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October 19, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Brazil - Staff Report for Review Under Extended Arrangement

Attached for consideration by the Executive Directors is the staff report for review under the extended arrangement with Brazil. Draft decisions appear on pages 33-37.

It is understood that the Executive Director for Brazil will be requesting the Board for a waiver of the circulation period to enable this subject to be brought to the agenda for discussion on Friday, November 9, 1984.

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)

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INTERNATIONAL MONETARY FUND

BRAZIL

Staff Report for 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

October 18, 1984

I. Introduction

On May 9, 1984 the Executive Board completed the 1984 Article IV consultation with Brazil and the first of three reviews scheduled for 1984 under the extended arrangement for SDR 4,239.4 million (290 percent of quota) approved by the Executive Board on February 28, 1983 (EBS/83/33, 2/11/83; and Sup. 4, 3/3/84). Performance criteria for the period through September 1984 also were established. Brazil purchased all amounts it was entitled under the arrangement for 1983; in the current year the Executive Board approved on March 9, 1984 a request for waiver of performance criteria corresponding to the December 31, 1983 testing date which entitled Brazil to a purchase of SDR 374 million. Compliance with first and second quarter performance criteria qualified Brazil for two further purchases of SDR 374 million each, at the end of May and August, respectively. To date, Brazil has purchased SDR 2,368 million under the arrangement.

The arrangement called for the second review in 1984 to take place prior to November 20. Accordingly a staff team visited Brazil during August 13-28 to conduct this review, to discuss the economic and financial policies that will be pursued in the latter part of 1984, and to specify performance criteria for the final quarter of 1984. The representatives of the Brazilian Government in the discussions included the Minister of Planning, the Minister of Finance, 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), Robert Sheehy (ETR), Henri Ghesquiere and Joris Buyse (both WHD), and Elena Frolia (Secretary-WHD). Mr. Alexandre Kafka, Executive Director for Brazil, participated in the discussions.

In the letter dated September 28, 1984,1/ signed by the Minister of Planning, the Minister of Finance, and the President of the Central Bank, the Brazilian authorities request the modification of certain performance criteria and targets of the economic program corresponding to the September 30, 1984 testing date, and provide a description of their policy intentions for the remainder of 1984.

II. Performance Under the Extended Arrangement

1. Overall performance

Brazil's performance under the program during the first half of 1984 was characterized by a large improvement in the country's external position, which resulted in an accumulation of international reserves far in excess of that foreseen in the program. This increase in reserves contributed to a much faster than planned growth of the monetary base and money. At the same time, the expansion of the export sector induced a modest recovery of economic activity and the rate of GDP growth in 1984 is now expected to be positive. The resulting growth of aggregate demand, however, impeded the reduction of inflation.

The strengthening of the external position went well beyond what at the beginning of the year had been regarded as ambitious targets. On the basis of an active exchange rate policy and favorable demand conditions in markets abroad, Brazil's export performance improved substantially. In the period January-August the trade surplus amounted to US$8.4 billion; and for 1984 as a whole it is likely to exceed US$11 billion; this surplus compares with one of US$6.3 billion in 1983 and a target of US$9 billion originally set for 1984. As a result of the strong trade performance, the current account registered only a small deficit in the first half of the year and, notwithstanding a shortfall in respect of projected capital inflows, the overall balance of payments showed a surplus of US$4.2 billion, US$1.6 billion in excess of the amount targeted.

Even though a substantial part of the balance of payments surplus was not immediately monetized, it produced a net effect on the monetary base in the first semester of 1984 equivalent to about 68 percent of the monetary base at the beginning of the year. Part of this effect was neutralized by a stronger than projected fiscal performance and by larger than planned open market sales. Nevertheless, the sheer size of the change in international reserves in relation to the monetary base, together with certain other slippages in the execution of monetary policy, led to an increase in monetary aggregates far in excess of that contemplated. During the first half of 1984 the monetary base and the money supply (M-1) expanded by 57 percent and 40 percent respectively, against a planned growth of 50 percent for the year as a whole.

1/ EBS/84/204 (9/28/84).

A gradual decline in the monthly rate of inflation in 1984 had been expected as a result of the tightening of monetary policy that had been planned, together with the effects of the partial deindexation of wages, the normalization of agricultural supply conditions, and the less constrained import situation. Instead, the rate of inflation remained stubbornly pegged around 10 percent a month, resulting in an inflation of 114 percent during the period January-August 1984, some 24 percentage points higher than had been expected in the program.

Economic activity, has responded to these more expansionary circumstances. Industrial production in the period January-June 1984, especially in sectors tied to exports, grew by some 5 percent from the first half of 1983 and there was a moderate increase in employment. The improved situation in respect of industrial output, together with a good performance in agriculture and mining, more than offset the stagnant conditions in the other sectors, particularly construction, that are geared toward domestic demand. For 1984 as a whole, GDP is now expected to grow by 1 to 2 percent, which compares with a decline of 3.3 percent registered in 1983.

