by stagnant world trade, high real rates of interest, and dependency on high-cost energy sources. The foreign debt accumulated over the previous 20 years made the country vulnerable to circumstances in international capital markets, and its servicing constrained the authorities in their exchange and interest rate policies. Domestically, the economy was beset by a number of distortions, many of which were consequences of the growth process. The public sector, in particular the state enterprises, had become very large; inflation was at the historically high level of 100 percent; and indexation, special incentives, and controls adversely affected the allocative efficiency of the price mechanism.

Thus, the disturbances in international capital markets that emerged in mid-1982 brought to the fore the realization that the development path followed by Brazil was no longer feasible, and that a fundamental change in the country's economic strategy was required. Brazil no longer would be able to rely on foreign resources to finance its development effort to the extent it had in the past. Rather, future growth would depend on increasing the efficiency of the economy and on the generation of larger domestic savings.

These considerations provided the basis for the economic program adopted by the Brazilian authorities in late 1982 which was supported by an extended arrangement with the Fund. The program aimed at reducing external and internal imbalances while bringing about structural

1/ EBS/84/61 (3/19/84).

changes that would permit the resumption of growth on a sustainable basis. The basic objectives of the program were to raise domestic savings, especially by improving the financial position of the public sector, and to increase the efficiency of the economy by allowing relative prices to adjust, eliminating subsidies, and cutting back restrictions. Accordingly, the program sought a reduction in the external current account deficit from almost US$15 billion (6.5 percent of GDP) in 1982 to US$7 billion (3.0 percent of GDP) in 1983, to be followed by further reductions to 2.1 percent of GDP in 1984 and to 1.6 percent in 1985. Domestically, the program called for a reduction in the public sector's financing requirement from the equivalent of 15.8 percent of GDP in 1982 to 8.8 percent in 1983, 5.5 percent in 1984, and 4 percent in 1985. The improvement in the public finances was to be instrumental in scaling down foreign borrowing and reducing the rate of domestic inflation to some 90 percent in the year ended December 1983, and to some 40 percent and 20 percent during 1984 and 1985, respectively. The program also contemplated reductions in credit subsidies to agriculture, a substantial strengthening of domestic pricing policies (in particular with respect to prices of fuel products), and a tightening of incomes policies.

2. Overall performance

Brazil's performance under the program during 1983 was marred by substantial shortcomings in the implementation of domestic adjustment policies that were corrected only in the latter part of the year. However, in spite of these shortcomings, considerable progress was made in achieving the program's objectives in respect of relative prices and a large improvement was registered in the external position, although this was obtained to a large extent through an intensification of exchange and trade restrictions.

In the earlier part of the year, the momentum that domestic imbalances carried forward from the past was compounded by the emergence of substantial delays in the implementation of corrective domestic policies. In particular, the adjustment of the public finances lagged behind that envisaged in the program and increases in certain key prices were postponed. These shortcomings had adverse effects on the conduct of monetary policy and led to an inflation considerably higher than had been forecast.

The rate of inflation in 1983 was 211 percent, more than twice that envisaged in the original program. The higher rate of price increase arising from the shortcomings in financial policies that occurred in the first half of the year was compounded subsequently by the corrective price measures undertaken as part of the adjustment effort, by the effects of unforeseen events such as floods and droughts, and by the sharp change in domestic relative prices favoring agriculture that accompanied external trade developments and the removal of subsidies to that sector. The monthly rate of inflation remained in the range of 12-13 percent from June through October 1983; afterwards there was a slowing down in the inflationary pace with the rate declining to about 8 percent in November and December. However, in the first quarter of 1984 the rate of inflation moved up again to the range of 10-12 percent.

Several factors combined to produce negative effects on economic activity in 1983. These included uncertainties with regard to developments in the economy (in particular with regard to the course of inflation), the effects of the cutbacks in public investment, the natural disasters affecting agriculture, and some constraints on the availability of key imported inputs. Preliminary estimates indicate that real GDP declined by 3.3 percent, and industrial output by 6 percent in 1983; this followed a decline of real GDP by some 2 percent in 1981-82.

3. Price and incomes developments

Starting in June 1983, a number of steps have been taken to eliminate subsidies. In early June the prices of petroleum products (and alcohol for combustion purposes) were raised on average by 45 percent, thereby ending the subsidization of oil products. Subsequently, the prices of these products have been adjusted in line with currency depreciation, thus preventing the re-emergence of the subsidy which had been financed by the monetary authorities. The price of wheat was raised by 100 percent in June 1983, by 40 percent in September 1983, and 50 percent in February 1984; further increases are planned in order to eliminate the subsidy to wheat by mid-1984. Prices of steel and electricity have been raised so as to produce a real increase of about 5 percent, consistent with understandings reached with the World Bank. The prices of other public sector services have been adjusted approximately in line with inflation.

Substantive changes in wage legislation were introduced during 1983. Various automatic adjustment formulae had been applied in Brazil over the years, but, as these formulae had come to relate wage and salary adjustments to past increases in prices virtually on a one-to-one basis, anti-inflation policies were seriously hampered. In particular, some modification of the indexation of wages was essential to moderate the effects of demand restraint on employment. A number of wage adjustment schemes, involving different degrees of deindexation, were proposed and were in effect through parts of the year (a description of these schemes was provided in EBS/83/227, Sup. 2 (11/17/83)). However, legislative approval of a definitive system of wage adjustments was not reached until November 1983. Through most of the year, therefore, the search for consensus on wage policy added to the uncertainties concerning the implementation of the program. Decree-law 2065, approved by the National Congress on November 9, 1983, established a sliding scale of wage indexing factors which, starting with full adjustment for the lower end of the salary scale, yielded an overall average adjustment factor of 86 percent of past inflation. Wage increases lower than the minimum prescribed by law are possible in cases where the economic viability of an enterprise is threatened, and Decree-law 2065 also contains provisions that call for the gradual establishment of free wage negotiations beginning in mid-1985. Legislation also was passed near the end of the year limiting wage increases and reducing fringe benefits in the state enterprise sector.

4. Fiscal developments

The imbalance in the public finances is measured by the public sector's borrowing from domestic or foreign sources, including the borrowing related to the maintenance of value of the public debt. In the case of Brazil, the stock of public debt has been indexed to the domestic price level (monetary correction) or the exchange rate (exchange correction). The indexation of the principal of the debt ensures that a positive real rate of interest is paid on this debt, but it also introduces a direct relationship between the level of domestic prices (or the exchange rate) and the size of the public sector deficit. The adjustment of the debt for inflation amounts to an increase in the deficit which is automatically financed, thereby further increasing the debt (alternatively, this can be conceived as a system of variable interest on the public debt, interest which is positive in real terms and is automatically capitalized). The pressure exerted by the public sector on domestic and on available foreign savings is given by the borrowing requirement as a whole, and it is the total value of the outstanding debt which affects the consumption, saving and investment behavior of its holders. In the formulation of fiscal policy, however, the authorities have chosen to give considerable emphasis to those elements of the revenue-expenditure equation that are under their immediate control, and thus to make use of the concept of operational deficit. The operational deficit, which is defined as the difference between the total borrowing requirement and the amount of monetary and exchange correction on the stock of domestic debt outstanding, has been incorporated as a subceiling in the program (the definitions of the public sector borrowing requirement and of the operational deficit were presented in Appendix IV of EBS/83/227 (10/19/83)).

At the time it was approved, the program called for a reduction in the public sector borrowing requirement (PSBR) from the equivalent of 15.8 percent of GDP in 1982 to 8.8 percent in 1983. With the assumed decline in inflation, this would have led to the elimination of the operational deficit (6.6 percent of GDP in 1982) in the first year of the program. The delays in introducing measures in the fiscal area in the earlier part of 1983 and the subsequent acceleration of inflation rendered the original targets unattainable and led to the modification of the fiscal targets for 1983.

New targets for 1983 were incorporated in the program at the time of the Executive Board's approval of the modified program in November 1983. The operational deficit was then targeted at the equivalent to 2.7 percent of GDP in 1983; at the same time, with a rate of inflation that was more than twice the rate that had been assumed in the original program, the total PSBR was reset at 18.6 percent of GDP.

Results for 1983 indicate that the revised ceilings on the public sector's deficit were met; the PSBR amounted to the equivalent of 17.7 percent of GDP while the operational deficit was the equivalent of 2.6 percent of GDP (Table 2). Thus, from 1982 to 1983 the overall public sector deficit rose by almost 2 percent of GDP while that of the operational budget of the public sector was reduced by the equivalent of 4 percentage points of GDP.

Total expenditures of the Central Administration declined by the equivalent of 1.6 percent of GDP; the wage bill declined by 14 percent in real terms (Table 3) as wage increases were held considerably below inflation and a freeze was imposed on hiring and promotions. At the same time, transfers to other levels of government and other expenditures (current and capital) were cut in real terms by about 16 percent. This containment in direct expenditures (equivalent to more than 1 percent of GDP) permitted a real increase of more than 55 percent in the transfers to the monetary authorities to finance expenditures made on behalf of the Treasury, such as subsidies, the agricultural minimum price program, and interest and other costs related to the public sector debt. These latter expenditures declined by about 1.5 percent of GDP on the strength of cuts in subsidies and reduced costs related to the public sector debt. However, the revenues of the Central Administration also registered a small decline (equivalent to 0.3 percent of GDP) in spite of the tax measures implemented during the year; the drop in the tax burden is explained by the acceleration of inflation, the decline in industrial activity, and the fact that a number of elements of the tax base are related to changes in the consumer price index which rose less rapidly than the GDP deflator.

Revenues of the federal state enterprises at constant prices rose only slightly in 1983 despite more adequate pricing policies (Table 4). Current expenditures declined by 3 percent in real terms, with a decline in the wage bill of 19 percent offsetting increases in interest payments and (imported) raw materials. Capital expenditures were cut by almost 24 percent in real terms, as a number of large-scale projects reached completion and no new projects were initiated, and also because of the suspension or slowdown of other projects.

The Government imposed tight controls on the access of public sector entities to domestic and foreign borrowing. This was particularly effective in forcing some improvement in the operational deficit of state and municipalities which took steps to reduce wages, and curtail investment outlays. However, this improvement was more than offset by the increased expenditure related to the indexation of the debt. The other institutions in the public sector strengthened their position as some weakening in the finances of the social security system was more than offset by transfers to funds and programs of additional earnings obtained by the Bank of Brazil as a result of the reduction in credit subsidies.

Table 2. Brazil: Public Sector Adjustment Effort 1/

(As percent of GDP)

	1982	Prog. 2/ 1983	Prel. 1983	Proj. 1984
Total financing	15.8	18.6	17.7	12.4
Operational	6.6	2.7	2.6	-0.3
Monetary correction	9.2	15.9	15.1	12.7
Central Administration	5.4	3.5	4.1	2.6
Operational	2.0	-0.9	-0.2	-0.8
Revenues	(9.1)	(8.4)	(8.8)	(8.8)
Expenditures	(11.1)	(7.5)	(8.6)	(8.0)
Direct 3/	/7.8/	/6.5/	/6.7/	/7.1/
Indirect	/3.3/	/1.0/	/1.9/	/0.9/
Monetary correction	3.4	4.4	4.3	3.4
States and municipalities	4.0	5.2	5.3	3.8
Operational	1.3	0.7	0.8	-0.1
Monetary correction	2.7	4.5	4.5	3.9
State enterprises	6.8	10.0	8.8	6.6
Operational	3.5	3.0	2.5	1.3
SEST enterprises 4/	(2.9)	(2.4)	(1.6)	(1.1)
Revenues	/14.1/	/13.5/	/14.5/	/15.4/
Treasury transfers	/2.9/	/2.0/	/2.3/	/1.9/
Expenditures	/19.9/	/17.9/	/18.4/	/18.4/
State public enterprises 5/	(0.6)	(0.6)	(0.9)	(0.2)
Monetary correction	3.3	7.0	6.3	5.3
Other institutions	-0.4	-0.1	-0.5	-0.6
Operational	-0.2	-0.1	-0.5	-0.7
Monetary correction	-0.2	--	--	0.1

Sources: Central Bank of Brazil; Secretary of Control of the State Enterprises; Secretary of the Budget and Finance; and Fund staff estimates.

1/ A negative sign means a surplus.
2/ As specified in EBS/83/227, Supplement 2 (11/17/83).
3/ Includes transfers to rest of nonfinancial public sector.
4/ Enterprises under the control of the Federal Government.
5/ Enterprises under the control of the states or municipal governments.

Table 3. Brazil: Central Administration Accounts

(In billions of cruzeiros; and in percent)

	1982	Real Rate of Change	Prel. 1983	Real Rate of Change	Proj. 1984	Real Rate of Change
Revenues 1/	4,811	4.7	11,700	-4.4	32,555	-0.5
Expenditures 2/	4,131	0.9	9,004	-14.4	26,255	4.3
Wages and salaries	1,017	10.0 3/	2,239	-13.5	5,237	-16.3
Transfers	2,353	17.3	5,135	-14.2	16,669	16.1
SEST state enterprises	(1,302)	(28.4)	(2,608)	(-21.3)	(6,865)	(-5.9)
States and municipalities	(867)	(10.7)	(1,929)	(-12.6)	(5,982)	(10.9)
Social Security System (SINPAS)	(57)	(...)	(232)	(59.9)	(752)	(15.9)
National Petroleum Council (CNP)	(--)	(--)	(--)	(--)	(1,150)4/	(...)
Other 5/	(127)	(...)	(366)	(13.2)	(1,920)	(87.6)
Contingency reserve	--	--	--	--	800	...
Other expenditures 6/	761	-34.6 3/	1,630	-15.8	3,549	-22.1
Transfers to Monetary Authorities	680	35.9	2,696	55.8	6,300	-16.4
Memorandum item						
Monetary correction on public federal debt	1,751	57.2	5,743	28.9	9,600/12,500	-32.0/-22.0

Sources: Secretary of the Budget and Finance; and Fund staff estimates.

1/ Includes borrowed resources, which amount to Cr$47 billion in 1982, Cr$190 billion in 1983, and Cr$815 billion in 1984.
2/ Excluding monetary correction.
3/ Starting in 1982, stipends of employees under contract included under "Other expenditures" have been gradually incorporated in "Wages and salaries".
4/ Part of resources from IOF surcharge on petroleum imports directed to the equalization of petroleum prices across states (previously not included in budget).
5/ Includes transfers to other levels of the public sector for payments of debt service (certain amortization payments by entities belonging to the Central Administration are also included here).
6/ Includes FINSOCIAL starting in 1983.

Table 4. Brazil: Federal Public Enterprises' (SEST) Accounts

(In billions of cruzeiros; and in percent)

	1982	Real Rate of Change	Prel. 1983	Real Rate of Change	Proj. 1984	Real Rate of Change
Revenues	7,495	-5.3	19,410	1.8	57,135	5.3
Operating	6,325	-5.5	15,875	-1.4	51,607	16.3
Other	1,171	-4.0	3,535	18.7	5,523	-44.1
Current expenditures 1/	7,239	0.4	17,871	-3.0	54,258	8.6
Wages	1,590	0.5	3,293	-18.6	8,283	-10.0
Interest	1,088	42.4	2,963	7.0	9,273	11.9
External debt	(795)	(47.4)	(2,255)	(11.5)	(6,067)	(-3.8)
Internal debt	(303)	(35.5)	(708)	(-8.2)	(3,206)	(19.2)
Other	4,561	-6.2	11,615	0.1	36,702	13.0
Operating surplus	257	-63.6	1,539	136.2	2,877	-33.1
Transfers from Central Administration	1,541	-4.6	3,091	-21.2	7,019	-18.8
Capital expenditures	3,295	-6.6	6,410	-23.6	14,111	-21.3
Investment	2,698	-2.5	5,388	-21.5	11,816	-21.6
Other	597	-21.7	1,022	-32.7	2,295	-19.7
Other expenditures	69	...	347	...	20	--
Other revenues	-108	...	-911	...	...	...
Other expenditures 2/	108	...	1,258	...	20	...
Floating debt 3/	69	...	--	...	--	...
Operational deficit	-1,566	40.4	-2,127	-46.6	-4,235	-26.6
Financing	-1,566	40.4	2,127	-46.6	4,235	-26.6
Foreign (net)	938	40.0	2,750 4/	15.2	3,055	-60.3
Domestic (net)	628	16.9	-623	...	(1,180)	...
Banking system	(559)	(41.0)	(-560)	(...)	(1,330)	(...)
Floating debt	(69)	(...)	(-63)	(...)	(-150)	(...)
Memorandum item						
Monetary and exchange correction on public enterprises' domestic debt 5/	1,775	30.9	8,635	91.2	15,025/19,535	-30.0/-19.0

Sources: Secretary of Control of the State Enterprises; and Fund staff estimates.

1/ Excluding monetary correction.
2/ Authorized by the National Monetary Council for the Institute of Sugar and Alcohol (IAA).
3/ Expenditures, current or capital, financed with floating debt.
4/ Authorized foreign borrowing, most of which did not take place as foreign creditors preferred to lend directly to the Central Bank, which in turn transferred these resources to the public or private sector.
5/ Includes all public enterprises, as data availability precludes the separation of the correction corresponding to enterprises under the control of states and municipalities.

The establishment, in August 1983, of an Interministerial Committee for monitoring the Implementation of Public Budgets (COMOR) was instrumental in the achievement of the public sector targets. COMOR acts in an advisory capacity at the ministerial level and coordinates policies at the different levels of the public sector, including the state enterprises and state and municipal governments. As such, COMOR has proved to be effective in providing the required coherence and discipline to budgetary decision making.