Brazil met all quantitative performance criteria specified in the program for the period January-June 1984 (Table 1). Similarly, Brazil complied with the performance clauses in the arrangement relating to the elimination of exchange restrictions and multiple currency practices.

2. Monetary developments

The high rates of inflation that Brazil has experienced over several decades have resulted in a continuous decline in the demand for narrow money, as the liquidity requirements of the economy have come to be met by other financial assets that are indexed to inflation and have become increasingly liquid, for example, time and savings deposits and government securities. In the period 1979-83, while private sector holdings of a broad aggregate of financial assets 1/ fluctuated around the equivalent of 33 percent of GDP (Table 2), the share of M-1 in this aggregate dropped from 26 to 11 percent, which corresponds to an increase in the velocity of circulation of M-1 from 12 to 21 in this four-year period.

The decline in the demand for narrow money was also reflected in the reduction of the monetary base from 5.5 percent of GDP in 1979 to 2.7 percent in 1983. The shrinkage of the monetary base is of particular relevance when seen against the size of the public sector budgets or the balance of payments aggregates. For 1984 the overall borrowing requirement of the public sector is projected to be about 15 times, and the overall surplus of the balance of payments about 3 times, the size of the monetary base at the beginning of the year. In these circumstances, deviations in the public sector or external accounts can lead to very large repercussions on the monetary base.

1/ Currency, demand deposits, time and savings deposits, exchange bills, treasury bills and bonds, and state and municipal bonds.

Table 1. Brazil: Extended Arrangement, Quantitative Performance Criteria for the Period through June 1983

	1983	1984			
		Jan.-Mar.		Apr.-June	
	Actual	Ceiling 1/	Actual	Ceiling 1/	Actual
(In billions of cruzeiros)					
Borrowing requirement of nonfinancial public sector 2/	23,857	11,750	9,081	23,750	23,550
Operational result of public sector 2/	-3,560	-1,300	843	-300	1,537
Net domestic assets of the monetary authorities 3/	6,685	5,350	4,325	4,550	3,034
(In millions of U.S. dollars)					
Change in net international reserves of the monetary authorities 2/	-3,330	1,700	2,630	2,650	4,220
Net disbursements of medium- and long-term, and selected short-term external debt of the public and private sectors 2/	3,489	3,900	3,109	6,800	5,084
External payments arrears	2,300	—	—	—	—

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

1/ Floor in case of net international reserves.
2/ Cumulative change in the calendar year.
3/ Stock at end of period.

Table 2. 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	4,367	8,516
Money (M-1)1/	723	1,240	2,249	3,869	7,499	14,638
Private sector holdings of financial assets 2/	2,758	4,576	10,569	23,233	64,955	216,200
(In percent of GDP; period average)						
Base money	5.5	4.4	3.7	3.4	2.7	1.7
Money (M-1)	8.5	7.5	6.8	6.0	4.7	2.9
Private sector holdings of financial assets	35.2	27.9	29.5	33.3	36.4	37.0
Memorandum items						
Velocity of circulation of M-1 3/	11.7	13.4	14.7	16.6	21.3	34.3
GDP (trillions of cruzeiros)	6.3	13.2	25.6	50.8	121.1	380.0

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

1/ Monetary liabilities to the private sector.
2/ Currency, demand deposits, time and savings deposits, exchange bills, treasury bills and bonds, and state and municipal bonds.
3/ GDP divided by the average stock of M-1.

The program for 1984 had envisaged an expansion of the money supply and the monetary base of about 50 percent for the whole of 1984; however, in just the first six months of the year, the balance of payments registered an overall surplus of US$4.2 billion (against US$2.6 billion projected in the program) which was roughly equivalent to 130 percent of the monetary base at the beginning of the period. A substantial part of the resulting increase in international reserves did not cause an expansion of the monetary base because of arrangements whereby the proceeds from the financial packages provided by foreign commercial banks are deposited in part at the Central Bank. Nevertheless, during January-June 1984 external sector operations accounted for an expansion of the base equivalent to Cr$3.0 trillion, or 68 percent of the base at the beginning of the period. Of this total, about Cr$2.2 trillion (50 percent of the base) can be estimated to correspond to the monetization of the excess in the balance of payments surplus with respect to the program's estimates.

The expansionary effect of the accumulation of international reserves was offset in part by a reduction in the domestic assets of the monetary authorities. Credits to exporters of manufactured products were cut back and had the effect of reducing the expansion of the monetary base by some Cr$200 billion during the first half of 1984. Similarly, net credit to the public sector was maintained some Cr$400 billion below the amount contemplated in the program as deviations related to certain operations of the public sector were more than offset by larger than planned deposits from the Treasury and placement of government securities in the open market. The financial difficulties of the social security system and the continued high level of the price subsidy to wheat producers resulted in an unplanned expansion of credit from the monetary authorities of about Cr$500 billion. Of greater importance, moreover, were the monetary consequences of slippages occurring at the level of the states and municipalities, which resulted in commercial banks owned by the states incurring sizable reserve deficiencies. During the first semester of 1984 such reserve deficiencies increased by Cr$1.1 trillion. However, a stronger than expected performance of the Treasury enabled it to make transfers to the monetary authorities 1/ beyond the amounts contemplated in the initial monetary program. Such transfers amounted to Cr$3.8 trillion in the first half of 1984 as against Cr$2.2 trillion that had been programmed. Also, the monetary authorities made net sales of government securities in the open market in an amount of Cr$237 billion whereas the program envisaged net purchases of some Cr$200 billion in the first half of 1984.

Since late 1983 the authorities have followed a more active interest rate policy which has resulted in relatively high real rates of interest. During the first semester of 1984 commercial bank lending rates for working capital of favored borrowers were in the range of

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1/ Institutional arrangements in Brazil contemplate that while the monetary authorities perform a number of operations on account of the Treasury, the latter transfers to the authorities whatever excess balances are achieved during the year.

20 to 30 percent per annum above the rate of inflation, while government securities were sold at a real yield of some 15 percent. The degree to which open market sales could be used to contain growth of the monetary base was hampered by this high level of real rates of interest and by the precarious situation of a number of institutions in the financial markets. Particularly vulnerable to an increase in real interest rates were the institutions related to the housing sector, which had most of their assets tied up in long-term commitments and were therefore not able to raise the real rate of interest on passbook savings accounts on which they depend for their financing.

All in all, the efforts to curb monetary growth proved to be insufficient to maintain the expansion of the monetary base inside the limits originally contemplated. The monetary base, defined so as to take into account the reserve deficiencies by state banks (i.e., assuming 100 percent compliance with legal reserve requirements), grew by 57 percent in the first semester of 1984 against a planned growth of 14 percent. The money supply grew in this period by 40 percent, against a target of 12 percent. As the main expansionary impulse had come from the accumulation of international reserves, and in view of the domestic offsets just described, the net domestic assets of the monetary authorities contracted by more than had been planned, and that performance criterion of the program was met by a wide margin.

3. Fiscal developments

The performance of the public sector during the first half of 1984 was somewhat stronger than had been expected and the fiscal targets established in the program were met even though inflation was higher than had been projected. This performance reflected mainly the results obtained in the Central Administration and the state enterprises.

The imbalance in the public finances in Brazil is measured by the public sector's borrowing from domestic or foreign sources, including the borrowing related to the maintenance of value of the domestic public debt. The stock of domestic public debt is indexed to the domestic price level (monetary correction) or the exchange rate (exchange correction). Thus, inflation has an important, and not directly controllable, effect on the nominal level of public expenditure. Moreover, the total expenditure on account of the monetary and exchange correction can be affected by the distribution of revenues and other expenditures both over time and across the different operations of the public sector.1/

1/ Indexation is in most cases applied on a monthly basis, therefore the distribution over time of the revenues and other expenditures underlying the public sector's need to borrow, affects the total expenditures for monetary and exchange correction. Furthermore, indexation is not extended evenly to all operations of the public sector--e.g., central government deposits at the monetary authorities are not indexed--so that differences across the public sector with respect to operations that generate surpluses or deficits have a bearing on the total net expenditures for monetary and exchange correction.

During January-June 1984, monetary and exchange correction on the public debt amounted to Cr$25.1 trillion, exceeding the program estimates by Cr$1.6 trillion. More than half of this excess was the result of inflation being larger than projected during this period. These higher expenditures for monetary and exchange correction, were offset by a surplus in the remaining operations of the public sector (an operational surplus) of Cr$1.5 trillion which compares with an operational deficit of Cr$300 billion targeted in the program. Thus, the target for the overall borrowing requirement of the public sector (PSBR) of Cr$23.75 trillion was met by a narrow margin.

The operations of the Central Administration were more favorable than had been expected and provided about Cr$700 billion to offset the higher costs of the indexation of the public debt. The main element behind this more favorable outturn was the performance of income tax revenues which exceeded the program estimates by wide margins as a consequence of both a strong underlying trend and a change in the seasonal pattern of tax collections. The positive effects of the tax measures implemented in late 1983 proved to be larger than estimated initially, and income tax collections for 1984 as a whole are now projected to exceed the initial estimates. In addition there was a change in the seasonal pattern of income tax payments resulting from a modification of legislation that made it profitable for enterprises not to delay the payment of taxes. The authorities did not permit these higher revenues to give rise to larger expenditures, and in fact succeeded in holding expenditures below what had been budgeted for the semester. However, there were also a number of negative developments which limited the gains obtained from higher tax revenues and expenditure containment efforts. These related mainly to larger than projected subsidies, in particular to wheat, and especially to higher interest costs on the public debt resulting from the increase in real interest rates and the larger than planned volume of securities placed in the open market in the attempt to offset the effects of the higher than planned accumulation of international reserves.