5. Monetary developments

Beginning in June 1983 the Brazilian authorities moved to correct some of the major deficiencies in the area of monetary policy. Foremost among the measures adopted was the substantial reduction in interest rate subsidies to certain sectors, principally in agriculture, but also in export activities and small- and medium-size enterprises. Initially, the major change brought by the new measures in the agricultural area was the move to interest rates expressed in relation to inflation instead of the previous system of fixed rates. The interest rate for the relevant agricultural credits was increased from a fixed 65 percent per annum to 85 percent of monetary correction plus 3 percentage points. The rate of interest on export financing was increased from 40 percent a year to 60 percent. In December 1983 the process of eliminating credit subsidies was accelerated as credits to export activities and to small enterprises were made subject to the same conditions as agricultural credit, and all rates were raised to 100 percent of monetary correction plus 3 percentage points.1/

Prior to these reforms, credit was channeled to priority sectors through the application of portfolio requirements on banks, which resulted in increased rates of interest on loans to other sectors of the economy (Chart 1). Moreover, as the bulk of subsidized credit operations were carried out by the Bank of Brazil, the reduction of subsidies gave rise to additional earnings in the Bank of Brazil which are being transferred to the monetary budget to help finance the nonfinancial public sector.

The conduct of monetary policy in 1983 was seriously hampered by the departures from the program in the fiscal field and by the increase in inflationary expectations. The persistent inflation affecting Brazil has led to a continuous decline in the demand for money as the liquidity requirements of the economy have come to be met increasingly by the expansion of quasi-money that is indexed to inflation, particularly savings and time deposits, and government titles which have become increasingly liquid (Chart 2). The acceleration of inflation in 1983 resulted in a further and unexpected intensification of this process.

1/ Special rates apply in certain less developed regions (principally the Northeast), where indexing at 70 percent and 80 percent of inflation during the first and second semester of 1984, respectively, and 85 percent from 1985 on, will be in effect.

During 1983 currency and demand deposits (M-1) deflated by the general price index dropped by almost 40 percent, following a decline of similar magnitude from 1979 to 1982. The increase in the velocity of circulation of money has also been reflected in the reduction of the monetary base from 5.5 percent of GDP in 1979 to 3.2 percent in 1982 and 2.4 percent at the end of 1983 (Table 5). The shrinkage of the monetary base, which is expected to continue in 1984, is of particular relevance when seen against the size of the public sector budgets or the balance of payments aggregates; the disparity is such that deviations in the public sector or external accounts which otherwise could be considered minor, become major disturbances when it comes to the management of the monetary base toward a given target.

The monetary base expanded by 89 percent in 1983. The original program established a limit of 70 percent but, as a consequence of the slippages in the earlier part of the year, the authorities in May raised this figure to 90 percent. This limit was maintained for the rest of the year in spite of the acceleration in inflation and in M-1 velocity. The program's ceilings on the net domestic assets of the monetary authorities were established on the basis of this intended expansion of the monetary base and the target for the balance of payments. These ceilings, which were defined as the difference between liabilities to the private sector and net international reserves of the monetary authorities, underwent a number of technical modifications (described in EBS/83/227 (10/19/83)) as regards their precise definition in the course of the year, but they continued to be consistent with the policy intentions relating to the expansion of the monetary base mentioned above.1/ As described in EBS/84/39 (3/2/84), the limit on the net domestic assets for December 31, 1983 would have been observed once account is taken of the difference between the actual disbursement of foreign loans and the amount originally projected.

The apparent ineffectiveness of monetary controls in checking inflation during 1983 owes much to the unexpected decline in demand for M-1, but it also was affected by the lack of steadiness of monetary policy. Through extended periods of the year, money supply grew at rates higher than those consistent with the program; subsequently, controls were tightened and the overall growth of monetary aggregates was brought back in line. For that purpose, the authorities increased legal reserve requirements and tightened their administration; also, rediscount rates were raised. However, the management of the public sector debt in the open and overnight markets repeatedly gave rise to deviations from the stance intended for monetary policy, reflecting in part differing views as regards to credit and interest rate policy. In the latter part of the year the authorities stated their intention to pursue policies which would ensure positive real rates of interest; accordingly, it was decided to raise the monetary correction factor used to adjust the value of financial assets and obligations at least to the rate of inflation, and to set the rates in the overnight market at or above the rate of inflation.

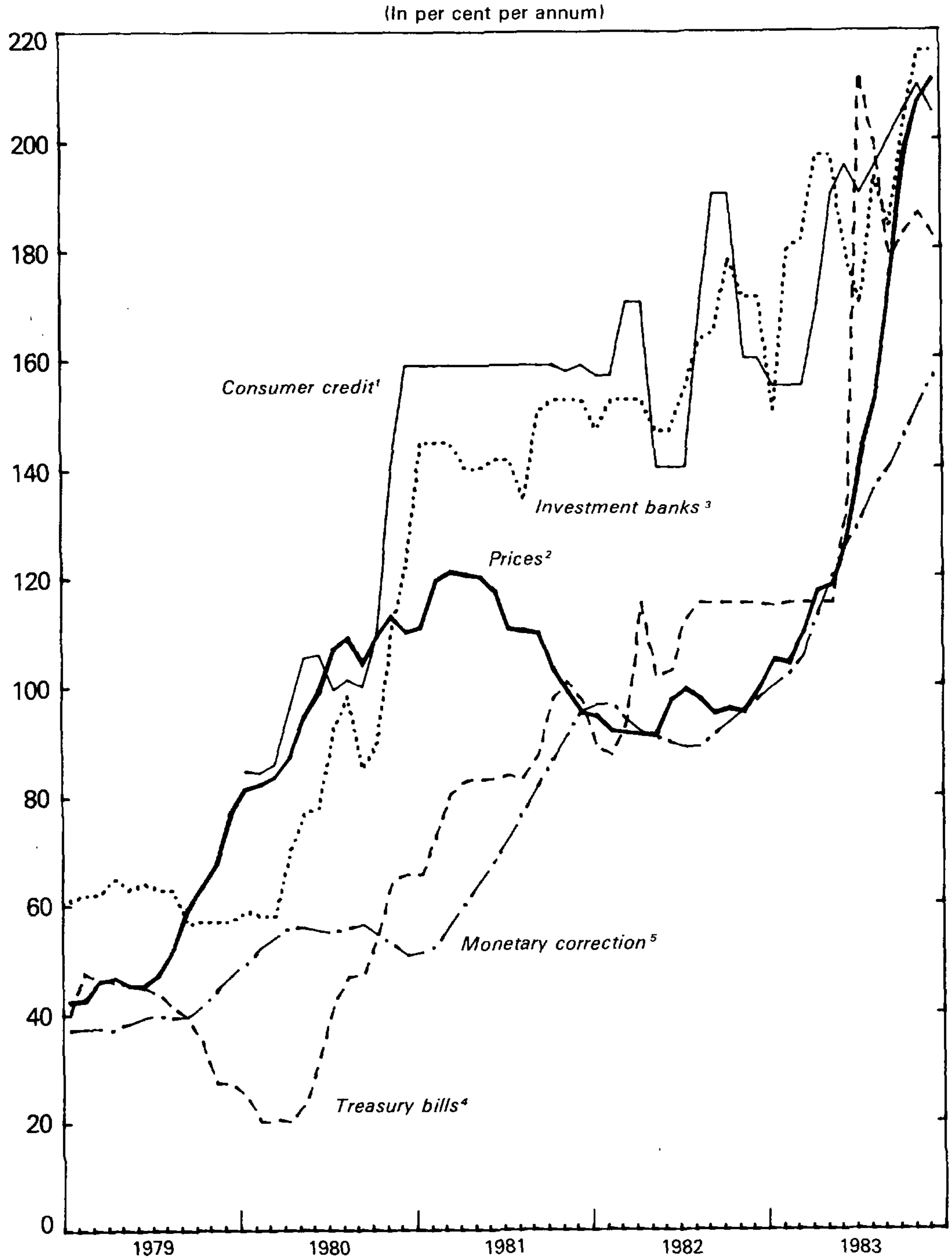
1/ Appendix VI, describes the definition of the net domestic assets ceiling during 1983.

CHART 1

BRAZIL

INTEREST RATES

(In per cent per annum)

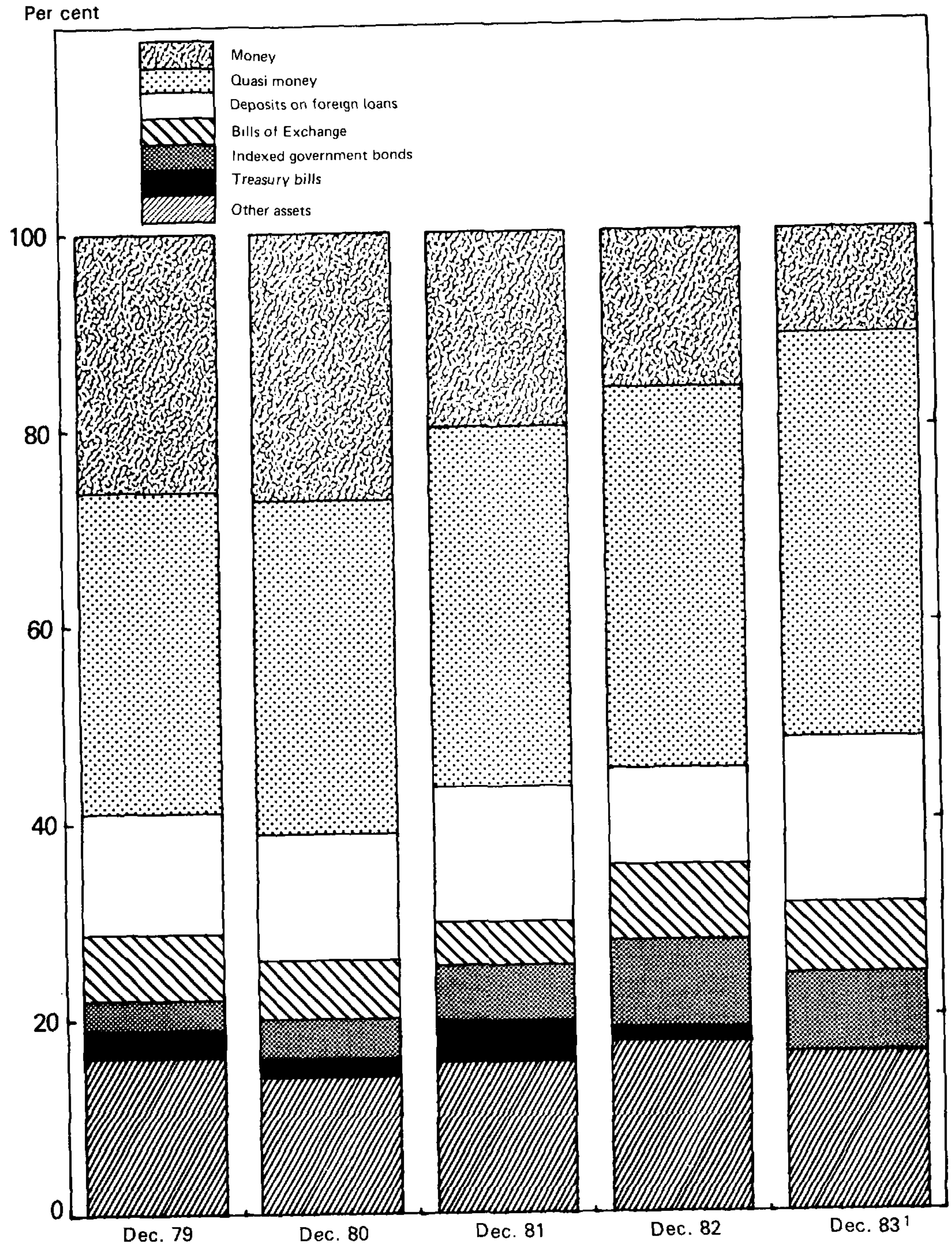


Sources: Central Bank of Brazil; and Fund staff estimates.
[1]Finance companies.
[2]General price index - domestic supply.
[3]Prime rate charged by investment banks.
[4]Rate of return on 91 day Treasury bills in the primary market.
[5]Twelve month period.

CHART 2

BRAZIL

PORTFOLIO COMPOSITION OF PRIVATE SECTOR HOLDINGS OF FINANCIAL ASSETS



Sources: Central Bank of Brazil; and Fund staff estimates.
[1]Estimate.

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Table 5. Brazil: Selected Monetary Aggregates

	1979	1980	1981	1982	1983	Proj. 1984
(In billions of cruzeiros; end of period)						
Base money	446	700	1,188	2,219	4,197	6,296
Money (M-1)	723	1,240	2,079	3,700	6,957	10,435
Private sector holdings of financial assets 1/	2,758	4,576	10,569	23,233	64,955	138,200
(In percent of GDP; period average)						
Base money	5.5	4.4	3.5	3.2	2.4	1.4
Money (M-1)	8.5	7.5	6.2	5.4	4.0	2.3
Private sector holdings of financial assets	35.2	28.0	28.2	31.8	33.0	27.3
Memorandum items						
Velocity of circulation of M-1 2/	11.7	13.4	16.2	18.4	25.1	42.7
GDP (billions of cruzeiros)						

Sources: Central Bank of Brazil; and Fund staff estimates.

1/ Currency, demand deposits, time and savings deposits, exchange bills, Treasury bills and bonds, and state and municipal bonds.
2/ GDP divided by the average stock of M-1.

6. External policies

Brazil met with considerable success in achieving the external objectives of the program for 1983. The trade surplus amounted to US$6.5 billion, with exports of US$21.9 billion and imports of US$15.4 billion (the revised program had projected US$22.3 billion and US$16.0 billion, respectively). The current account deficit was US$6.2 billion, a decline of US$8.6 billion with respect to 1982 and US$1.5 billion less than the target projected for 1983 in the revised program (Chart 3). In addition to the better than anticipated trade results, the strong performance in the current account resulted from lower than projected payments abroad on account of interest, leasing operations by the state oil company and administrative expenses of Brazilian banks abroad. The strong trade performance of 1983 has continued in 1984; the trade surplus in the first quarter of 1984 amounted to US$2.4 billion, with exports in this quarter being 21 percent higher than in the corresponding period of 1983, and imports 16 percent lower.

Notwithstanding the progress made in reducing the current account deficit, Brazil's foreign exchange situation remained very difficult throughout 1983 as net capital inflows fell short of the amount projected. The shortfall was particularly large as regards direct foreign investment and short-term financing provided by international banks. The precarious foreign exchange situation led to an intensification of exchange restrictions and the emergence of external payments arrears. Beginning in the third quarter of 1983, new arrangements with official and private creditors were sought in order to stabilize Brazil's external financial position and to secure the financing required to meet the program's balance of payments targets for 1983 and 1984. These arrangements took some time to complete and the overall balance of payments for 1983 showed a deficit of US$3.3 billion compared with the program's target of equilibrium. The failure to meet the balance of payments target can be related to the nondisbursement of US$3.5 billion in loans from foreign commercial banks which had been assumed to take place in the last quarter of 1983.1/

Effective February 21, 1983 Brazil depreciated its currency by 23 percent in terms of U.S. dollars per cruzeiro. To some extent this action represented an advance of the real depreciation of the cruzeiro that had been programmed to take place gradually during 1983. For the period March 1983 through January 15, 1984 the cruzeiro was devalued in line with the general price index, thus complying with the performance criterion in the program. As a result of this exchange rate policy during 1983 the cruzeiro depreciated by 289 percent in terms of cruzeiros per U.S. dollar, with the real value of the cruzeiro declining by 25 percent in relation to the U.S. dollar, and by about 21 percent in relation to a basket of currencies of the main trading partners.

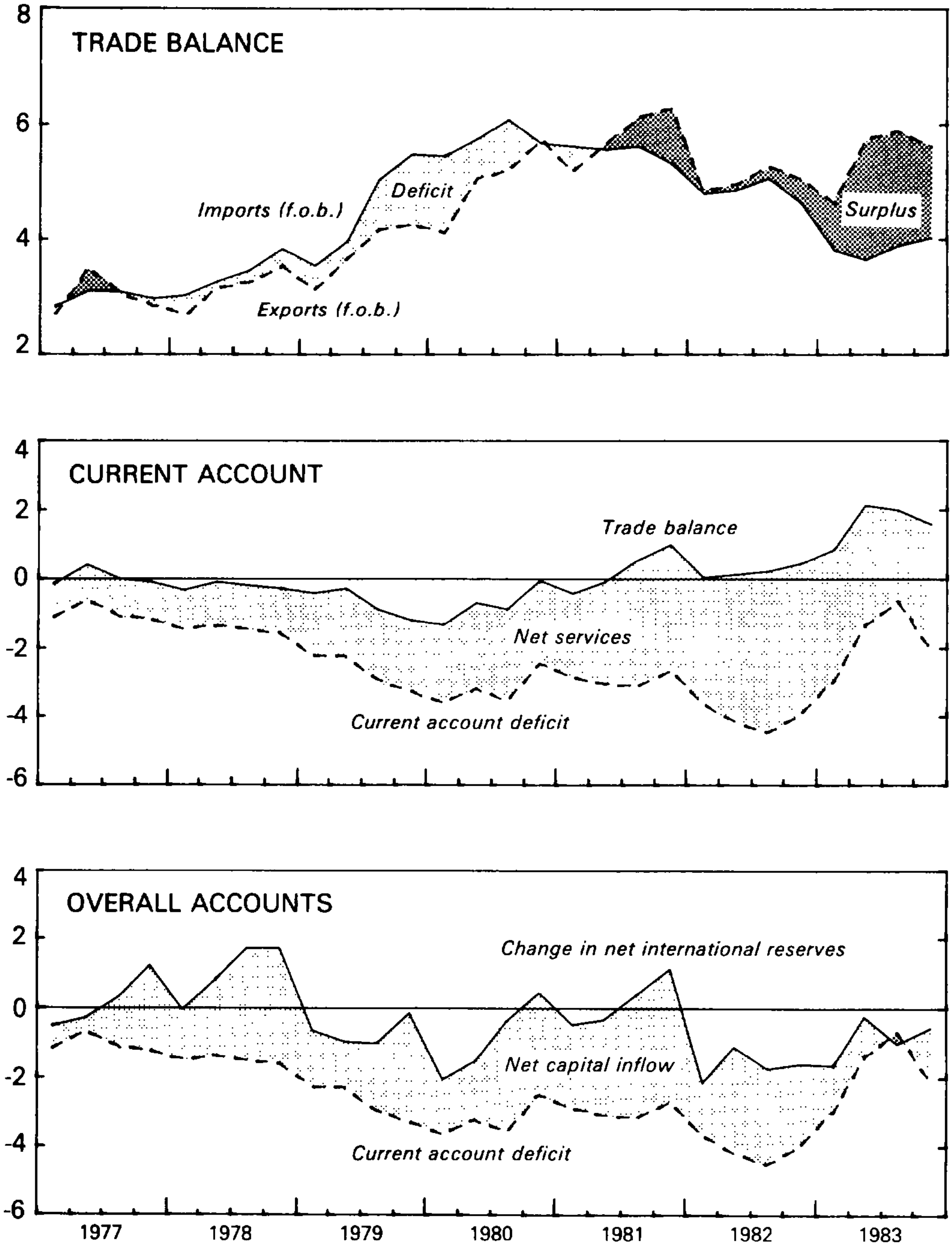
1/ A description of the consequences that this shortfall in bank disbursements had on a number of performance criteria of the program was provided in EBS/84/39 (3/2/84).