The total borrowing by state enterprises in the first semester was about Cr$800 billion lower than projected, reflecting mainly continued restraint on their sources of financing. State enterprises had less access to foreign financing than had been envisaged earlier as foreign creditors opted not to assign proceeds of their lending (both new loans and rescheduling of old loans) to a particular state enterprise, but instead to leave the proceeds at the Central Bank, as provided for under the loan agreements. At the same time, the Central Bank restricted considerably the access to domestic credit by enterprises, as part of its effort to control the expansion of monetary aggregates.

Decentralized agencies and the funds and programs administered by the Central Bank registered a larger than anticipated surplus of about Cr$800 billion, due mainly to the transfer from the Bank of Brazil of additional profits stemming from the reduction of interest rate subsidies.

In contrast, the performance of the states and municipalities and of the social security system fell short of the program's targets. The financial situation of the states and municipalities was affected adversely by the sluggishness of domestic economic activity, which resulted in reduced levels of value added and service tax collections. Efforts to reduce expenditures were not sufficient to offset the revenue shortfall and total borrowing by the state and municipal governments exceeded the program projections by about Cr$400 billion. Total net borrowing by the social security system exceeded the program projections by about Cr$250 billion reflecting the effects of the modified wage legislation which resulted in larger adjustments in benefits than in revenues 1/ as well as the behavior of domestic economic activity. Apparently, there also was an increase in the degree of noncompliance with required social security contributions.

4. Developments in price and incomes policies

During the first half of 1984 administered prices were adjusted in a manner broadly consistent with the understandings reached in this area. The price of petroleum products (and alcohol for combustion purposes) has been adjusted in line with currency depreciation, thereby avoiding the re-emergence of a subsidy. Similarly, the 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, and the prices of other public sector services have been adjusted in line with inflation. The main area of slippage in respect of pricing policy has related to wheat, where delays in making price adjustments meant the continuation of substantial subsidies. The price of wheat and wheat products was adjusted by 50 percent in February 1984 and by 51 percent in July 1984; these increases, however, barely offset inflation and thus did little to reduce the subsidy.

The scope of price controls has been reduced thus far this year. Several rounds of liberalization have lifted controls on a number of items. By July 1984, the total weight of goods free of controls represented more than half of the goods in the wholesale price index.

Real wages in Brazil have experienced a decline in the wake of the changes in wage legislation introduced in 1983, and the acceleration of inflation that occurred in that year. Available information indicates that real wages declined by some 12 percent from 1982 to 1983. This decline continued in 1984 as the average real wage during the first half of the year declined further to about 17 percent below 1982 levels. The erosion of real wages has created growing resistance to the application of the existing wage legislation which contemplates an average factor of adjustment for past inflation of 86 percent. In the private sector, where the wage law determines only a minimum which can be exceeded by mutual agreement, there have been a number of reports of

1/ Legislation submitted by the Executive to limit the growth of benefits to that of revenues was rejected by Congress in early 1984.

firms granting full compensation for past inflation. In the public sector, some state enterprises have been authorized to revise their salary profiles in order to limit the compression of salaries in the medium and upper ranges. By and large, however, the adjustment of wages has remained below what might have been indicated by past inflation.

5. External sector

The improvement in Brazil's external position during the first half of 1984 exceeded all expectations. Net international reserves increased by US$4.2 billion during January-June 1984, substantially more than the performance criterion of a surplus of US$2.65 billion; indeed, the outturn in the first half of the year nearly matched the program target of US$4.3 billion specified for the entire year. Although analysis of the components of the balance of payments is complicated by the emergence since mid-1983 of measurement problems,1/ the improvement is attributable largely to a better than projected performance on the current account. Reflecting mainly the strength of the trade balance the external current account deficit, which amounted to almost US$4 billion in the first six months of 1983, appears to have been nearly eliminated in the first half of 1984. On the strength of larger sales of semimanufactured and manufactured products, exports in the first half of 1984 were 22 percent higher than in the corresponding period of the previous year, whereas imports were 12 percent lower. Much of the decline in imports reflected increased substitution of domestic production, particularly as regards petroleum; there are signs of a recovery in the value of non-oil imports, which by mid-1984 had reached the monthly level of the preceding year.

Net capital inflows during the first half of 1984, although more than double the exceptionally low level recorded in the corresponding period of the previous year, were considerably smaller than had been projected. Despite higher than expected inflows from direct foreign investment and a change in the terms of Brazilian lending abroad, total net capital inflows during the first semester fell short of the projection by nearly US$1.5 billion. Lower than expected disbursements of loans from multilateral and bilateral agencies and suppliers account for most of this shortfall. The lower disbursements from these creditors were attributable to several factors, including a decline in demand for import financing stemming from both the reduction in imports and a shift toward shorter-term credits, delays in putting into place the arrangements for the US$2.5 billion of new trade credits from official lenders, a suspension of disbursements by certain official creditors pending completion of bilateral agreements under the Paris Club, and temporary shortages of counterpart funds for certain multilateral credits.

1/ Errors and omissions during the 12-month period ended June 1984 amounted to a negative flow of more than US$2 billion. This amount apparently is related to both certain types of service payments and some capital accounts.

The cruzeiro, which was depreciated by 23 percent on February 21, 1983, has subsequently been adjusted frequently by small amounts to offset movements in the general price index. As a result of this policy, which was a performance criterion under the program, the cruzeiro was depreciated in nominal terms by some 52 percent with respect to the U.S. dollar during January-August 1984. The real value of the cruzeiro in relation to a basket of currencies of the main trading partners declined by about 2 percent during the same period.

Further progress was achieved during the first half of 1984 in liberalizing the exchange and trade system. Outstanding external arrears were eliminated and the comprehensive system of foreign exchange allocation was abolished in March, the multiple currency practice affecting cocoa exports was eliminated in April, and the authorities announced that the coffee contribution quota will be replaced by an export tax with effect from January 1985. Brazil has made steady progress in concluding the bilateral debt rescheduling agreements pertaining to the understandings reached under the auspices of the Paris Club, and despite considerable delays in obtaining and reconciling the necessary information on outstanding claims, these agreements are now expected to be completed during this month.

III. Policy Discussions

1. General considerations

The discussions focused on the policies required to re-establish consistency between the strong external performance and the need to slow the expansion of monetary aggregates so as to break the momentum of inflation. In the context of a highly indexed economy, the relatively strong demand from the foreign sector has contributed to maintain, if not to aggravate, the inflationary pressures carried forward by the indexation. The pervasiveness of indexation practices is having far-reaching consequences, as it retards the speed at which inflation can be brought down while it maintains the vulnerability of the economy to exogenous shocks that move inflation to higher levels. In view of the existing high rate of inflation, it is especially important that the elimination of indexation be accompanied by the implementation of policies that lead to a decisive break in inflation. The indexation system represents a delicate balance of mechanisms built over the years to protect the relative income position of different sectors of the economy and to preserve the efficacy of key instruments of economic policy, such as the interest rate and the exchange rate. The elimination of indexation requires, therefore, a balanced approach that avoids distortions in the use of these policy instruments and takes into account the impact on income distribution that such an initiative cannot fail to have.

During the first half of 1984, the authorities were not able to contain the growth of the monetary base to the rate specified in the program, in spite of efforts to offset the effects of the higher than anticipated accumulation of international reserves through the sterilization of fiscal revenues and larger than planned open market operations. It became apparent, therefore, that successful slowdown of monetary growth without a further crowding out of the private sector would require greater assistance from fiscal policy. The anti-inflation effort also would be helped by a faster liberalization of the trade system. Thus, the discussions centered on the design of a set of measures in the fiscal, monetary, and trade areas that would help to break the inflationary stalemate and start the rate of inflation on a downward path. Nevertheless, in view of the ground lost already in 1984 and the rigidities imposed by indexation, the program's initial objective for inflation in 1984 was no longer within reach. Accordingly, the projected rate of inflation for 1984 had to be reassessed and was raised to nearly 200 percent, compared with an initial objective of 100-130 percent.

The deviations in the first half of the year with respect to some key assumptions in the program, in particular in relation to inflation and the balance of payments, resulted in a need to modify some of the performance criteria that had been established for September 1984 (Table 3). In particular, the criteria relating to fiscal performance had to be adjusted to reflect the effects of the higher inflation and the higher than forecast real interest costs on the public debt. At the same time, the criteria relating to net domestic assets, international reserves and external indebtedness were tightened, primarily to reflect the improved performance of the balance of payments. Performance criteria for the quarter ending December 1984 were established consistent with the new policy understandings.

2. Fiscal policy

The program for the second year of the extended arrangement, as initially formulated, contemplated a reduction of some 5 percentage points of GDP in the overall borrowing requirement of the public sector (PSBR) in 1984. About half of this was to come from lower expenditures for the maintenance of value of the public debt as the result of the expected deceleration of inflation. The failure of inflation to decline precluded any reduction in monetary correction expenditures relative to GDP. Indeed, monetary correction costs increased more than might have been expected, as a consequence of the rise in public debt that resulted from the open market operations undertaken to offset the inflow of

Table 3. Brazil: Extended Arrangement, Quantitative Performance Criteria for the Period through December 1984

	Prel. Actual June 1984	Targets and Limits for 1984		
		Orig.1/ July-Sept.	Modif. July-Sept.	Oct.-Dec.
(In billions of cruzeiros)				
Borrowing requirement of nonfinancial public sector 2/3/	22,926	34,500	44,500	67,800
Operational result of the public sector 2/3/	1,815	-700	-1,100	2,100
Net domestic assets of the monetary authorities 4/	3,034	2,800	1,600	-50
(In millions of U.S. dollars)				
Change in net international reserves of the monetary authorities 3/	4,220	3,650	5,100	5,700
Net disbursements of medium-, long-, and selected short-term external debt of the public and private sectors 3/	5,084	9,100	8,600	10,800

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

1/ As specified in EBS/84/84.
2/ New definition. See Appendix IV for detailed explanation.
3/ Cumulative change in the calendar year.
4/ Stock at end of period.

foreign reserves,1/ and a different distribution of debt-generating operations (e.g., state enterpises had less recourse to foreign borrowing in the earlier part of the year, and used instead a larger than planned volume of domestic borrowing on which monetary correction had to be paid). For the year as a whole, therefore, and in spite of a tightening of operations other than those related to monetary correction, the decline in the PSBR in relation to the outcome of 1983 is expected to be less than 1 percentage point of GDP (Table 4).