CHART 3

BRAZIL

QUARTERLY BALANCE OF PAYMENTS

(In billions of U.S. dollars)



Source: Central Bank of Brazil; and Fund staff estimates.

7. Performance criteria in the 1983 program

During the first half of 1983, Brazil did not observe any of the quantitative performance criteria originally specified in EBS/83/33, Sup. 1 (2/24/83) with the exception of the ceiling on net disbursements of external debt (Table 6). The criteria for the quarters ending September and December were modified as described in EBS/83/227 (10/19/83) and EBS/83/227, Sup. 2 (11/17/83). These modified targets were met on both dates, with the exception of those pertaining to December 1983 that were affected by the changes in the pattern of disbursement of foreign loans that was referred to above.

Brazil complied with most of the performance clauses in the arrangement relating to the elimination of exchange restrictions and multiple currency practices by December 31, 1983, including the replacement of a number of exchange taxes on receipts from exports by taxes based on the physical movement of the exports, the replacement of a tax on remittances of profits and dividends by a tax on all distributions of profits and dividends to nonresidents, and the elimination of those features of remaining bilateral payments arrangements that were subject to approval under Article VIII. Apart from two measures which were tied to the disbursement of loans from commercial banks,1/ the only understanding in the area of exchange restrictions that remained to be acted upon by end-1983 related to the multiple currency practice arising from the contribution quota on coffee exports. Executive Directors considered the circumstances relating to the nonobservance of these understandings at the time of the discussion of Brazil's request for waiver and modification of performance criteria (EBS/84/39, 3/2/84).

III. The Program for 1984

1. Strategy and objectives

The performance during the first year of the program, although flawed in many respects, provided a realistic basis for the implementation of effective policies in 1984. The substantive progress made on the external front during 1983, together with the external financing arrangements already in place, should allow for further gains without the uncertainties and foreign exchange difficulties that were present the first year of the program. Domestically, major changes aimed at strengthening the role of relative prices were successfully put in place in 1983; the withdrawal of subsidies to agricultural credit and the elimination of other credit subsidies restored to a large degree the ability of the monetary authorities to conduct monetary policy through measures affecting the pricing of financial resources instead of quantitative restrictions. Similarly, the actions with respect to

1/ The elimination of the exchange restriction evidenced by the centralized system of foreign exchange allocation and the elimination of external payments arrears which at end-1983 totaled US$2.3 billion.

Table 6. Brazil: Extended Arrangement, Quantitative Performance Criteria for the Period through December 1983

	1982	1983							
		Jan.-Mar. 1/		Apr.-June 1/		July-Sept. 2/		Oct.-Dec. 2/	
	Actual	Ceiling 3/	Actual	Ceiling 3/	Actual	Ceiling 3/	Actual	Ceiling 3/	Prel. Actual
			(In billions of cruzeiros)						
Borrowing requirement of nonfinancial public sector 4/	8,385	2,800	3,575	5,000	8,334	14,900	13,461	24,600	23,679
Operational deficit of the public sector 4/	3,531	n.a.	815	n.a.	1,458	n.a.	1,417	3,600	3,413
Net domestic assets of the monetary authorities	5,057	6,150	7,415	6,950	9,895	5,600	5,379	3,540	6,100
			(In millions of U.S. dollars)						
Change in net international reserves of the monetary authorities 4/	-8,956	-1,500	-1,626	-1,500	-1,835	-3,100	-2,817	--	-3,330
Net disbursement of medium- and long-term, and selected short-term, external debt of the public and private sectors 4/	...	3,000	1,327	4,500	2,519	5,500	2,663	9,000	3,489
External payments arrears 5/	--	--	1,269	--	1,425	n.a.	2,783	--	2,300

Source: Fund staff estimates.

1/ As specified in EBS/83/33, Sup. 1 (2/24/83).
2/ As specified in EBS/83/227, Sup. 2 (11/17/83).
3/ Floor in case of net international reserves.
4/ Cumulative change in each calendar year.
5/ Limit tested at the end of 1983.

subsidies for petroleum products and wheat removed a major obstacle in the way of both fiscal and monetary policies. The wage legislation produced a wage system that provides a measure of flexibility that should, in combination with other policies, be helpful in the effort to slow inflation and mitigate the effects of demand restraint on employment. Moreover, even in the areas of shortcomings as regards policy implementation during 1983, viz., fiscal and monetary policies, there has been a gradual tightening of these policies and correction of major deficiencies, and thus the second year of the program opens with a more solid and coherent set of instruments in these areas.

Inflation has continued at a very high rate, and breaking its momentum has become one of the central policy objectives of the authorities since the persistency of high inflation rates is preventing the recovery of economic activity and is eroding confidence in the program. There are a number of factors pointing to a deceleration of inflation; unlike the previous year, 1984 should be free from major cost-push pressures as there are indications of a good agricultural crop and there is no need to repeat the large changes in the structure of relative prices brought about in 1983 by the devaluation and elimination of subsidies; the improved external situation should permit an increase in non-oil imports, which are projected to grow by 22 percent; and more importantly, the continuous application of tight financial policies should succeed in producing the break in inflation. At the same time, it has to be recognized that these factors will have to contend with the high degree of indexing in the economy and with stubbornly high inflationary expectations. Thus, it continues to be very difficult to forecast the rate of inflation in 1984 and even less the path it will take in the course of the year. As just noted, the present stance of fiscal and monetary policies can be expected to produce a major reduction in the rate of inflation. With inflation during the first quarter continuing at the high rates registered during the second half of 1983, it now seems likely that inflation in the year ending December 1984 will be higher than assumed in November 1983. However, a reduction in inflation should appear soon and a rate of 100-130 percent during 1984 is possible. The authorities have expressed their readiness to reassess the overall stance of their policies, and to seek a further tightening, in case the expected decline in inflation does not materialize.

The broad outline of the program for 1984 was specified during the discussions with the authorities in November 1983. The understandings reached at that time called for limiting the expansion of the money supply (M-1) and the monetary base to 50 percent during 1984, and for a reduction in the public sector's borrowing requirement to about 9-11 percent of GDP (consistent with the then expected rate of inflation of some 75-100 percent in the year ending December 1984). The operational budget was to move into a surplus equivalent to 0.3 percent of GDP in 1984. In the external area, on the basis of a trade surplus of US$9 billion, the current account deficit was expected to be reduced to US$6 billion.

The financial program that has been adopted assumes no change in real GDP during 1984. It is expected that the recessionary conditions of 1983 will continue during the first part of 1984 but that subsequently, and depending on the speed at which inflationary pressures abate, there will be a recovery in economic activity. Monetary and fiscal policies will continue to be geared to the observance of the understandings mentioned above, namely the limitation of the expansion of the monetary base to 50 percent and the achievement of a surplus equivalent to 0.3 percent of GDP in the operational budget in 1984. With inflation in 1984 now assumed to be higher than had been expected in November, the public sector borrowing requirement is projected to amount to between 11 and 13 percent of GDP depending on the rate of inflation.

In view of the better than expected result in the current account of the balance of payments in 1983, the program envisages now that the deficit in 1984 will be reduced to about US$5 billion. This further reduction provides a safety margin that should help to cover unexpected capital movements and to ensure the achievement of the objective of an increase in net international reserves of US$1 billion for 1983 and 1984 taken together.

2. Fiscal policy

The reduction in the imbalance in the public sector continues to be the key factor in the adjustment process. The program for 1984 contemplates a cutback in the public sector borrowing requirement equivalent to some 5 to 7 percentage points of GDP (see Table 2). This reduction will be mainly the result of a further improvement in the operational budget of the public sector, equivalent to about 3 percentage points of GDP, which would follow an adjustment of 4 percentage points of GDP in 1983. The operational position of the public sector is to turn from a deficit of Cr$3,400 billion to a surplus of Cr$950 billion.

The achievement of the fiscal objectives for 1984 is based on an improvement in the financial performance of state enterprises, further reductions in subsidies, continued control over expenditures, and the strengthening of tax collections.

Additional measures to increase overall public sector revenues in the equivalent of almost 2 percent of GDP at an annual rate were taken in late 1983.1/ These include the resources obtained from the increase in interest rates on the previously subsidized credit of the monetary authorities, together with increases in some income tax rates, changes in the assessment value of indexed government bonds held by corporations, reductions in tax exemptions, the closing of major loopholes in the taxation of capital gains, dividends, and interest from financial operations, and the tightening of tax administration procedures. Also, the

1/ A more detailed description of some of these measures was provided in EBS/83/227, Sup. 2 (11/17/83).

value-added tax at the state level (ICM) was raised by 1 percentage point (to 17 percent) and was extended to cover imported raw materials and capital goods. Furthermore, the social security surcharge on gasoline sales was raised to 4 percent (from 1 percent) and extended to cover sales of alcohol for combustion purposes, and the collection period for employer's social security contributions was shortened.

In addition to the increased revenue to be provided by the above measures, the gross receipts of the federal public enterprises are expected to grow by about 1 percent of GDP as a result of higher production resulting from a number of investment projects coming on stream, the elimination of the subsidy on petroleum products, and the generally aggressive pricing policy that is being followed.

Outlays of the Central Administration, are projected to decline by about 1.5 percent of GDP, with direct expenditures increasing slightly despite a decline of some 16 percent in the real wage bill (see Table 3). Transfers to other levels of government are projected to increase by 16 percent in real terms, notwithstanding an additional cut of 6 percent in the transfers to federal public enterprises. This increase in transfers is largely the consequence of the substantial increase in earmarked revenue to be transferred to states and municipalities (as the result of a constitutional amendment approved by Congress in December), of transfers to the National Petroleum Council that previously were not part of the budget, and of the inclusion in the budget (under "other transfers") of provisions for payment of debt by other segments of the public sector (but which also include some entities belonging to the Central Administration).

Expenditures made by the monetary authorities on behalf of the Treasury (excluding monetary correction) are projected to decline by almost 1 percent of GDP on the strength of the elimination of subsidies for petroleum and wheat, and a reduction in the expenses associated with the commercialization of agricultural products. Transfers from the Treasury to the monetary authorities to cover for these expenditures are expected to decline by some 16 percent in real terms; however, there could be room to improve this performance as federal revenues appear to be somewhat underestimated and also in the light of a contingency reserve built into the budget equivalent to about 0.2 percent of GDP.

Expenditures by the federal public enterprises are projected to remain constant as a proportion of GDP.1/ The wage bill is projected to be cut by a further 10 percent in real terms as wage increases will be contained below the rate of inflation and certain benefits have been eliminated or reduced. However, current expenditures will still show an increase of close to 9 percent in real terms (see Table 4) because

1/ Excluding monetary correction. Available information does not permit the separation of the monetary correction paid on the debt of enterprises controlled by states and municipalities from the monetary correction charged on all public enterprises' debt.

of the growth of interest payments and other current expenditures. The increase in the latter mirrors the expected higher level of activity and the start of operations in some projects recently completed. In contrast, capital expenditures are projected to decrease in real terms by a further 21 percent, with cuts affecting mainly investment in the steel sector (-70 percent), in ports (-42 percent), in roads (-39 percent), and in electricity (-28 percent).

The finances of the states and municipalities will be strengthened substantially through the increase in their participation in Federal Treasury revenues and the increase in the ICM tax. As a result, it is projected that their borrowing needs will decline to some 3.8 percent of GDP, about 1 1/2 percentage points less than in 1983, and they are expected to register an operational surplus equivalent to 0.1 percent of GDP in 1984, compared with a deficit of 0.8 percent in 1983. Control of their access to credit will continue to be tight, with the states and municipalities and their enterprises allowed to finance only up to 70 percent of the service (principal and interest) on domestic debt and 100 percent on foreign debt.1/

As regards other public sector institutions, the estimates indicate that their overall surplus will increase slightly (to 0.6 percent of GDP) in 1984. Measures have been implemented which should improve the financial position of the social security system by the equivalent of 1/2 percentage point of GDP and additional measures amounting to about 0.3 percent of GDP are under consideration. On the basis of these actions, the accounts of the social security system should be balanced in 1984.

Even though the measures that should result in a small operational surplus for the overall public sector are in place, there are several areas of concern which the authorities need to monitor closely. These include the monetary budget, in particular, the expenses related to the commercialization of wheat, sugar, and other agricultural products, and the costs of servicing the public debt in the light of rising real rates of interest; the use of credit by states and municipalities; the finances of the social security system; and the mounting pressures on the National Housing System to increase expenditures for infrastructure and low-income housing.

3. Monetary policy

The monetary budget for 1984 prepared by the authorities is consistent with the aim of limiting the expansion of the monetary base to 50 percent during the year ending December 1984. The budget contains detailed monthly projections of the assets and nonmonetary liabilities of the monetary authorities. On the asset side, in addition to the

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1/ In early March 1984, the allowed limit on financing of service payments on foreign debt by states and municipalities and their enterprises was reduced to 70 percent.

effects of the elimination of subsidies to petroleum and wheat, the budget contemplates substantial reductions in credit operations in real terms, particularly in operations of the Bank of Brazil, and credits supported by rediscounts from the Central Bank; in large measure these reductions will affect credits to agriculture and to manufacturing for export. The limitation of these credits is required in order to accommodate mainly the expected increase in international reserves. The monetary budget includes among its resources, transfers from the Treasury which are projected to exceed Cr$6 trillion in 1984, equivalent to about 45 percent of the total projected expansion in the assets of the budget. These transfers finance expenses incurred by the monetary authorities on behalf of the Government (they are therefore also included in the program's definition of the public sector borrowing requirement). Notwithstanding these projected transfers, achievement of the target in regard to the monetary base will require a net placement of government securities in the market in the amount of about Cr$1.3 trillion. The projected expansion in the monetary base, together with the strict application of legal reserve requirements, is expected to limit the growth of M-1 to 50 percent during 1984. The monthly totals for the monetary base and money supply resulting from these projections have been specified in the program and are to be monitored closely.

The severe limitations on the growth of credit in real terms implicit in the monetary budget underscores the need to achieve, and if possible exceed, the transfer to the monetary budget from the Treasury projected in the public sector accounts. It also points to the importance of an active interest rate policy to raise the volume of financial savings and improve the efficiency of their allocation. It is the intention of the authorities to pursue policies which will ensure positive real rates of interest; to this end, the monetary correction factor that is used to adjust the value of financial assets and obligations will continue to be aligned to the rate of inflation. Furthermore, the authorities intend to gear open market operations fully to the observance of the targets of the monetary budget and to manage their intervention in the overnight market in such a way as to avoid providing permanent net financing through this market.

The reduction of subsidized credit and of the incidence of portfolio requirements on banks has resulted in a more efficient allocation of credit and has reduced the dispersion of interest rates. At present, and with the exception of some minor instances where negative real rates continue to exist (such as on agricultural credits to the Northeast), lending rates range from 3 percent a year in real terms in the case of credits to agriculture and export activities up to real rates of 30-40 percent for commerce and industry. The authorities intend to proceed with the liberalization of the credit market through further reductions in subsidies and in the incidence of portfolio requirements.

Quarterly limits have been placed on the expansion of the net domestic assets of the monetary authorities (the limits for the period through September 1984 are performance criteria under the extended arrangement). The projection of the liabilities to the private sector is consistent with the increase of 50 percent in the monetary base, while the projection of net international reserves 1/ is consistent with the balance of payments target of an increase in net reserves equivalent to US$1 billion over 1983 and 1984 taken together (Table 7). On the basis of these projections, credit from the monetary authorities to the public and private sectors is expected to grow by 51 percent which, depending on the outcome in respect of inflation, would imply a decline in real terms of 25 percent to 35 percent.

A projection of monetary and credit aggregates for the entire banking system is presented in Table 8. The projected rate of growth of the liabilities to the private sector during 1984 of a little more than 100 percent, largely reflects the indexation to inflation of time and savings deposits as the growth of currency and demand deposits is expected to be constrained to 50 percent. This targeted expansion of M-1, depending again on the inflation that actually will obtain in 1984, would imply a further increase in the velocity of circulation of M-1 in the range of 50 percent to 70 percent. For the banking system as a whole, credit to the private sector is expected to increase by 117 percent, which could imply a further decline in real terms that would add to the contraction by 17 percent in real terms experienced in 1983. Contrary to the previous year, however, the banking system's credit to the public sector in 1984 is also expected to decline in real terms.

Several initiatives directed at restructuring arrangements in the banking system are under study, with the aim of separating more strictly the respective functions of the Ministry of Finance, the Central Bank, and the Bank of Brazil. In particular, this reform proposes to allocate responsibility for management of the public debt to the Ministry of Finance, thereby establishing the Central Bank's open market operations solely as a tool of monetary control. In addition, it is intended to separate from the Central Bank those economic development activities and related programs that fall more under the sphere of competence of the Government or the Bank of Brazil. Pertinent legislation is to be sent to Congress during 1984, with the expectation of completing the banking reform by 1985.

1/ Expressed in cruzeiros at the rate of Cr$1,325 per U.S. dollar for March 31, 1984; Cr$1,655 per U.S. dollar for June 30, 1984; and Cr$1,960 per U.S. dollar for September 30, 1984.

Table 7. Brazil: Summary Accounts of the Monetary Authorities

(In billions of cruzeiros, and in percent; end of period)

	1982		1983		
	Value	Real Rate of Change	Value	Real Rate of Change	Prel. 1984 Value
Liabilities to private sector	1,734	-5.5	3,420	-36.6	5,490
Monetary liabilities	1,412	-7.8	2,671	-39.2	4,050
Quasi-money	202	9.7	507	-19.3	1,050
Other liabilities	120	-1.0	242	-35.2	390
Net international reserves	-864	...	-3,226	20	3,490
Net domestic assets	2,598	576	6,646	-17.8	2,000
Net claims on public sector	240	...	4,104	549.8	-175
Credit to private sector	3,392	-13.7	6,783	-35.7	16,428
Other net foreign assets	842	9.1	4,460	70.3	11,589
Medium- and long-term foreign liabilities	-1,163	-9.1	-10,299	184.7	-31,915
Deposits on foreign loans	-2,274	-22.2	-10,817	52.9	-21,606
Official capital and surplus	1,264	-26.1	9,366	-138.3	24,885
Other	297	...	3,049	230.1	2,794

Sources: Central Bank of Brazil; and Fund staff estimates.

Table 8. Brazil: Summary Accounts of the Banking System, End of Period

(In billions of cruzeiros, and in percent)

	1982		Prel. 1983		
	Value	Real Rate of Change	Value	Real Rate of Change	Proj. 1984 Value
Liabilities to private sector	16,058	9.6	42,031	-15.8	86,694
Monetary liabilities	3,700	-10.7	6,956	-39.5	10,478
Quasi-money	9,010	16.7	26,683	-4.8	61,277
Other liabilities 1/	3,348	19.0	8,392	-19.4	14,939
Net international reserves	-311	...	-874	-9.5	8,976
Net domestic assets	16,369	29.1	42,905	-15.7	77,718
Net claims on public sector	7,685	31.5	25,098	5.0	54,345
Net social security funds	-5,698	12.4	-16,341	-7.8	-37,500
Credit to private sector	21,074	3.1	55,331	-15.6	119,938
Official capital and surplus	-1,347	-25.3	2,270	...	9,964
Medium- and long-term foreign liabilities	-5,822	9.1	-28,797	59.0	-77,700
Deposits on foreign loans	-2,274	-21.8	-10,818	52.9	-21,606
Other	2,751	70.3	16,162	88.9	30,277

Sources: Central Bank of Brazil; and Fund staff estimates.

1/ Import and "other" deposits, bonds, private capital and surplus.

4. Price and incomes policies

The Brazilian representatives explained that the bulk of the adjustments in the administered prices had been effected during 1983. The process of elimination of price subsidies to consumers is to be completed by June 1984 with the termination of the subsidy implicit in the price of wheat and wheat products. Wheat prices were increased by 50 percent in February 1984, and similar increases are slated for April and June 1984. The prices of petroleum and related products are being adjusted periodically in line with the exchange rate so as to prevent the emergence of a subsidy. The authorities have undertaken in connection with programs with the World Bank that the prices of steel and electricity will be adjusted during 1984 so as to yield an increase 5 percent above the rate of inflation as measured by the industrial wholesale price index and the national consumer price index, respectively.

During 1983 the authorities implemented a system of surveillance over the prices of more than 300 manufactured products, whereby price increases in excess of 80 percent of past inflation required official approval. The authorities are of the view that this system had led firms to adjust every month their prices by the allowed margin without apparent regard to their particular cost or market conditions. In February 1984, the authorities decided to move to a system of outright control over the prices of a slightly more reduced number of products. Producers were set free to determine the prices for a number of industrial products, but controls were tightened for those lines where oligopolistic conditions are felt to prevail. Firms in this latter category are required to present full justification for any intended price increase. The authorities have indicated their awareness of the adverse effects of price controls on the efficiency of the Brazilian economy, and they have stated their intention to proceed to a relaxation of these controls as the monthly rate of inflation begins to decline.

In the area of wage policy, the legislation adopted in late 1983 relating to the general adjustment formula, as well as the measures taken in respect of wages and fringe benefits in the state enterprises are now fully in effect, although it is still too early to assess the consequences of their operation. There are indications that even though the general adjustment formula specifies only minimum increases, wage settlements in the economy are being kept by and large to the prescribed levels.

5. External policies

a. Balance of payments projections

After the substantial adjustment in the external accounts in 1983 further progress, albeit at a slower pace, is contemplated in the program for 1984. The current account deficit is projected to be reduced by about US$1 billion in 1984, on the basis of an increase in the trade surplus that is expected to more than offset the projected increase in service payments that is envisaged.

Exports are projected to increase by 12 percent in value terms, from US$21.9 billion in 1983 to US$24.6 billion in 1984 (Table 9). This growth of exports is expected to reflect the improved competitiveness of the Brazilian economy, increased activity levels in industrial countries, and some recovery in Brazil's markets in the developing world. The increase in exports is expected to be about evenly distributed between primary products and manufactures. Primary products, in particular coffee and soybeans, are expected to benefit from higher prices in world markets. In the manufacturing sector there have been significant gains in competitiveness as their domestic prices (and hence most of their costs) rose by less than the general price index which determined the rate of currency depreciation. The Brazilian authorities stated that trading partners in industrial countries have taken a series of protectionist actions which are prejudicial to Brazilian exports, and which make more difficult Brazil's effort to adjust its economy.

The value of total imports in 1984 is projected to remain at US$15.5 billion, practically the same level as in 1983. However, as petroleum imports are projected to decline by US$1.5 billion as a consequence of increased domestic production and replacement by other energy sources, non-oil imports should be able to grow by 22 percent. The additional room created for the growth of imports by the private sector will allow a relaxation of quantitative restrictions and will contribute to the deceleration of inflation.

The deficit in the service and transfer account, which amounted to US$12.7 billion 1/ in 1983, is expected to increase to US$14.4 billion in 1984, mainly as a consequence of increased interest payments. These payments are projected to rise by about US$1 billion to US$11.3 billion, owing to the larger stock of debt and a small increase in the average interest rate. With over 80 percent of Brazil's external debt estimated to carry variable interest rates, the current account of the balance of payments is extremely sensitive to variations in international interest rates. The LIBOR assumed in the 1984 projection, 10 1/2 percent, is already one point higher than the one expected at the beginning of the program, and recent indications of a possible upward movement in interest rates are being viewed with concern by the Brazilian authorities. Net payments for other services are also projected to increase in 1984 as they recover from the low levels of 1983.

The current account deficit, expected to amount to US$5.3 billion, together with net capital inflows projected at US$9.6 billion, 2/ should result in an increase in net international reserves of US$4.3 billion in 1984, thereby meeting the program's target of an increase in net reserves of US$1 billion for 1983 and 1984 combined. Capital account

1/ Excluding reinvested profits.
2/ Including the delayed disbursement from 1983 of US$3.5 billion from foreign commercial banks.

Table 9. Brazil: Balance of Payments, 1980-85

(In billions of U.S. dollars)

	1980	1981	1982	Est. 1983	Proj. 1984	Proj. 1985
Trade balance	-2.8	1.2	0.8	6.5	9.1	10.5
Exports	20.1	23.3	20.2	21.9	24.6	27.7
Imports	22.9	-22.1	-19.4	-15.4	-15.5	-17.2
Oil	(-9.8)	(-11.0)	(-10.1)	(-8.2)	(-6.7)	(-6.8)
Other	(-13.1)	(-11.1)	(-9.3)	(-7.2)	(-8.8)	(-10.4)
Services and transfers	-9.6	-12.2	-15.6	-12.7	-14.4	-14.5
Interest (net)	-6.3	-9.2	-11.4	-9.6	-10.5	-10.1
Other	-3.3	-3.0	-4.2	-3.1	-3.8	-4.4
Current account 1/	-12.4	-11.0	-14.8	-6.2	-5.3	-4.0
(in percent of GDP)	(6.1)	(5.2)	(6.5)	(2.7)	(2.2)	(1.6)
Capital account	9.0	11.8	8.2	2.9	9.6	5.9
Direct investment (net)	1.1	1.6	1.0	0.7	0.7	0.7
Financial loans 2/	4.1	8.7	8.8	3.6	7.1	3.4
Disbursements	(8.6)	(14.0)	(13.8)4/	(10.5)	(12.2)	(...)
Amortizations	(-4.5)	(-5.3)	(-5.0)	(-6.9)5/	(-5.1)	(...)
Other long term (net)2/3/	0.6	1.2	0.2	0.8 6/	3.5 7/	2.5
Brazilian lending abroad (net)	0.4	-0.9	-0.6	0.1	-0.6	-0.7
Short-term and errors and omissions (net)	2.8	1.2	-1.2	-2.3	-1.0	--
Overall balance	-3.4	0.8	-6.6	-3.3	4.3	2.0
Change in net international reserves (increase -)	3.4	-0.8	6.6	3.3	-4.3	-2.0
Assets 8/	3.2	-0.9	4.3	--	-3.8	-3.6
Liabilities	0.2	0.1	2.3	3.3	-0.5	1.6
IMF	(--)	(--)	(0.6)	(2.2)	(1.8)	(1.6)
Other	(0.2)	(0.1)	(1.7)	(1.1)	(-2.3)	(--)

Sources: Central Bank of Brazil; and Fund staff estimates.

1/ Excludes reinvested earnings.
2/ Includes refinanced amounts as amortization matched by new disbursements.
3/ Includes amounts refinanced by the Paris Club as disbursements.
4/ Includes US$2,339 million bridge loan.
5/ Includes repayment of US$2,339 million bridge loan.
6/ Includes US$714 million of Paris Club refinancing.
7/ Includes US$1,286 million of Paris Club refinancing.
8/ Adjusted for valuation changes and gold monetization.

projections involve various elements of uncertainty. Direct investment, projected at US$700 million, will be only marginally higher than in 1983. The net inflow of long-term loans is projected at US$10 1/2 billion, reflecting the financial arrangements completed in late 1983 with official and international banking creditors. As regards this latter amount, continuous efforts will need to be made to ensure full disbursement of the credits made available by official export credit agencies and by multilateral lending agencies. Net Brazilian lending abroad is projected to increase to US$600 million in connection with the increased export effort this year. A final element of uncertainty is in the area of short-term capital movements; these are projected to register a net outflow of US$1 billion which compares with the outflow of US$1.8 billion registered in 1983.

b. Exchange and trade policies

In 1984 the authorities intend to maintain the policy of frequent but small depreciations of the currency in line with domestic inflation, thereby preserving the improved external competitiveness attained during the previous year. Continued pursuit of this policy should facilitate the elimination of the remaining multiple currency practices and exchange restrictions.

The elimination of a number of exchange restrictions and multiple currency practices in December 1983 (reported to Executive Directors in EBD/84/38, 2/7/84), together with the elimination of those evidenced by the centralized system of foreign exchange allocation 1/ and of external payments arrears effected in March 1984, has reduced the complexity of Brazil's trade and payments system. The authorities have announced to the public that the system of contribution quota on coffee exports will be modified as of January 2, 1985 so as to eliminate the multiple currency practice that is involved. The authorities also have stated their intention to restore before the end of 1984 allotments of exchange for foreign travel to at least the level prevailing before September 1983, and to eliminate the exchange restriction which arises pending the implementation of the recommendations of the Paris Club. There remain in effect a number of major restrictive practices which the authorities intend to eliminate during the rest of the program period. Principal among them are the system of import budgeting, and multiple currency practices arising from the imposition of the financial transactions tax (IOF) on the sale of foreign exchange, and from tax credits given to exporters of manufactured goods. The authorities intend to introduce during the period of the arrangement a trade system that would provide protection to domestic activity through tariffs rather than through quantitative exchange and trade restrictions. Technical work to this end has been initiated, and relevant legislation is expected to be submitted to Congress by mid-1984.

1/ Effected through Resolution 898, (3/14/84).

c. External debt policies

The broad parameters of the external debt policies in 1984 have been already determined by the arrangements concluded in the latter part of 1983 aimed at securing the financing required to meet the program's balance of payments targets. These involved the rescheduling through the Paris Club of principal and interest obligations on official and officially guaranteed debt due during 1984, and the arrangement of US$2.5 billion in new trade credits from official lenders. In addition, a new financing package from commercial banks contemplates the stabilization through formal procedures of their short-term exposure to Brazil, (in trade credits as well as in the interbank market), the refinancing of principal payments due on medium-term loans through 1984, and a new US$6.5 billion medium-term loan.

Brazil's medium- and long-term debt (public as well as private) increased from US$73.7 billion at the end of 1982 to US$78.1 billion at the end of 1983, and is expected to reach close to US$89 billion at the end of 1984 (Table 10). In terms of ratios to GDP, these figures amount to 32 percent, 34 percent, and 37 percent, respectively. However, adding short-term obligations and obligations to the IMF, the total debt is expected to reach US$100 billion at the end of 1984, or 42 percent of GDP. The adjustment realized in the current account of the balance of payments in 1983, and the further improvement projected for the coming years, greatly diminishes the need to rely on external borrowing in the future. In consequence, the rate of growth of total debt is expected to decline rapidly, and the ratios of debt to GDP or exports should decline accordingly.

The debt service ratio declined to 85 percent in 1983 as a result of the reduction in the average interest rate for that year. Under present assumptions for net new borrowing in the period 1984-89, and for the growth of exports over this period (see Section IV below), the debt service ratio (including rescheduled amounts) would decline to about 72 percent in 1984 and then would continue to fall steadily to levels of about 40 percent by the end of the decade. The ratio of total average debt to GDP also would fall from 40 percent projected for 1984 to about 30 percent in 1989.

6. Performance criteria of the program

In accordance with paragraph 4(b) of the extended arrangement as amended (EBS/83/227, Sup. 4, 11/23/83), on this occasion performance clauses are being specified for the calendar quarters ending June and September 1984 (Table 11). In some areas the authorities have already specified policy intentions that cover the whole second year of the program; however, the specification of performance clauses for the calendar quarter ending December 1984 will be undertaken in the review of the program scheduled for August 1984.

Table 10. Brazil: External Debt (end of period)

					Projected					
	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
					(In billions of U.S. dollars)					
Total debt	66.2	77.7	86.4	91.2	100.4	107.9	110.5	111.1	109.4	106.3
Financial loans	55.1	65.1	67.7	68.3	78.8	82.3	83.5	83.1	80.8	78.1
Net obligations to the IMF 1/	...	...	0.5	2.8	4.7	6.2	6.1	5.8	5.2	4.2
Other	11.1	12.6	18.2	20.1	16.9	19.4	20.9	22.2	23.4	24.0
Medium- and long-term debt	54.8	64.7	73.7	78.1	88.7	94.7	97.4	98.3	97.2	95.1
Financial loans	43.7	52.3	61.1	64.7	71.8	75.3	76.5	76.1	73.8	71.1
Other	11.1	12.4	12.6	13.4	16.9	19.4	20.9	22.2	23.4	24.0
Short-term debt	11.4	13.0	12.2	10.3	7.0	7.0	7.0	7.0	7.0	7.0
					(In percent of GDP)					
Memorandum items										
Average debt/GDP	30.8	33.7	35.8	38.4	39.9	40.6	39.0	36.2	33.0	29.5
Interest payments/GDP	3.7	4.8	5.5	4.5	4.7	4.5	3.7	3.3	2.7	2.4
					(In percent of exports of goods and services)					
Average debt	266.7	267.0	349.5	364.9	351.0	336.7	322.7	296.0	272.7	245.0
Debt service 2/	60.9	66.2	88.4	84.7	71.6	68.7	66.3	59.5	50.5	39.3
Interest payments (gross)	32.0	38.3	53.5	42.2	41.2	37.7	30.5	27.0	22.6	19.5
Amortization	28.8	27.9	34.9	42.5	30.4	31.0	35.8	32.5	27.9	19.8

Sources: Central Bank of Brazil; and Fund staff estimates.

1/ Converted at SDR 1=US$1.06.
2/ Including the IMF.

Table 11. Brazil: Extended Arrangement - Quantitative Performance Criteria for the Period Through September 1984

	Prel. Actual Dec. 1983	Targets and Limits for 1984 Jan.-Mar.	Apr.-June	July-Sept.
(In billions of cruzeiros)				
Borrowing requirement of the non-financial public sector 1/	23,679	11,750	23,750	35,500
Operational result of the public sector 1/	-3,413	-1,300	-300	-600
Net domestic assets of the monetary authorities	6,646	5,350	4,550	2,800
(In millions of U.S. dollars)				
Change in net international reserves of the monetary authorities 1/	-3,300	1,700	2,650	3,650
Net disbursement of medium-, long-, and selected short-term external debt of of the public and private sectors 1/	3,730	3,900	6,800	9,100

Sources: Technical Memorandum of Understanding; and Fund staff estimates.

1/ Cumulative change in the period.