In the early part of 1984, the increase in expenditures associated with monetary correction was more than offset by a surplus in other operations; however, there were indications that this surplus was likely to disappear in the second half of the year. As already mentioned, an important factor explaining the better than projected results in the first semester of 1984 was a change in the seasonal distribution of tax revenues and expenditures by state enterprises. Furthermore, a re-estimation of interest payments by the public sector showed that a markedly larger than projected total interest bill was likely to result in 1984 as a consequence of the higher level of real rates of interest in the economy and the larger than planned outstanding stock of public debt. These developments suggested that, apart from the higher than projected monetary correction outlays, the other operations of the public sector were likely to result in a deficit for the year as a whole of some Cr$400 billion (0.1 percent of GDP) instead of the surplus of Cr$1.1 trillion (0.3 percent of GDP) that had been expected. To avoid such an outcome and offset in part the larger monetary correction outlays in prospect, the authorities decided to implement a set of fiscal measures that would increase fiscal savings in 1984 by about Cr$2 1/2 trillion and would result in an operational surplus of Cr$2.1 trillion (0.6 percent of GDP). For the most part, these measures emphasized further expenditure containment, particularly in the Central Administration and state enterprises, and the additional sterilization of tax revenue with the monetary authorities.

The Central Administration is now projected to have a borrowing requirement in 1984 equivalent to about 5.5 percent of GDP. Monetary correction expenditures would amount to about 6 percent of GDP, while

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1/ Even though, in principle, open market operations for purposes of monetary control do not affect the public sector deficit, there is in the case of Brazil an assymetry in the treatment of the financial assets and liabilities of the public sector. While the latter pay monetary correction, some assets, in particular certain deposits in the banking system, do not earn monetary correction. This discrepancy is to disappear in the context of the proposed financial reform which is described below. In view of the importance that deposits of the Treasury with the Central Bank and open market sales attained in 1984, this factor is of increasing relevance in the analysis of fiscal performance. Preliminary estimations indicate that the monetary correction cost of the operations effected for purposes of monetary control could amount to some 3 to 5 percentage points of GDP.

Table 4. Brazil: Public Sector Operations 1/

(As percent of GDP)

	1982	1983	Prog.2/ 1984	Proj. 1984
Total financing	15.8	18.5	13.3	17.8
Operational	6.2	1.9	-0.4	-0.6
Monetary correction	9.6	16.6	13.7	18.4
Central Administration	5.5	4.4	2.9	5.5
Operational	2.0	-0.6	-1.1	-0.6
Revenues	(9.4)	(9.7)	(9.7)	(9.3)
Expenditures	(11.4)	(9.1)	(8.6)	(8.7)
Direct 3/	/8.0/	/7.6/	/7.8/	/7.0/
Indirect	/3.4/	/1.5/	/0.8/	/1.7/
Monetary correction	3.5	5.0	4.0	6.1
States and municipalities	4.4	5.9	4.4	5.9
Operational	1.5	0.9	0.1	0.1
Domestic financing	(1.4)	(1.0)	(-0.2)	(—)
Foreign financing	(0.1)	(-0.1)	(0.3)	(0.1)
Monetary correction	2.9	5.0	4.3	5.8
State enterprises	7.1	9.2	6.8	7.4
Operational	3.8	2.5	1.4	1.0
SEST enterprises 4/	(2.6)	(1.6)	(1.2)	(0.6)
Revenues	/14.3/	/16.2/	/17.0/	/16.8/
Treasury transfers	/2.9/	/2.6/	/2.1/	/2.1/
Expenditures	/19.8/	/20.4/	/20.3/	/19.5/
State public enterprises 5/	(1.2)	(0.9)	(0.2)	(0.4)
Monetary correction	3.3	6.7	5.4	6.4
Other	-1.2	-1.0	-0.8	-1.0
Operational	-1.1	-0.9	-0.8	-1.1
Decentralized agencies	(0.3)	(0.2)	(-0.1)	(—)
Bond security system	(-0.4)	(-0.2)	(-0.1)	(0.3)
Funds and programs	(-1.0)	(-0.9)	(-0.6)	(-1.4)
Monetary correction	-0.1	-0.1	—	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/ New definition, revised GDP numbers. A negative sign means a surplus.

2/ As specified in EBS/84/84 but on the basis of the new definition of PSBR and the revised GDP numbers.

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.

the other operations would be in surplus. This operational surplus would largely reflect the decline in direct expenditures, by about 8 percent in real terms when compared with 1983 (Table 5) which results from a contraction in the real wage bill and a smaller than initially projected increase in transfers to other levels of government. Measures recently announced aimed at increasing revenues of the social security system and reducing tax subsidies to exports also would contribute to this result. By contrast, indirect expenditures, i.e., those made by the monetary authority on behalf of the Treasury, are projected to increase from earlier estimates because of the larger interest payments on government securities and the increased cost of the wheat subsidy. The authorities have stated their intention to eliminate the wheat subsidy by the end of 1984 through a number of price increases during the fourth quarter. The indirect expenditures, however, are more than covered by the transfers from the Treasury to the monetary authorities,1/ which are projected to increase from 1983 by some 15 percent in real terms to Cr$9 trillion, or 2.4 percent of GDP.

The operational performance of state enterprises (i.e., excluding the increased payments for monetary correction) is now expected to be somewhat stronger than initially projected. While the financing required to cover monetary correction, which amounted to 6.7 percent of GDP in 1983, is now projected to decline only to 6.4 percent instead of 5.3 percent as initially estimated, the deficit in the other operations of state enterprises is projected to be limited to 1 percent of GDP as compared with 2.5 percent in 1983 and 1.3 percent in the earlier projection for 1984. This result is mainly the consequence of the continued restraint in expenditures projected for the latter part of the year.

The finances of the states and municipalities, which had deteriorated during the first half of 1984, are expected to improve in the second semester of the year mainly on the strength of an increase in the yield of the sales tax (ICM) with the recovery of economic activity. The second stage of a legislative initiative that increases the participation of states and municipalities in total public sector revenues is slated to become effective on January 1, 1985. All in all, states and municipalities are expected to register a borrowing requirement equivalent to 5.9 percent of GDP in 1984, virtually all of which would be accounted for by expenditures associated with the monetary correction of the debt.

The overall surplus of other public sector institutions will be maintained roughly unchanged from the previous year at the equivalent of 1 percent of GDP. The social security system, which has problems that are more structural than cyclical in nature, will register a deficit equivalent to some 0.3 percent of GDP, in spite of a recently

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1/ Including an increase in government deposits at commercial banks by about Cr$1 trillion.

Table 5. Brazil: Central Administration Accounts

(In billions of cruzeiros; and in percent)

	1982	1983	Real Rate of Change	Proj. 1984	Real Rate of Change
Revenues 1/	4,775	11,782	-3.1	35,430	-3.3
Expenditures 2/	4,089	9,244	-11.4	26,345	-8.1
Wages and salaries	1,017	2,239	-13.5	5,634	-19.1
Transfers	2,263	4,993	-13.3	16,956	7.9
SEST state enterprises	(1,212)	(2,465)	(-20.1)	(6,788)	(-11.5)
States and municipalities	(867)	(1,929)	(-12.6)	(6,290)	(4.9)
Social security system (SINPAS)	(57)	(233)	(60.6)	(752)	(3.8)
National Petroleum Council (CNP)	(--)	(--)	(--)	(1,000)	(...)
Other 3/	(127)	(366)	(13.2)	(1,926)	(69.2)
Other expenditures 4/	809	2,012	-2.5	3,955	-36.8
Transfers to monetary authorities 5/	686	2,538	45.1	9,085	15.1
Memorandum item					
Monetary correction on public federal debt	1,759	5,743	28.5	22,365	25.2

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

1/ Includes certain borrowed resources, which amount to Cr$47 billion in 1982, CR$200 billion in 1983, and Cr$815 billion in 1984.
2/ Excluding monetary correction.
3/ Includes transfers to other levels of the public sector for payments of debt service.
4/ Includes FINSOCIAL from 1983 onward.
5/ Includes changes in deposits of tax collections with the commercial banks.

decreed increase in taxes earmarked for this sector. However, better performance with respect to 1983 in the decentralized agencies and the funds and program should make up for this shortfall.

The measures to increase public sector savings described above are expected for the most part to have their effects only in the fourth quarter of the year, therefore, and in view of the developments in respect to inflation and interest rates in the economy thus far in 1984, it is proposed to modify the criteria relating to fiscal performance that had been specified in the program for the calendar quarter ended September 1984. The authorities propose to increase the ceiling on the PSBR for the period January-September from Cr$34.5 trillion 1/ to Cr$44.5 trillion in reflection of the increased costs associated with monetary correction. The subceiling on the operational deficit of the public sector is to be raised from Cr$700 billion 1/ to Cr$1.1 trillion, mainly to take into account the increased interest payments by the public sector which could not be offset fully by other savings during the third quarter of the year. Taking into account the additional measures being undertaken in the fiscal area, and given the projection of inflation of 194 percent during 1984, the ceiling on the PSBR during the 12-month period ending December 1984 has been specified at Cr$67.8 trillion, equivalent to 17.8 percent of GDP. The corresponding operational result has been specified to show a surplus of Cr$2.1 trillion or 0.6 percent of GDP.