The program contains the following performance criteria: (1) a set of quarterly targets for the change of the net international reserves position of the monetary authorities (paragraph 1 of the Technical Memorandum of Understanding attached to the letter of intent, EBS/84/61); (2) a set of cumulative quarterly ceilings on the borrowing requirement of the nonfinancial public sector (paragraph 2 of the Technical Memorandum); (3) a set of cumulative quarterly targets on the operational performance of the public sector (paragraph 3 of the Technical Memorandum); (4) a set of quarterly ceilings on the net domestic assets of the monetary authorities (paragraph 5 of the Technical Memorandum); (5) a set of cumulative quarterly ceilings on net disbursement of medium- and long-term external debt of both the public and private sectors, plus changes in the net position of certain types of short-term indebtedness (paragraph 7 of the Technical Memorandum); and (6) a set of cumulative quarterly minimum requirements in respect of the rate of depreciation of the cruzeiro with respect to the U.S. dollar (paragraph 8 of the Technical Memorandum).

The program also specifies monthly targets for the borrowing requirement of the Central Government, the state enterprises, and the state and municipal governments (paragraph 4 of the Technical Memorandum) and monthly targets for the money supply and the monetary base (paragraph 6 of the Technical Memorandum); deviations from these monthly targets will be subject to consultation with the Fund staff.

In addition, the general clause pertaining to the authorities' intentions in respect to multiple currency practices, restrictions on payments and transfers for current international transactions, bilateral payments agreements, and restrictions on imports for balance of payments reasons (paragraph 4(d) of the extended arrangement) remains in effect. Two further reviews of the program during 1984 are contemplated (paragraph 4(b) of the extended arrangement), including the specification of performance clauses for the calendar quarter ending December 1984 during the review to be held before August 31, 1984 (paragraph 23 of the letter of intent of March 15, 1984). Understandings with the Fund will have to be reached before February 27, 1985 on suitable performance clauses for the last year of the extended arrangement (paragraph 4(c) of the arrangement).

IV. Medium-Term Prospects

On the strength of the expected deceleration of inflation and the maintenance of external competitiveness, the Brazilian economy is projected to resume growth during the second part of the 1980s at a rate of about 4 percent per year. Concomitantly, Brazil's external position is forecast to improve considerably owing mainly to the rapid expansion of exports and the gradual reduction of interest payments abroad.

While modest when compared with the performance of the 1970s, a 4 percent real growth rate would allow an increase in per capita income of about 1.5 percent a year from 1985 onward, thereby reversing the declining trend that started in 1980. Investment is likely to remain at 15 percent of GDP in 1984 but would increase steadily to 22 percent of GDP by 1989, roughly the ratio to GDP attained in the mid-1970s. On the basis of the strengthening of the public finances and a policy of keeping real interest rates on financial assets positive, the gross domestic savings ratio is expected to increase from about 17 percent of GDP in 1983 to more than 25 percent of GDP by the end of the decade. The relative compression of consumption is expected to increase the surplus on the resource balance from nearly 2 percent of GDP in 1983 to about 4.5 percent in 1989.

The rate of inflation is projected to be roughly halved during 1984 and again during 1985. From about 50 percent in 1985, the inflation rate is expected to fall further to about 20 percent in 1988-89, about the same rate Brazil had in the period 1969-73.

The projections for the external sector are based on the medium-term assumptions of the World Economic Outlook (WEO). Thus, oil prices are expected to increase only moderately during the remainder of the 1980s while interest rates are assumed to decline from 10 percent in 1984-85 to 8 percent in 1986-87 and 7 percent in 1988. During the 1984-89 period, exports are expected to increase on average by 10 1/2 percent a year, on the basis of WEO assumptions for the relevant prices and demand in industrial countries, but with growth of 1 percentage point a year higher in the case of primary products and 2.5 percentage points a year higher in the case of manufactures. With increased production of crude oil and the further development of substitutes, oil imports are expected to decline by some 18 percent in value terms in 1984 and to remain roughly unchanged at about US$7 billion for the remainder of the decade. Non-oil imports, which amounted to about 3 percent of GDP in 1983, are expected to return to their 1982 level of about 4 percent in 1985 and subsequently to increase by 1/10 of 1 percentage point of GDP a year to around 4 1/2 percent of GDP in 1989. Thus, from 1983 to 1989 non-oil imports are expected to grow at a compound rate of 14.5 percent a year. The trade balance is expected to improve from US$6.5 billion in 1983 to US$9.1 billion in 1984, and to US$16.6 billion in 1989.

With the assumed decline in interest rates, gross interest payments are expected to drop from US$11.5 billion a year in 1984-85 to about US$10.0 billion in 1986-87, and to US$9.0 billion in 1988-89. Although the amortization of medium- and long-term debt is concentrated in 1986-87, total debt service relative to exports of goods and services is assumed to decline from 88 percent in 1982 to about 60 percent in 1987 and to around 40 percent in 1989. In spite of this decline, however, still sizable reschedulings of debt service obligations will be required. The ratio of average debt to exports of goods and services is expected to decline from roughly 3.6 in 1983 to 3.0 in 1987, and possibly to 2.4 in 1989.

On the basis of this projection, Brazil's external current account is expected to move from a deficit of nearly US$15 billion in 1982--6.5 percent of GDP--to a small surplus in 1987 (Table 12). Thereafter, this surplus could increase to about US$2 billion in 1988 and nearly double that amount in 1989, while gross reserves are maintained at about four months of imports of goods and services.

V. Exchange Arrangements Subject to Fund Approval

The exchange system currently in effect in Brazil involves multiple currency practices and restrictions on payments and transfers for current international transactions subject to Fund approval under Article VIII, Sections 2(a) and 3. The system was described in the 1982 Article IV consultation report,1/ subsequent changes were discussed in a number of reports to the Board 2/ and also in previous sections of this paper. The exchange measures subject to approval include:

(1) Multiple currency practices arising from: (a) the application of a contribution quota to receipts from exports of coffee; (b) the imposition of the financial transactions tax (IOF) on the purchase of exchange for specified imports of goods and services; and (c) the tax credits granted on export proceeds from manufactured goods (*credito-premio*).

(2) Exchange restriction arising from exchange budgets imposed on imports.

(3) Exchange restriction on availability of exchange for travel abroad.

(4) Exchange restriction arising from the imposition of minimum financing requirements on the making of payments for certain categories of capital goods and replacement part imports.

1/ Brazil--Staff Report for 1982 Article IV Consultation, Request for Extended Arrangement, and Use of Fund Resources--First Credit Tranche (EBS/83/33, 2/11/83), and Brazil--Recent Economic Developments SM/83/33, 2/15/83).

2/ Brazil--Exchange Measures, Request for Waiver and Modification of Performance Criteria, and Approval of Certain Exchange Measures (EBS/83/77, 4/19/83); Brazil--Exchange System (EBS/83/198, 9/12/83); Brazil--Staff Report for the Consultation Under Extended Arrangement, and Request for Waiver and Modification of Performance Criteria (EBS/83/227, 10/19/83, and Sup. 2, 11/17/83); Brazil--Exchange System (EBD/84/38, 2/7/84); and Brazil--Waiver and Modification of Performance Criteria (EBS/84/39, 3/2/84).

Table 12. Brazil: Medium-Term Macroeconomic Projections

	1982	1983	1984	1985	1986	1987	1988	1989
			(Annual percentage changes)					
Production and prices								
Real GDP	1.4	-3.3	--	2.5	4.0	4.0	4.0	4.0
GDP deflator	95.4	159.9	178.3	70.2	39.3	28.9	22.0	17.5
General price index (end of period)	99.7	211.0	100.0-130.0	50.0	35.0	25.0	20.0	20.0
			(In percent of GDP) 1/					
Gross domestic expenditure	101.0	98.2	97.3	96.9	96.5	96.1	95.8	95.4
Consumption 2/	82.6	83.2	82.3	78.8	77.5	76.0	74.7	73.4
Gross domestic investment 2/	18.4	15.0	15.0	18.0	19.0	20.0	21.0	22.0
Gross domestic savings	17.4	16.8	17.7	21.2	22.5	24.0	25.3	26.6
Net factor payments abroad 3/	4.0	4.5	5.0	5.0	4.3	4.0	3.5	3.2
			(In billions of U.S. dollars)					
Balance of payments								
Trade balance	0.8	6.5	9.1	10.6	11.9	13.7	15.0	16.6
Of which: Exports	20.2	21.9	24.6	27.7	30.4	33.7	36.5	39.8
Non-oil imports	-9.3	-7.2	-8.8	-10.3	-11.6	-13.0	-14.5	-16.2
Nonfactor services and transfers (net)	-3.6	-2.4	-3.0	-3.1	-3.4	-3.6	-3.8	-4.2
Nonfactor current account	-2.8	4.1	6.1	7.5	8.5	10.1	11.2	12.4
Current account 3/	-14.8	-6.2	-5.3	-4.0	-1.8	0.1	2.1	3.8
Capital account	8.2	2.9	9.6	6.0	2.7	0.9	-1.1	-2.1
Of which: direct investment	1.0	0.7	0.7	0.7	0.8	0.9	1.0	1.1
Overall balance	-6.6	-3.3	4.3	2.0	0.9	1.0	1.0	1.7
International reserves and external debt								
Gross international reserves 4/	5.4	3.5	5.7	9.4	11.6	12.3	12.7	13.2
Total external debt 4/5/	82.0	88.8	95.8	104.2	109.3	110.8	110.2	107.8
Medium and long- term 5/	69.5	77.6	87.1	97.2	102.3	103.8	103.2	100.8
Short term	12.5	11.2	8.7	7.0	7.0	7.0	7.0	7.0
Total debt service 6/	20.8	20.6	19.6	21.2	22.5	22.6	21.0	18.2
Interest payments (gross)	12.6	10.3	11.3	11.6	10.3	10.1	9.1	8.6
Amortization	8.2	10.3	8.3	9.6	12.2	12.5	11.9	9.6
Memmorandum items								
GDP in trillions of cruzeiros	53.2	133.6	371.7	648.5	939.5	1,259.4	1,597.9	1,952.7
GDP in billions of US. dollars 7/	229.1	231.3	240.3	256.7	280.3	306.1	334.2	365.0

Sources: Central Ba^ of Brazil; Getulio Vargas Foundation; and Fund staff estimates.

1/ Based on national income figures in cruzeiros. The relevant external flows are converted at the average exchange rate.
2/ From 1980 onward, changes in stocks are included in domestic consumption.
3/ Excludes reinvested profits.
4/ Period average.
5/ Includes obligations to the IMF.
6/ Includes interest payments to and repurchases from the IMF.
7/ Series derived through adjusting 1983 GDP in U.S. dollars for real growth and the change in the U.S. GNP deflator. The 1983 GDP in dollars is obtained by converting GDP in cruzeiros at the average exchange rate.

(5) Exchange restriction on the transfer of certain balances, which arises pending the implementation of the recommendation adopted by the Paris Club.

VI. Adequacy of Economic Data

Financial and economic data in Brazil are adequate in terms of their timeliness, coverage and quality, although improvements are needed in some areas. Data on the balance of payments, external debt, and prices, are generally satisfactory. Data on the financial system are fairly up-to-date, and there are no major inconsistencies between financial data in reports to the Board and those published in the IFS. National income data, however, have been available only with delays and there is scope for methodological improvement in this area. The World Bank has arranged technical assistance aimed at a thorough overhaul of the system of national accounts. Detailed information on the public finances is available for the Central Administration and the federal state enterprises; for the rest of the public sector, information is available only from the financing side.

VII. Staff Appraisal

The economic program adopted by the Brazilian authorities in late 1982 and supported by an extended arrangement with the Fund responded not only to the sudden deterioration of the country's external position but more fundamentally to the need to change the country's long-term growth strategy from one that relied heavily on foreign borrowing to one based on the generation of domestic savings. The severity of the foreign financing constraint and the size of the domestic imbalances indicated the need for a substantial adjustment in the first year of the program. Accordingly, in the external area the current account deficit was to be cut in half, or by more than US$7 billion, involving the generation of a trade surplus of about US$6 billion. Domestically, the adjustment program focused on the achievement of a sharp reduction in the public sector deficit as a means of slowing inflation and avoiding continued reliance on exchange and trade restrictions. In addition, in its first year, the program was to bring about important structural changes through the elimination of subsidies to increase the efficiency of the economy and set the stage for a resumption of growth in the latter years of the program.

Considerable progress was made in adjusting the external accounts in 1983, even though this progress reflected in part the extension of a restrictive exchange and trade system. The trade surplus, at US$6.5 billion, exceeded the original projection and the current account deficit, of only US$6.2 billion, amounted to an improvement of almost US$9 billion with respect to the previous year. However, during most of 1983 Brazil's foreign exchange situation remained very difficult because credits from banking sources and inflows of direct investment were smaller than projected. The critical foreign exchange situation gave rise to external payments arrears and an intensification of exchange restrictions.

The progress made in the external area was not matched on the domestic front where large deviations occurred at the beginning of the program. In the earlier part of the year, the difficulties posed by the tight foreign exchange constraint, together with the existing domestic imbalances, were exacerbated by substantial delays in the implementation of domestic policies. In particular, the adjustment of the public finances lagged behind that envisaged in the program, and the correction of certain key prices was postponed. The resulting adverse effects on the conduct of monetary policy led to an inflation considerably higher than had been forecast. Subsequently, inflation acquired additional momentum in the wake of natural disasters that affected agricultural supplies and as a consequence of severe inflationary expectations in a system of widespread indexation.

The comprehensive measures to reinforce the domestic adjustment effort taken by the authorities from the middle of 1983 did much to help bring the economy to a path consistent with the basic aims of the adjustment program, even though by then the authorities had to contend with an inflation that was running at historically high levels. The steps taken to eliminate subsidies for key commodities, as well as on credit to particular sectors, produced substantial structural changes. On the strength of measures to increase revenues and to curb the growth of expenditures, the public sector achieved an improvement in its operational performance equivalent to 4 percent of GDP. However, the high rate of inflation raised the overall borrowing requirement of the public sector in relation to GDP to a level above that of 1982. Monetary policy was gradually strengthened and the targets set for monetary aggregates were observed without, however, obtaining the expected results in regard to inflation.

Inflation continues to be the most urgent problem confronting the authorities in 1984. The authorities have been particularly concerned over the negative effects of inflation on economic activity and on confidence in the program. The authorities have agreed that firm and decisive action was required, and they emphasized their commitment to a demand management policy that seeks a major reduction in the inflation rate. For this purpose the authorities plan to apply monetary policy vigorously; the permitted expansion of the monetary base in 1984 has been greatly curtailed and an active interest rate policy is being followed. However, because of the entrenched nature and strength of inflationary expectations and the high degree of indexing in the economy, the staff is uncertain about the time required for these policies to produce a significant and lasting reduction in inflation. The authorities have stated their intention to hold to the agreed course of financial policies until inflation is reduced, and they have also stated their willingness to take additional measures if necessary.

The overall public sector borrowing requirement for 1984 is currently expected to be reduced only to the range of 11-13 percent of GDP. Since the public sector's operational budget is projected to be in surplus, the entire borrowing requirement represents the adjustment of the debt for inflation. The adverse effects of inflation on the public finances, and on the conduct of economic policy in general, underscore the urgency of bringing inflation under control and of increasing the surplus in the operational performance of the public sector. The public sector's policies already in place provide assurances that a small operational surplus will be achieved in 1984; however, continued vigilance over the public sector will be required if the aims are to be achieved. In this connection, the staff welcomes the positive results obtained so far by COMOR, the advisory group in charge of supervising budgetary implementation.

It is clear that, in the light of existing uncertainties, progress in implementing monetary and fiscal policies must be monitored with particular care. To this end, the 1984 program has established monthly targets for the main components of these policies. These targets serve the purpose of an early warning mechanism, and deviations from them may give rise to consultation with the staff in addition to the substantive reviews already contemplated in the program.

The decisive measures to eliminate subsidies taken during the first year of the program represented a fundamental step in the effort to improve efficiency and to enhance the feasibility of pursuing appropriate fiscal and monetary policies. However, the intensification of price controls is a matter of concern, even when applied to sectors ostensibly operating under oligopolistic conditions. The staff urges the authorities to proceed to relax price controls. The wage legislation adopted in late 1983 has provided a measure of wage flexibility needed to help sustain employment and economic activity. At the same time, wage policy is contributing to the restoration of balance in the public sector's finances with less pressure on investment than otherwise would be the case. While the authorities are convinced that lasting improvements in real wages must be based on a sound growth performance, they are concerned with the effects of inflation on real wages under the existing legislation.

The depreciation of the cruzeiro in early 1983, together with the policy of frequent adjustments of the exchange rate in line with domestic inflation that was pursued subsequently, restored the competitiveness of the economy and strengthened the balance of payments. The staff considers that access for Brazilian exports to international markets is a critical requirement for the success of Brazil's economic adjustment program. The improvement in the external position was also the result of the maintenance of a trade and payments system that is highly complex and involves distortions and restrictions. The critical foreign exchange situation confronting the country throughout most of 1983 brought with it a further intensification of the restrictiveness of the system, as sizable external payments arrears developed and a centralized system of foreign exchange allocation was imposed. The staff welcomes that the authorities did succeed by the end of 1983 in fulfilling most of their intentions with respect to the elimination of exchange restrictions and multiple currency practices. In particular, the staff welcomes the elimination of external payments arrears and the centralized system of foreign exchange allocation effected in March 1984.

The authorities have started work on a trade system that will provide protection to domestic activity through tariffs rather than through quantitative exchange and trade restrictions. The relevant legislation is to be submitted to Congress by mid-1984. This initiative will be an important step toward the elimination of the remaining exchange restrictions and multiple currency practices as listed above on page 34, and which are scheduled to be eliminated by the end of the program period. The progress made so far in the elimination of restrictions together with the strengthening of Brazil's external position hold out the hope that the need for restrictive measures will decline rapidly. On this basis the staff proposes that the measures that still remain be granted temporary approval.1/

In sum, during the first year of the program Brazil made substantial progress toward the adjustment of its external situation and introduced significant structural changes through changes in relative prices. There were, however, major shortcomings in the implementation of financial policies which contributed to the acceleration of inflation. Inflation is at present the major challenge facing economic policy making and reducing it is of decisive importance for the achievement of the program's objectives. However, the timing of the downturn in inflation and the speed of its eventual reduction are uncertain. The Brazilian authorities have taken actions to reinforce their policies and they are firmly committed to pursue policies calculated to produce a substantial decline in inflation and will result in an adjustment path for Brazil consistent with the purposes of the program. The staff believes that the required policies are in place and that the program for 1984 is appropriate to achieve the objectives described above.

It is recommended that the next Article IV consultation with Brazil be held on the standard 12-month cycle.

1/ The multiple currency practice arising from the applications of a contribution quota to receipts from exports of coffee has been already approved until January 2, 1985 in EBD 7642-43 - (84/37), 3/9/84.

VIII. Proposed Decisions

Accordingly, the following draft decisions are proposed for adoption by the Executive Board:

I. 1984 Consultation

1. The Fund takes this decision relating to Brazil's exchange measures subject to Article VIII, Sections 2(a) and 3, in concluding the 1984 Article XIV consultation with Brazil and in the light of the 1984 Article IV consultation with Brazil conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. In view of the circumstances of Brazil, the Fund grants approval of the multiple currency practices and exchange restrictions that are described under points 1 (b) and (c) through 5 on page 34 in EBS/84/84, (4/11/84), until November 20, 1984, or the completion of the review pursuant to paragraph 4(b)(ii) of the extended arrangement for Brazil (EBS/83/33, Sup. 4, 3/3/83, as amended), whichever is earlier.

II. Extended Arrangement

1. Brazil has consulted with the Fund in accordance with paragraph 4(b)(i) of the extended arrangement for Brazil (EBS/83/33, Sup. 4, 3/3/83, as amended) and paragraph 29 of the letter dated January 6, 1983 from the Minister of Finance and the President of the Central Bank of Brazil, in order to review progress made by Brazil in implementing its

program and reach understandings with the Fund regarding policies, measures and performance clauses for the calendar quarters ending June and September of the second year of the arrangement.

2. The letter dated March 15, 1984, together with the attached memorandum, from the President of the Central Bank, from the Minister of Planning and the Minister of Finance, shall be attached to the extended arrangement for Brazil; and (a) the letter dated January 6, 1983, with attached memorandum, from the Minister of Finance and the President of the Central Bank, (b) the letter dated February 24, 1983 from the Minister of Finance and the President of the Central Bank, (c) the memorandum dated March 31, 1983 from the Executive Director elected by Brazil, (d) the letter dated September 5, 1983 from the Minister of Planning and the Minister of Finance, (e) the letter dated September 15, 1983, with attached memorandum, from the Minister of Planning, the Minister of Finance and the President of the Central Bank, (f) the letter dated November 14, 1983 from the Minister of Planning, the Minister of Finance and the President of the Central Bank, (g) the letter dated February 27, 1984 from the Minister of Planning, the Minister of Finance and the President of the Central Bank, and (h) the quantitative performance criteria specified in Table 2 of EBS/84/39 (3/2/84) for the period ending March 31, 1984, shall be read as modified and supplemented by the letter dated March 15, 1984 with attached memorandum.

3. Paragraph 4 of the extended arrangement shall be amended to read as follows:

"Brazil will not make purchases under this arrangement:

(a) (i) during any period in which the data at the end of the preceding period indicate that the target for the net international reserves of the Brazilian Monetary Authorities, as specified in paragraph 1 of the Technical Memorandum of Understanding dated March 15, 1984, is not observed, or

(ii) during any period in which the limit on the public sector borrowing requirement, as specified in paragraph 2 of the Technical Memorandum of Understanding dated March 15, 1984, is not observed, or

(iii) during any period in which the limit on the operational deficit of the public sector, as specified in paragraph 3 of the Technical Memorandum of Understanding dated March 15, 1984, is not observed, or

(iv) during any period in which the limit on the net domestic assets of the Brazilian Monetary Authorities, as specified in paragraph 5 of the Technical Memorandum of Understanding dated March 15, 1984, is not observed, or

(v) during any period in which the data at the end of the preceding period indicate that the limit on the use of external credit, as specified in paragraph 7 of the Technical Memorandum of Understanding dated March 15, 1984, is not observed, or

(vi) during any period in which the cumulative quarterly target on the depreciation of the cruzeiro, as specified in paragraph 8 of the Technical Memorandum of Understanding dated March 15, 1984, is not observed, or

(vii) if the intentions to eliminate certain exchange restrictions and multiple currency practices that are specified in paragraph 20(b), third and fifth sentences, of the letter dated March 15, 1984 and in section 3, first paragraph, of the letter dated February 27, 1984, are not carried out on or before April 30, 1985, on or before December 31, 1985, or on or before January 2, 1985, respectively;

(viii) if the intensifications of exchange restrictions that took place on September 14, 1983 and arose from reduced limits on foreign exchange allotments for travel abroad, as specified on page 24 of EBS/83/227 (10/19/83), are not eliminated by December 31, 1984; or

(b) if the reviews with the Fund contemplated in paragraph 2 of the letter dated November 14, 1983 have not been completed in accordance with the following schedule:

(i) The "February" review, including the specification of performance clauses for calendar quarters ending June and September 1984, shall be completed before May 20, 1984;

(ii) The "August" review, including the specification of performance clauses for calendar quarter ending December 1984, shall be completed before November 20, 1984;

(iii) The "November" review, including the specification of performance clauses for the third year of this arrangement, shall be completed before February 27, 1985; or

(c) if Brazil

(i) imposes new or intensifies existing restrictions on payments and transfers for current international transactions, or

(ii) introduces or modifies multiple currency practices, or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or

(iv) imposes new or intensifies existing restrictions on imports for balance of payments reasons.

When Brazil is prevented from purchases under this extended arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Brazil and understandings have been reached regarding the circumstances in which such purchases can be resumed."

4. The Fund decides, pursuant to paragraph 4(b)(i) of the extended arrangement for Brazil, that the respective review, including the specification of performance clauses for calendar quarters ending June and September 1984, is completed.

Brazil - Fund Relations
(As of March 31, 1984)

I. Membership Status

(a) Date of membership: original member
(b) Status: Article XIV

A. Financial Relations

II. General Resources Account
(Position as of March 31, 1984)

		Millions of SDRs	Percent of Quota
(a)	Quota:	1,461.30	100.00
(b)	Fund holdings of Brazilian cruzeiros:	4,361.09	298.43
(c)	Fund credit:	2,899.72	198.43
	Of which: CFF	965.00	66.04
	Buffer stock	64.47	4.41
	Credit tranche	249.38	17.07
	EFF	810.43	55.46
	Enlarged access under EFF	810.43	55.46
(d)	Reserve tranche position:	--	--
(e)	Current Operational Budget:	--	--
(f)	Lending to the Fund:	--	--

III. Current Extended Arrangement and Special Facilities

(a) Current extended arrangement

(i) Duration: From February 28, 1983 to February 27, 1986
(ii) Amount: SDR 4,239.4 million
(iii) Utilization: SDR 1,620.8 million
(iv) Undrawn balance: SDR 2,618.6 million

(b) Previous stand-by and extended arrangements since 1974: None

(c) Special facilities since 1981:
- CFF purchase in the amount of SDR 498.75 million (50 percent of quota at that time) was approved on December 22, 1982
- CFF purchase in the amount of SDR 466.25 million was approved on February 28, 1983
- Purchase under the buffer stock: International Sugar Agreement in the amount of SDR 64.47 million was approved on November 22, 1983.

IV. SDR Department

(a)	Net cumulative allocation:	SDR 358.67 million
(b)	Holdings:	None
(c)	Current designation plan:	Not in designation plan

V. Administered Accounts: None

VI. Overall Obligations to the Fund: None

B. Nonfinancial Relations

VII. Exchange Rate Arrangement:

Since 1968 Brazil has followed flexible exchange rate policy under which the exchange rate for the cruzeiro is adjusted at relatively short intervals in terms of its intervention currency, the U.S. dollar. At present there are no unapproved exchange practices subject to Article VIII, Sections 2 and 3.

VIII. Past Decisions:

The last Article IV consultation was concluded by the Executive Board on February 28, 1983 (EBD 7350-53/(83/41), 2/28/83).

Certain exchange measures were approved on April 22, 1983 (EBD 7390/(83/67), 4/22/83).

The program was reviewed by the Executive Board on November 22, 1983 (EBD 7562-64/(83/160), 11/22/83).

On March 9, 1984 the Executive Board met to consider Brazil's request for a waiver and modification of performance criteria (EBD 7642-43/(84/37), 3/9/84).

The text of the decisions is provided in the attachment.

IX. Technical Assistance:

A staff member of the Bureau of Statistics visited Brasilia during February 13-24, 1984 to assist the authorities in implementing a system for electronic transmission of monetary data to headquarters for inclusion in the IFS.

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Brazil--Basic Data

Area and population			
Area	8,512,000 sq. kilometers		
Population (mid-1983)	130.0 million		
Annual rate of population increase (1979-83)	2.4 percent		
GNP (1983)	SDR 206.7 billion		
	US$221.0 billion		
	Cr$127.6 trillion		
GNP per capita (1983)	SDR 1,590.0		

	1982	Prel. 1983	Proj. 1984
		(percent)	
Origin of GNP			
Agriculture	12.1	...	...
Industry	31.9	...	...
Commerce	15.0	...	...
Transport and communications	5.0	...	...
Other	36.0	...	...
Ratios to GDP			
Exports of goods and services	10.3	10.5	11.4
Imports of goods and services	17.4	13.5	13.9
Current account of the balance of payments 1/	-7.1	-3.0	-2.5
Federal treasury revenues	9.1	8.8	8.8
Federal treasury expenditures 2/	7.8	6.7	7.1
Public sector overall surplus or deficit (-)3/	-15.8	-17.7	11.0-13.0
Total external debt (period average)	35.8	38.4	39.9
Total external debt service payments	9.1	8.9	8.2
Gross domestic savings	17.4	16.8	17.7
Fixed capital formation	18.4	15.0	15.0
Money and quasi-money 4/ (end of year)	23.7	25.2	19.3
Annual changes in selected economic indicators			
Real GDP per capita	-0.8	-5.7	-2.4
Real GDP	1.4	-3.3	--
GDP at current prices	98.1	151.3	178.3
Domestic expenditures (at current prices)	99.0	144.5	175.7
Fixed capital formation	(89.4)	(105.4)	(178.3)
Consumption 5/	(101.2)	(153.2)	(175.3)
GDP deflator	95.4	159.9	178.3
Wholesale prices 6/ (annual averages)	94.0	164.9	100.0-130.0
Cost of living 7/ (annual averages)	98.0	142.0	100.0-130.0
Federal Treasury revenues	104.5	143.2	178.2
Federal Treasury expenditures 2/	97.1	118.0	191.6
Money and quasi-money 4/	113.5	165.0	113.3
Money	(77.4)	(88.0)	(50.6)
Quasi-money	(132.6)	(196.0)	(129.6)
Net domestic bank assets 8/	135.7	165.3	83.0
Credit to public sector (net)8/	(64.6)	(108.4)	(69.6)
Credit to private sector 8/	(147.2)	(213.3)	(153.7)
Merchandise exports (f.o.b., in U.S. dollars)	-13.3	8.6	12.3
Merchandise imports (f.o.b., in U.S. dollars)	-12.2	-20.4	0.6

	1982	1983	Proj. 1984
	(billions of cruzeiros)		
Federal Treasury finances			
Revenues	4,811	11,700	32,555
Expenditures 2/	4,131	9,004	26,255
Overall surplus or deficit (-)	680	2,696	6,300
Internal financing (net)	-680	-2,696	-6,300
	(millions of U.S. dollars)		
Balance of payments			
Merchandise exports (f.o.b.)	20,175	21,899	24,600
Merchandise imports (f.o.b.)	19,397	15,429	15 500
Investment income (net)1/	-13,478	-11,010	-12,100
Other services and transfers (net)	-3,579	-2,328	-3,000
Balance on current and transfer accounts 1/	-16,279	-6,868	-6,000
Long-term capital (net)	10,827	5,891	11,330
Short-term capital (net)	-797	-1,822	-1,000
Errors and omissions	-368	-531	--
Change in net official international reserves (increase -)9/	6,617	3,330	-4,330
	Dec. 31 1982	Dec. 31 1983	Dec. 31 1984
	(millions of SDRs)		
International reserve position			
Monetary authorities (gross)	2,946	3,588	7,170
Monetary authorities (net)	-494	-3,199	925

1/ Includes reinvested profits: US$1,556 million in 1982; US$697 million in 1983; and US$700 million in 1984.

2/ Does not include monetary correction in the public debt, nor transfers to the monetary authorities which amount to Cr$680 billion in 1982, Cr$2.7 trillion in 1983, and Cr$6.3 trillion in 1984.

3/ Identified financing.

4/ Banking system liabilities vis-a-vis private sector.

5/ Includes change in stocks.

6/ Domestic supply.

7/ In Rio de Janeiro.

8/ In relation to the stock of liabilities to the private sector at the beginning of the period.

9/ Excludes changes in valuation of gold holdings and acquisition of gold.

Brazil: Selected Economic and Financial Indicators

	1981	1982	1983 Orig. Prog.1/	1983 Rev. Prog.2/	1983 Prel. Actual	1984 Orig. Prog.1/	1984 Rev. Prog.
(Annual percent changes, unless otherwise specified)							
National income and prices							
GDP at constant prices	-3.5	1.4	-3.5	-4.0	-3.3	2.0	--
GDP deflator	112.2	95.4	101.0	159.0	159.9	58.0	178.3
General price index (end of period)	95.2	99.7	87.0	223.0	211.0	40.0	100.0-130.0
External sector (on the basis of U.S. dollars)							
Exports, f.o.b.	15.7	-13.3	8.9	10.4	8.6	16.8	12.3
Imports, f.o.b.	-3.8	-12.2	-17.5	-17.5	-20.4	10.6	0.6
Non-oil imports, f.o.b.	-15.5	-16.4	-20.9	-15.1	-21.8	36.1	22.2
Private and public external debt (end of period)3/	17.4	11.2	10.8	12.1	5.6	7.6	10.1
Central Administration							
Revenues	78.2	104.5	160.6	138.5	143.2	...	178.2
Expenditures	111.9	97.1	99.8	115.2	118.0	...	191.6
Money and credit							
Domestic credit 4/	129.1	121.3	65.1	164.4	162.1	...	81.1
Public sector	(164.9)	(162.7)	(35.4)	(215.6)	(226.6)	(...)	(116.5)
Private sector	(103.1)	(106.0)	(108.7)	(193.5)	(162.6)	(...)	(116.8)
Money and quasi-money (M-2)5/	113.0	113.5	90.7	171.0	164.7	...	113.3
Velocity (GDP relative to average M-2)	6.1	6.2	3.9	5.7	5.8	...	7.1
(In percent of GDP, unless otherwise specified)							
Public sector borrowing requirement	12.5	15.8	8.8	18.6	17.7	5.5	11.0-13.0
Domestic financing	(11.2)	(13.4)	(6.7)	(17.7)	(17.4)	(4.2)	(10.2-12.2)
Direct foreign financing	(1.3)	(2.4)	(2.1)	(0.9)	(0.3)	(1.3)	(0.8)
Balance of payments current account deficit 6/	5.2	6.5	3.1	3.4	2.7	2.1	2.2
Private and public external debt (period average)3/	33.7	35.8	39.3	39.8	38.4	40.7	39.9
(In percent of exports of goods and services)							
Debt service 7/	66.2	88.4	78.5	79.8	84.7	59.4	71.6
Interest payments 7/	38.3	53.5	41.5	39.7	42.2	34.7	41.2
(In billions of U.S. dollars)							
Overall balance of payments	0.8	-6.6	--	--	-3.3	1.0	4.3
GDP	213.2	229.1	229.0	228.1	231.3	245.1	240.3

1/ Original program projections as specified in EBS/83/33, Sup. 1 (2/24/83).
2/ Revised program projections as specified in EBS/83/227 (10/19/83) and EBS/83/227, Sup. 2 (11/17/83).
3/ Includes short-term debt and use of Fund resources.
4/ Net domestic assets of the banking system.
5/ Banking system liabilities vis-a-vis private sector.
6/ Excludes reinvested earnings.
7/ Scheduled payments according to contracts as of beginning of period.

Brazil--Summary of the Economic Program for 1984

I. Targets

1. After experiencing a decline of 3.3 percent in 1983, real GDP is expected to remain unchanged in 1984. The weight of the public sector, and in particular of public sector investment, will continue to decline in relative importance in 1984.

2. The rate of inflation is expected to decline during 1984 although the extent and timing of this decline is uncertain. The 12-month rate of inflation is projected to be in the range of 100-130 percent during 1984 compared with 211 percent during 1983.

3. The overall balance of payments is targeted to show a surplus of US$4.3 billion in 1984. Such a surplus would meet the target of the program of a surplus of US$1 billion for 1983 and 1984 combined.

II. Assumptions

1. The U.S. dollar value of exports is projected to increase by 12.3 percent in 1984 on the strength of a 5 percent increase in export prices and an 8.8 percent rise in volume for manufacturing exports; and a 7 percent increase in the prices of primary exports combined with a 3 percent advance in their volume. Total imports are projected to remain unchanged in value terms; however, petroleum imports are expected to decline by US$1.5 billion under the assumption of unchanged oil prices and an increase of 39 percent in domestic oil output. Thus, non-oil imports are projected to increase by 22 percent.

2. The effective LIBOR applicable in 1984 to the variable rate element of Brazil's external debt is estimated at 10.5 percent compared with about 10.2 percent in 1983.

3. Depending on inflation, velocity (measured as the ratio of nominal GDP to average M-1) is projected to increase from 25 in 1983 to 38-43 in 1984.

III. Principal Elements of the 1984 Program

1. Public sector policies

a. Quarterly ceilings for the period through the end of September 1984 have been established on the borrowing requirement of the nonfinancial public sector. The definition of the public sector includes the Central Administration, special funds and programs operated through the banking system, decentralized agencies, the social security system, the state enterprises, and the state and municipal governments.

The borrowing requirement is measured as the increase in outstanding stocks of net credit from the domestic banking system, private holdings of public debt, and floating debt of state enterprises, plus net disbursements of foreign debt.

b. The public sector's operational budget is to register a surplus of Cr$950 billion (equivalent to 0.3 percent of GDP) in 1984. Quarterly ceilings consistent with this target have been established as performance criteria. The operational result of the public sector is measured by the difference between the overall borrowing requirement defined above and the sum of the monetary and exchange rate correction on the stock of domestic public debt included in that borrowing requirement.

c. Monthly targets for the borrowing requirements of the Central Administration, the state enterprises, and the state and municipal governments have been established as monitoring devices.

2. Money and credit

a. The net domestic assets of the monetary authorities are to be subject to quarterly ceilings as a performance criterion, these ceilings have been defined for the period through the end of September 1984. Under these ceilings, net credit of the monetary authorities to the public and private sectors is projected to grow by 16.5 percent during the nine-month period ending September 1984.

b. Monthly targets for the monetary base and for the money supply have been established as monitoring devices.

3. Prices and wages

a. The prices of wheat and wheat products will be raised during the second quarter of 1984 so as to eliminate the implicit subsidy by June. Other administered prices will be adjusted periodically in line with inflation or the exchange rate as it may be indicated, in order to prevent the re-emergence of subsidies. Adjustments to the prices of steel and electricity will seek an increase of 5 percent in real terms. Price controls, which are applied to prices determined under oligopolistic conditions, will be relaxed in line with the deceleration of inflation.

b. Wage policy will follow the recently passed legislation which determines an average indexing to past inflation of 86 percent.

4. External sector

a. The system of frequent and small depreciations of the cruzeiro in line with domestic inflation will be continued. A performance criteria to this effect has been established in the program.

b. The restrictiveness of the exchange system will continue to be reduced. The intensification of restrictions related to the reduction of travel allowances will be rescinded and the restriction arising from the recommendations of the Paris Club will be eliminated during 1984. The multiple currency practice related to the contribution quota on coffee exports will be eliminated on January 2, 1985.

c. A trade reform seeking the replacement of quantitative exchange and trade restrictions by tariffs is under preparation.

5. Reviews

Two further consultations on all aspects of the program are contemplated during 1984. These will take place in August and November, with outside dates for their completion on November 20, 1984 and February 28, 1985, respectively.

Performance Under the Program in the Light of the Recommendations Contained in the Chairman's Concluding Remarks on the Discussion on Brazil on November 22, 1983

The Chairman's summing up at the conclusion of the last consultation on Brazil (EBM/83/159 and EBM/83/160) was structured around the points listed below. Against this background, developments and policy actions in the program were as follows:

A. Pricing Policies

Summing Up	Program
1. Frequent revisions of administered prices are necessary to prevent re-emergence of subsidies.	1. Implemented.
2. Concerns about increased recourse to price controls in the private sector.	2. Controls have focused on prices determined under oligopolistic conditions. The authorities intend to relax controls in line with deceleration of inflation.

B. Fiscal Policies

Summing Up	Program
1. Operational budget to be in surplus in 1984.	1. Target of surplus equivalent to 0.3 percent of GDP in 1984 is performance criterion of program.
2. Overall deficit in 1984 should be much lower than the 18.6 percent of GDP projected for 1983.	2. Overall deficit amounted to 17.7 percent of GDP in 1983. The 1984 program projects a deficit in the range of 11-13 percent of GDP.
3. Operational deficit of state enterprises should be reduced from 3.1 percent of GDP projected for 1983 to 1.2 percent of GDP in 1984.	3. Actual operational deficit in 1983 amounted to 2.5 percent of GDP. The 1984 program projects a deficit equivalent to 1.2 percent of GDP.

Summing Up	Program
4. Continued monitoring of the performance of the public sector.	4. Domestic arrangements to this effect (COMOR) are in place and working satisfactorily. The program includes monthly targets for the main components of the public sector which provide early warning of deviations from agreed performance.
5. Reintroduction of legislation on wages and fringe benefits in state enterprises.	5. Implemented.

C. Monetary Policy

Summing Up	Program
1. Limit growth of M-1 in 1984 to no more than 50 percent.	1. The program has a target of an expansion in M-1 and base money of 50 percent.
2. Monetary policy to be kept under close scrutiny.	2. Monthly targets for the monetary base and M-1 have been established for monitoring purposes.
3. Broader set of monetary indicators should be monitored.	3. Surveillance is exercised over the wide spectrum of relevant interest rates, as well as over the net placement of government securities and developments in the open and overnight markets.
4. Elimination of negative interest rates, in particular for agriculture and exports.	4. Implemented (with the exception of agricultural credit operations in the Northeast).
5. Ensure a more active interest rate policy in the securities market and that monetary correction is adjusted in line with inflation.	5. Monetary correction and rates in the overnight market are set at or above the rate of inflation.

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D. External Policies

Summing Up	Program
1. Less reliance to be placed on quantitative controls or restrictions; elimination of subsidies on exports (tax incentives as well as subsidized credits); more reliance on tariffs and on a realistic exchange rate policy.	1. A number of exchange restrictions and multiple currency practices were eliminated; further measures to this end are contemplated in the 1984 program. Credit subsidies for exports were eliminated. A trade reform project is to start the legislative process by mid-1984. Removal of import licensing, tax incentives, and other restrictions is contemplated for 1985. The exchange rate continues to be adjusted in line with inflation.

E. Instrumentation of the Program

Summing Up	Program
1. In view of uncertainties, nominal quantitative performance criteria should be fixed for shorter periods, but have periodic reviews of the program instead.	1. The first of these reviews has been effected. Further reviews are contemplated for August and November. Ceilings for the net domestic assets and the PSBR, together with the related monthly targets on fiscal and monetary variables, have been established for the period through end-September 1984.
2. Early warning and monitoring system of access to credit by the public sector is required, together with frequent staff visits for this purpose.	2. Monthly arrangements for monitoring developments in the fiscal area have been established. Similar arrangements have been made for monetary developments. Staff visited Brasilia in December and January. A full review took place in February, further staff visits are programmed.

Summing Up

3. Additional measures on the form of contingency plans should be considered.

Program

3. Alternatives have been explored with the authorities and procedures for a reassessment of policies have been explicitly agreed.

The Definition of the Net Domestic Assets of the Monetary Authorities

A number of modifications to the program's definition of the net domestic assets of the monetary authorities were made in the course of the review of the program in June-July 1983. Specifically, and as mentioned in EBS/83/227 (10/19/83) page 17, deposits on foreign loans were excluded from the liabilities to the private sector, and medium- and long-term foreign obligations, together with other net foreign assets of the monetary authorities were excluded from the net foreign assets.

As in other financial programs supported by the Fund, the program for Brazil defines net domestic assets by the difference between liabilities to the private sector and net foreign assets. This way of rearranging the balance sheet of the monetary authorities is indicated whenever there are difficulties to monitor directly a precise and comprehensive definition of actual credit operations. A net expansion of credit results initially in an increase in the nominal supply of money. When the money supplied exceeds the demand for money, the economy will adjust to its desired level of real balances by either increasing the level of prices or buying foreign exchange. For financial programming purposes, therefore, it is crucial to have an estimate of the demand for money as accurate as possible (errors in this estimate will result in an unwarranted expansionary or contractionary stance of the agreed credit policy), and also to arrange the components of the balance sheet in such a way as to group together elements of similar nature, i.e., elements that can be broadly defined as behavioral (e.g., the demand for money), target (e.g., international reserves), and policy (e.g., credit) variables. The specific reasons for the modification of definition in mid-1983 are as follows:

(a) The deposits on foreign loans are cruzeiro deposits at the monetary authorities made by Brazilian obligors in respect to foreign loans. These deposits carry exchange correction and pay interest equivalent to the interest specified in the foreign loan. To some extent, and in particular in the case of deposits made by state enterprises, the authorities can exercise control over withdrawals from these deposits. At the onset of the program, these deposits were classified among the monetary liabilities to the private sector and it was assumed that a net withdrawal, estimated at the equivalent of US$1 billion, was going to take place during 1983. However, this assumption proved to be wrong; by midyear it became clear that these deposits were not declining, and even were showing signs of an upward trend. In the event, deposits on foreign loans increased by the equivalent of US$1 billion in 1983, a swing of US$2 billion with respect to the initial assumption. As can be seen from Appendix Table 1, the cruzeiro equivalent of this swing amounted to Cr$3.5 trillion. Since in the circumstances of 1983 the change in net foreign assets was by and large determined without regard to the stance of monetary policy, maintenance of the initial definition of the ceiling would have required more than totally wiping out the monetary and quasi-monetary liabilities of the authorities in order to observe the net domestic assets target of the program as then defined. The policy implications of shifting these deposits from the liabilities to the asset side (where they enter with a negative sign) is that where before larger than projected withdrawals of deposits created room under the ceiling, now they would force compensating action on other asset operations, while the converse applies in the case where these deposits turn out to be higher than projected.

(b) The medium- and long-term foreign liabilities as well as the other net foreign assets of the monetary authorities had been traditionally the result of the foreign lending and borrowing operations of the Bank of Brazil. The program had classified initially these items together with the net international reserves under the heading of net foreign assets. A change in this definition was required as a consequence of the way the financial arrangements with foreign commercial banks turned out to be concluded in February 1983. These arrangements stipulated that the loans made available by the banks, be it in the form of new money (Project 1) or the refinancing of obligations coming due (Project 2), were going to have the Central Bank of Brazil as the borrower of record. The foreign banks had the option to assign to individual debtors part or all of the funds provided under either facility, and this option was to remain open until June 1984 (subsequently extended until June 1985). The consequences of this arrangement were twofold: on the one hand, funds from the new money facility which had been budgeted to go to particular state enterprises went instead to the Central Bank, and the Central Bank was required to extend the corresponding credit to that state enterprise (which thereby acquired a domestic liability instead of a foreign liability). On the other hand, to the extent that Project 2 funds stayed at the Central Bank, this was tantamount to the Bank acquiring simultaneously a foreign liability and a domestic asset (or a reduction in its monetary liabilities to the extent that a domestic debtor paid the cruzeiro counterpart of the obligation coming due), corresponding to the debt that was being rescheduled. In accounting terms, the Central Bank experienced a large increase in its foreign liabilities, the counterpart of which in the balance sheet could not be projected with any degree of precision, and which introduced an element of uncertainty in the projection of net domestic assets. Under these circumstances, it was decided to shift the medium- and long-term assets and liabilities from the net foreign assets to the domestic assets section of the balance sheet, avoiding thereby any net effect on the measurement of net domestic assets arising from the process of assigning these obligations to individual borrowers.

Appendix Table 1 describes the December 1983 position of the monetary authorities projected in the revised program under the initial and modified presentations.

Appendix Table 1. Brazil: Accounts of the Monetary Authorities as of December 31, 1983

(In billions of cruzeiros)

	Projections of Revised Program (EBS/83/227) 1/		
	According to Initial Presentation	As Presented in EBS/83/227	Actual Result 2/
Liabilities to private sector	10,867	3,500	3,420
Money supply	2,780	2,780	2,671
Quasi-money	770	770	749
Deposits on foreign loans	7,317	--	--
Net foreign assets	-6,507	10	-3,226
Net international reserves	10	10	-3,226
Other foreign assets	3,252	--	--
Medium- and long-term foreign liabilities	-9,769	--	--
Net domestic assets	17,374	3,540	6,646
Credit	9,087	9,087	10,887
Deposits on foreign loans	--	-7,317 (US$9 billion)	-10,817 (US$11 billion)
Other foreign assets	--	3,252 (US$4 billion)	4,460 (US$4.5 billion)
Medium- and long-term foreign liabilities	--	-9,769 (US$12 billion)	-10,299 (US$10.5 billion)
Other	8,287	8,287	12,415

Sources: Central Bank of Brazil; and Fund staff estimates.

1/ Using accounting exchange rate of Cr$813 per U.S. dollar.
2/ Using actual exchange rate of Cr$979 per U.S. dollar.

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Federal Public Sector Investment in Brazil 1/

Over the decade of the 1970s, Brazil's public sector grew rapidly, both absolutely and relative to the rest of the economy. By 1982, the expenditures of the consolidated federal public sector, including transfers, were equivalent to about 43 percent of GDP. The direct investments of the consolidated federal public sector were equivalent to about 7 percent of GDP, with a substantial proportion of private investment, as well as that of other levels of government, directed and financed by federal transfers, tax incentives, and subsidized credit programs.

At the same time that public sector institutions and enterprises grew and proliferated in number, the channels for allocating resources among them and through them became increasingly complex and less transparent. Central authority over public sector resource use diminished with the growing relative importance of public enterprises and autonomous agencies, and the earmarking of revenues to specific agencies or end-uses. Despite a formal investment budgeting system, projects were frequently undertaken without adequate provision for their future financing, which had eventually to be covered by Treasury transfers and unprogrammed domestic or external borrowing.

Beginning in 1979, an important series of reforms have been introduced to improve the control of the central authorities over public sector resource use. Among the steps taken have been a significant reduction in tax earmarkings; the strengthening of the Planning Ministry's legal authority over the expenditures and finances of the public enterprises and autonomous agencies, and an upgrading of the institutional arrangements and staffing to perform that function; consolidation of the fiscal, monetary and public enterprise budgets with improved delineation and analysis, particularly of the expenditures executed by the monetary authorities; and the first elaboration in 1982 of a four-year investment and financing program (CPPG) for the public sector as a whole.

Since the mid-1970s, Brazil's sectorial development priorities have emphasized energy, particularly the substitution of domestic fuels for imported petroleum; agriculture; and export industries, including mining. Public sector investment has concentrated in the energy sector--particularly hydro-based electricity, petroleum exploration and development, nuclear power and fuel alcohol; the intermediate goods industries for both export and import substitution; and transport and communications infrastructure. The World Bank has endorsed most of these priorities.

In 1982, a World Bank mission undertook a review of public investment plans in the major sectors. At the time of the review, the first CPPG was in a process of "iteration", and the data, planning assumptions and definitions were not yet complete and uniform across all the

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1/ Prepared by staff from the World Bank.

sectors. Moreover, the overall program projected a total resource availability that shortly thereafter was made unattainable by the sudden drying up of foreign commercial bank financing.

In the period since, with resources increasingly constrained, few new projects have been undertaken. The most important of these, Carajas, offers excellent prospects, both for future export growth and the development of one of Brazil's most backward regions, and it has received World Bank support. Overall, however, public investment has been sharply cut back; the budgeted real investment levels for the major public enterprises in 1983 and 1984 being 25 percent and 40 percent, respectively below the level of 1981. In such a crisis atmosphere, across-the-board cuts, with little room for exception, became necessary. Moreover, the fall in economic activity and changes in relative prices that have occurred may have caused substantial shifts in the original priority ordering of projects. This has not yet been analyzed by Bank staff.

Accordingly, the planning assumptions underlying many of the sectorial investment programs, and the CPPG as a whole, are undoubtedly in need of revision, and work has begun in that direction. The World Bank is currently working with the Government in two important sectors--electric power and steel--to reformulate the sectorial investment programs and prepare viable financing plans for their completion. At the same time, agreements are in force in these and other areas regarding public enterprise pricing policies to assure the appropriate generation of internal resources. Future Bank economic and sector work on Brazil will attach high priority to the analysis of the composition of the reduced investment program and to its consistency with overall development priorities. As the foreign exchange constraint eases and many of the projects now near completion are brought on stream and begin to generate revenues, the institutional progress recently achieved can begin to bear fruit in more efficient project selection and budgetary control for the future.

World Bank
Latin America and Caribbean Region
March 27, 1984

Brazil: Illustrative List of Restrictive Measures Affecting Brazilian Exports 1/ (As of April 1984)

1. Restrictions of a multilateral nature on textiles and clothing

The Multifibre Agreement (MFA) calls for bilateral agreements between importing (developed) and exporting (developing) countries. The MFA suggests criteria which might be used as the basis for bilateral agreements (e.g. annual rate of increase; quota flexibility; transfer or anticipation of quotas). Brazil currently has bilateral agreements with Austria, Canada, the European Community, Sweden, and the United States.

In recent renegotiations of bilateral agreements, importing countries have reduced the allowed annual rate of increase (in some cases to zero), have reduced permitted flexibility, have introduced new mechanisms designed to reduce imports (e.g. the "surge" clause in the agreement with the EEC), and have reduced under-utilized quotas.

2. Products subject to restrictions by the European Community

a. Brazilian exports involved in countervailing duty procedures in the EC

(1) Leather footwear
(2) Cotton yarn
(3) Soybean oil and bran 2/
(4) Carbon steel plates
(5) Carbon hot-rolled and cold-rolled sheets

b. Brazilian exports involved in antidumping duty procedures by the EC

(1) Carbon steel plates
(2) Carbon hot-rolled and cold-rolled sheets
(3) Oxalic acid

Comment

The items listed above represent about 25 percent of Brazilian exports to the EC.

1/ Based on information provided by the Brazilian authorities. Includes restrictive actions, antidumping and countervailing duty petitions filed and under investigation.

2/ The EC is currently considering imposing countervailing duties on Brazilian exports of soymeal.

3. Products involved in restrictive actions by Australia

a. Brazilian exports involved in antidumping duty procedures

(1) Electric motors
(2) Paper for printing
(3) Nonilfenol exoxilado
(4) Trietolanamina

Comment

The items listed above represent about 5 percent of Brazil's export to Australia.

4. Products involved in restrictive actions by Canada

a. Brazilian exports involved in antidumping duty procedures

(1) Leather footwear
(2) Hydrogenated castor oil and 12-hidroxystearic acid
(3) Cotton yarn
(4) Steel wheels and rims
(5) Bailing twine
(6) Stainless steel bars and wire rods
(7) Carbon steel plates
(8) Alloy tool steel bars and sheets and forged parts

Comment

The items listed above represent about 12 percent of Brazilian exports to Canada.

5. Products involved in restrictive actions by Chile

a. Brazilian exports involved in antidumping or antisubsidy duty procedures

(1) Wheat pastry flour
(2) Steel cables
(3) Towels and sheets
(4) Rugs
(5) Rubber tires
(6) Alcohol
(7) Aluminum bars, shapes, tubes, and twines
(8) Mixers and waxing machines
(9) Wicks for explosives
(10) Sandpaper
(11) Galvanized steel fences

Comment

The items listed above represent about 3 percent of Brazilian exports to Chile.

6. Products involved in restrictive actions by the United States

a. Products subject to Brazilian export tax (so as to avoid imposition of countervailing duties by the United States)

(1) Carbon steel plates 1/
(2) Carbon steel plates in coils, hot and cold rolled steel sheets 1/
(3) Carbon steel wire rods 1/
(4) Welded steel tubes and pipes 1/
(5) Stainless steel wire rods and bars 1/
(6) Pig iron 1/
(7) Scissors and shears
(8) Concentrated orange juice
(9) Nonrubber footwear
(10) Cotton yarn
(11) Leather handbags for women
(12) Leather apparel for men and boys
(13) Hydrogenated castor oil products and 12-hydroxystearic acid
(14) Textiles
(15) Alloy steel products 1/

b. Brazilian exports involved in antidumping duty procedures

(1) Carbon steel plates 1/
(2) Carbon steel hot and cold rolled sheets 1/
(3) Carbon steel wire rod 1/

c. Brazilian exports involved in import quota procedures (under Section 201 of the Trade Act of 1984)2/

(1) Footwear
(2) Carbon steel plates 1/
(3) Carbon steel hot and cold rolled sheets 1/
(4) Alloy tool steel products 1/
(5) Stainless steel products 1/

1/ Steel products - The Internationl Trade Commission of the United States has concluded that Brazilian exports of steel sheet to the United States are subject to subsidy and are therefore eligible for countervailing by the Commission. The Commerce Department of the United States has found that steel plate exports for Brazil are subject to dumping margins which vary from 50 percent to 100 percent (depending on the exporter), although this finding is being reviewed. In July 1983, a 10 percent additional tariff was imposed on imports of stainless steel sheets and strips, and three other products were made subject to global quotas. Brazil has not yet negotiated a bilateral quota within the global amount. As of March 13, 1984, Brazil imposed a tax on exports of a number of steel products to the United States at a rate of 27.42 percent ad valorem.

2/ Section 201 permits import relief from injury caused by import competition.

d. United States procedures under Section 301 of the Trade Act of 1974 relating to Brazilian exports to third markets 1/

(1) Soybean bran and oil (all markets)
(2) Poultry (Middle Eastern markets)

e. Brazilian exports subject to other measures

(1) Alcohol 2/
(2) Sugar 3/
(3) Tobacco
(4) The decrease in the number of Brazilian products eligible for the Generalized System of Preferences
(5) The effects of the Caribbean Basin Initiative

Comment

The items listed under Sections a, b, c, and e above represent about 34 percent of manufactured products exported by Brazil to the United States. The items under Section d above represent about 11 percent of Brazil's exports to the United States.

1/ Section 301 permits relief from unfair trade practices of trade competitors in third markets.

2/ Ethylitic alcohol for fuel - Brazilian exports of this product to the United States are subject to a specific surcharge of US$0.50 per gallon, in addition to a basic tariff.

3/ Sugar - Brazilian sugar exports to the United States are subject to a variable specific surcharge designed to protect domestic production through a price equalization scheme.

Recent Executive Board Decisions on Brazil

A. EBD 7350-53 - (83/41), 2/28/83 (1982 Article IV Consultation, Request for Extended Arrangement, and Use of Fund Resources - First Credit Tranche).

I. Article IV Consultation

1. The Fund takes this decision relating to Brazil's exchange measures subject to Article VIII, Sections 2 and 3, and, in concluding the 1982 Article XIV consultation with Brazil, in the light of the 1982 Article IV consultation with Brazil conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund urges Brazil to eliminate at the earliest possible date the tax on certain industrial exports to a Fund member. In view of the circumstances of Brazil, the Fund grants approval of the multiple currency practices and exchange restrictions that are described under points 1, 2, and 3 on page 13 in EBS/83/33, Sup. 1, until August 30, 1983, or the completion of the first review under the extended arrangement, whichever is earlier.

II. Extended Arrangement

1. The Government of Brazil has requested an extended arrangement for a period of three years from March 1, 1983 for an amount equivalent to SDR 4,239.375 million.

2. The Fund approves the extended arrangement attached to EBS/83/33, Sup. 1.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

III. First Credit Tranche Purchase

1. Brazil has requested a purchase equivalent to SDR 249.375 million, which is the amount equivalent to its first credit tranche.

2. The Fund approves the requested purchase.

B. EBD 7390 - (83/67), 4/22/83 (Exchange Measures).

1. Brazil has consulted the Fund in accordance with paragraph 29 of the letter dated January 6, 1983, attached to the extended arrangement for Brazil (EBS/83/33, Supplement 4), concerning the observance of the performance criteria set out in paragraph 4(d)(ii) of the extended arrangement.

2. The Fund notes that:

a. On March 10, 1983 the financial transactions tax (IOF) was reduced from 25 percent to 15 percent for a specific list of commodity imports and reduced from 25 percent to 12 percent for the same commodity imports from LAFTA/LAIA countries;

b. On March 29, 1983, the export taxes on soybeans and soybean by-products, Brazil nuts, unprocessed animal hides, lumber, and processed wood were reduced from 20 percent to 5 percent;

c. On March 29, 1983, new reduced rates of export taxes, ranging from 8 percent to 13 percent, were adopted for cocoa and by-products and certain minerals; they will be further reduced by 1 percentage point per month, in most cases, until their complete elimination; and

d. Discriminatory export taxes were to have been introduced on stainless steel bar and rod on March 31, 1983, and will be introduced on frozen concentrated orange juice on April 30, 1983 and on tool steel on May 1, 1983 at rates corresponding to various subsidies for which these products are eligible.

3. The attached communication dated March 31, 1983 from the Brazilian authorities shall be annexed to the extended arrangement for Brazil (EBS/83/33, Supplement 4), and the letters dated January 6 and February 24, 1983, together with the attached technical memorandum of understanding, shall be read as modified and supplemented by the communication of March 31, 1983. The Fund finds that, in view of the objectives of the extended arrangement for Brazil, no additional understandings are necessary concerning the modification of the multiple currency practices described under 2(a), (b), and (c) above.

4. In view of the circumstances of Brazil, the approval of Brazil's multiple currency practices granted under Decision No. 7350-(83/41), adopted February 28, 1983, is extended to the modifications of the multiple currency practices described under 2(a), (b), and (c) above and to prospective modifications in the multiple currency practices described under point 5 in the attached communication of March 31, 1983. The Fund approves the retention by Brazil of the exchange restriction involved in the imposition of minimum financing requirements for certain categories of capital goods and replacement parts imports described in EBS/83/77, until August 30, 1983, or the completion of the first review under the extended arrangement, whichever is the earlier.

C. EBD 7562 - 64 - (83/160), 11/22/83 (Consultation Under Extended Arrangement and Exchange Measures).

a. Extended Arrangement

1. Brazil has consulted with the Fund in accordance with paragraph 29 of the letter dated January 6, 1983 from the Minister of Finance and the President of the Central Bank of Brazil and paragraph 4

of the extended arrangement for Brazil (EBS/83/33, Sup. 4, 3/3/83), in order to review progress made by Brazil in implementing its program, reach understandings with the Fund regarding the circumstances in which purchases may be resumed by Brazil under the arrangement, and reach understandings with the Fund regarding policies, measures and performance clauses for the first calendar quarter of the second year of the arrangement.

2. The letter dated September 15, together with the annexed memorandum, and the letter dated November 14, 1983 from the Minister of Planning, the Minister of Finance, and the President of the Central Bank of Brazil, and the letter dated September 5, 1983 from the Minister of Planning and the Minister of Finance shall be attached to the extended arrangement for Brazil; and the letter with the attached memorandum dated January 6, 1983, together with the communication dated February 24, 1983, shall be read as modified and supplemented by these communications.

3. (a) Purchases under the extended arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 2,743.125 million, provided that purchases shall not exceed the equivalent of SDR 1,246.875 million until February 20, 1984, the equivalent of SDR 1,620.875 million until May 20, 1984, the equivalent of SDR 1,994.875 million until August 20, 1984, and the equivalent of SDR 2,368.875 million until November 20, 1984;

(b) Paragraph 4 of the extended arrangement shall be amended to read as follows:

"Brazil will not make purchases under this arrangement:

(a) (i) during any period in which the data at the end of the preceding period indicate that the target for the net international reserves of the Brazilian Monetary Authorities, as specified in paragraph 1 of the Technical Memorandum of Understanding dated September 15, 1983 and in paragraph 7, third sentence, of the letter dated November 14, 1983, is not observed, or

(ii) during any period in which the limit on the public sector borrowing requirement, as specified in paragraph 2 of the Technical Memorandum of Understanding dated September 15, 1983 and in paragraph 6, third sentence, of the letter dated November 14, 1983, is not observed, or

(iii) during any period in which the limit on the operational deficit of the public sector, as specified in paragraph 6, fourth sentence of the letter dated November 14, 1983, is not observed, or

(iv) during any period in which the limit on the net domestic assets of the Brazilian Monetary Authorities, as specified in paragraph 4 of the Technical Memorandum of Understanding dated September 15, 1983 and paragraph 3, fifth sentence, of the letter dated November 14, 1983, is not observed, or

(v) during any period in which the data at the end of the preceding period indicate that the limit on the use of external credit, as specified in paragraph 5 of the Technical Memorandum of Understanding dated September 15, 1983 and in paragraph 7, third sentence, of the letter dated November 14, 1983, is not observed, or

(vi) during any period in which the cumulative quarterly target of the depreciation of the cruzeiro, as specified in paragraph 6 of the Technical Memorandum of Understanding dated September 15, 1983 and paragraph 7, second sentence, of the letter dated November 14, 1983, is not observed, or

(vii) if the intentions to eliminate certain exchange restrictions, including bilateral payments arrangements and payments arrears, and multiple currency practices that are specified in paragraph 15, third sentence, of the letter dated September 15, 1983, paragraphs 7 and 8 of the Technical Memorandum of Understanding dated September 15, 1983 and paragraph 7, fifth sentence, of the letter of November 14, 1983, are not carried out before December 31, 1983; or

(viii) if the intensification of exchange restrictions that took place on September 14, 1983 and arose from reduced limits on foreign exchange allotments for travel abroad, as specified on page 24 of EBS/83/227 (10/19/83), are not eliminated by December 31, 1984; or

(b) if the review with the Fund contemplated in paragraph 2 of the letter dated November 14, 1983 have not been completed in accordance with the following schedule:

(i) The "February" review, including the specification of performance clauses for calendar quarters ending June and September 1984, shall be completed before May 20, 1984;

(ii) The "August" review, including the specification of performance clauses for calendar quarter ending December 1984, shall be completed before November 20, 1984;

(iii) The "November" review shall be completed before February 28, 1985; or

(c) for the third year of this arrangement, if before February 28, 1985 suitable performance clauses have not been established in consultation with the Fund, or if any such clauses, having been established, are not observed, or

(d) if Brazil

(i) imposes new or intensifies existing restrictions on payments and transfers for current international transactions, or

(ii) introduces or modifies multiple currency practices, or

(iii) conclude bilateral payments agreements which are inconsistent with Article VIII, or

(iv) imposes new or intensifies existing restrictions on imports for balance of payments reasons.

When Brazil is prevented from purchases under this extended arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Brazil and understandings have been reached regarding the circumstances in which such purchases can be resumed."

4. The Fund finds that no other understandings are necessary regarding the circumstances in which Brazil can resume purchases under the extended arrangement.

b. Exchange Measures

In view of the circumstances of Brazil, the Fund grants approval of the multiple currency practices and exchange restrictions that are described under points (1), (3)(a), (3)(b), (3)(d), and (5) on page 25 in EBS/83/227, until December 31, 1983; and of those that are described under points (2), (3)(c), (3)(e), (3)(f), (4), and (6) on page 25 in EBS/83/227, until May 20, 1984 or the conclusion of the 1983 Article IV consultation with Brazil, whichever is earlier. The Fund urges Brazil to eliminate at the earliest possible date the discriminatory aspects of its exchange system that are described under points (7) and (8) on page 25 in EBS/83/227 and paragraph 7 of letter dated on November 14, 1983 and contained in EBS/83/227, Supplement 1.

D. EBD 7642 - 43 - (84/37), 3/9/84 (Waiver and Modification of Performance Criteria).

a. Extended Arrangement

1. Brazil has consulted with the Fund in accordance with paragraph 4, last sentence, of the extended arrangement for Brazil (EBS/83/33, Supplement 4, 3/3/83, as amended) and paragraph 29 of the letter dated January 6, 1983 from the Minister of Finance and the President of the Central Bank of Brazil, in order to reach understandings with the Fund regarding the circumstances in which purchases by Brazil can be resumed under the arrangement.

2. The letter dated February 27, 1984 from the Minister of Planning, the Minister of Finance and the President of the Central Bank shall be attached to the extended arrangement for Brazil; and (a) the letter dated January 6, 1983, together with the attached memorandum, from the Minister of Finance and the President of the Central Bank, (b) the letter dated February 24, 1983 from the Minister of Finance and the President of the Central Bank, (c) the memorandum dated March 31, 1983 from the Executive Director elected by Brazil, (d) the letter dated September 5, 1983 from the Minister of Planning and the Minister of Finance, (e) the letter dated September 15, 1983, together with the attached memorandum, from the Minister of Planning, the Minister of Finance and the President of the Central Bank, and (f) the letter dated November 14, 1983 from the Minister of Planning, the Minister of Finance and the President of the Central Bank, shall be read as modified and supplemented by the letter dated February 27, 1984 and by the quantitative performance criteria for the period ending March 31, 1984 as specified in Table 2 of EBS/84/39 (3/2/84).

3. (a) The performance clause in paragraph 4(a)(i) of the extended arrangement shall be amended to read:

"during any period in which the data at the end of the preceding period indicate that the target for the net international reserves of the Brazilian Monetary Authorities, as specified in paragraph 1 of the Technical Memorandum of Understanding dated September 15, 1983, in paragraph 7, third sentence, of the letter dated November 14, 1983, and, as modified in Table 2 of EBS/84/39 (3/2/84) is not observed, or"

(b) The performance clause in paragraph 4(a)(iv) shall be amended to read:

"during any period in which the limit on the net domestic assets of the Brazilian Monetary Authorities, as specified in paragraph 4 of the Technical Memorandum of Understanding dated September 15, 1983, in paragraph 3, fifth sentence, of the letter dated November 14, 1983 and, as modified in Table 2 of EBS/84/39 (3/2/84) is not observed, or"

(c) The performance clause in paragraph 4(a)(v) shall be amended to read:

"during any period in which the data at the end of the preceding period indicate that the limit on the use of external credit, as specified in paragraph 5 of the Technical Memorandum of Understanding dated September 15, 1983, in paragraph 7, third sentence, of the letter dated November 14, 1983 and, as modified in Table 2 of EBS/84/39, 3/2/84, is not observed, or "

(d) The performance clause in paragraph 4(a)(vii) shall be amended to read:

"if the intentions to eliminate certain exchange restrictions, including those evidenced by payments arrears, and multiple currency practices that are specified (A) in paragraph 15, third sentence, of the letter dated September 15, 1983, (B) in paragraph 7(ii) (with respect to receipts from coffee exports only) of the Technical Memorandum of Understanding dated September 15, 1983, and (C) in section 2, second paragraph, of the letter dated February 27, 1984, are not carried out before March 31, 1984, on January 2, 1985, or before March 31, 1984, respectively;"

4. The Fund finds that no other understandings are necessary regarding the circumstances in which purchases may be made under the extended arrangement and that in these circumstances Brazil may proceed to request purchases under the arrangement.

b. Exchange Measures

1. The approval set out in Decision No. 7563-(83/160) adopted November 22, 1983 with respect to the exchange measures described under points (1) and (5) on page 25 in EBS/83/227, 10/19/83 is extended until March 31, 1984 or the conclusion of the 1983 Article IV consultation with Brazil, whichever is earlier. The approval with respect to the exchange measure described under point 3(e) on page 25 in EBS/83/227, 10/19/83, also will apply to the enlargement of the exchange tax to purchases of exchange for petroleum imports. Furthermore, the approval with respect to the exchange measure described under point 3(a) and pertaining to receipts from coffee exports on page 25 in EBS/83/227, 10/19/83, is extended until January 2, 1985.

2. Pending the completion of bilateral arrangements for the rescheduling or refinancing of Brazil's external debt pursuant to the recommendation adopted by the Paris Club on November 23, 1983, the Fund grants approval of the restriction on payments and transfers for current international transactions that are covered by that recommendation.