Experience with the program for over one year suggested the advisability of certain changes in the definition and measurement of the PSBR. Moreover, improvements in the availability of information also indicated areas where the definition might be improved. The modifications that were introduced affect specific components of the overall public sector borrowing requirement as well as the breakdown between the operational outcome and monetary and exchange correction. As these modifications by and large offset one another, the overall picture of the process of adjustment of the public sector does not change significantly (Table 6). Appendix IV contains a detailed description of the changes introduced and a quantification of their effects.

3. Monetary policy

The strength of the forces behind the expansion of the monetary aggregates--particularly the accumulation of international reserves--gave rise to a need to revise the monetary program for 1984. The initial aim of limiting the expansion of the monetary base and M-1 to 50 percent during 1984 could no longer be maintained given that by end-July the monetary base and M-1 had grown by 71 percent and 52 percent, respectively (or by 139 percent for each variable in the 12 months

1/ According to the modified definition of the PSBR (see below and Appendix IV). In terms of the previous definition, the September ceilings for the PSBR and the operational deficit were Cr$35.5 billion and Cr$600 billion respectively.

ended July 1984). Also, the balance of payments projections for the second semester indicated a further accumulation of international reserves of some US$1.5 billion, equivalent (if fully monetized) to 47 percent of the monetary base of June 1984. Concern about the inflationary effect of the rapid expansion of liquidity led the authorities to decide to limit the growth of both aggregates in 1984 to 95 percent, implying a reduction in the rate of expansion of the monetary base from an average of 8 percent a month during the first seven months to 2.7 percent a month during the last five months of the year. This deceleration is even more pronounced if seasonal factors are taken into account, as the new targets imply that the monetary base and M-1 would grow by 6 percent and 18 percent respectively in the last quarter of the year, compared with rates of 21 percent and 30 percent contemplated in the initial program. The large improvement in public sector finances projected for the last quarter of the year, which to a large extent will be transferred to the monetary authorities, should facilitate achievement of the new targets.

Table 6. Brazil: Effect of the Modification of Definition of the Public Sector Borrowing Requirement 1/

(As percent of GDP)

	1982	1983	1984
Total financing			
Old definition	16.4	19.7	18.3
New definition	15.8	18.5	17.8
Operational			
Old definition	6.8	2.9	-0.5
New definition	6.1	1.9	-0.6
Monetary correction			
Old definition	9.6	16.8	18.8
New definition	9.7	16.6	18.4

Sources: Central Bank of Brazil, Getulio Vargas Foundation; and Fund staff estimates.

1/ For a detailed explanation of the differences between the two definitions used, see Appendix IV.

The monetary budget, which contains detailed monthly projections of the assets and nonmonetary liabilities of the monetary authorities, was revised to incorporate the new assumptions regarding 1984. On the asset side the budget was adjusted to reflect, inter alia, the monetary impact of the overall balance of payment surplus that is now expected to reach US$5.7 billion in 1984, the elimination of the rediscounts from the Central Bank to exporters of manufactures,1/ and the increased expenditures for social security and the commercialization of wheat. To offset the net expansionary effect of the changes made in the asset side, the monetary budget contemplates a substantial expansion of its resources, mainly enlarged transfers from the Treasury and substantially larger placements of securities in the open market. The monthly totals for the monetary base and money supply resulting from the projections of the monetary budget have been specified in the program for monitoring purposes.

The authorities have been pursuing policies that ensure positive real rates of interest and intend to continue doing so by maintaining the monetary correction factor that is used to adjust the value of financial assets and obligations in line with inflation. The achievement of the targets implicit in the monetary budget for 1984 requires a large increase in the net placement of government securities in the market, which is likely to put upward pressure on interest rates. In September 1984 the authorities took a number of measures aimed at facilitating the intended shift in the portfolios of holders of financial assets. These measures included new portfolio requirements on banks and private insurance funds to be fulfilled with government securities, and restrictions on competing financial assets, such as time deposits. In addition, the authorities decreed a temporary freeze on the withdrawals of deposits on foreign loans of the private sector.2/ These deposits at the Central Bank (amounting to the equivalent of about US$7 billion) constituted a large potential source of monetary expansion, especially in the event of a further rise of domestic interest rates.

1/ On August 21, 1984 the Monetary Council decided to transfer the responsibility for credit to exporters of manufactures to the private commercial banks. The initial monetary budget for 1984 had included Cr$700 billion for this purpose. The subsidy element involved in these credit operations was substantially reduced and made more transparent as the Treasury undertook to grant a fixed subsidy equivalent to 10 percentage points of the market's annual rate of interest. The immediate effect of this measure was to raise the real rate of interest paid by exporters from 3 percent to some 15 percent.

2/ The deposits on foreign loans are cruzeiro deposits with the monetary authorities made by Brazilians obligors in respect to foreign loans. These deposits carry exchange correction and pay interest equivalent to the interest specified in the foreign loan.

The proposed performance criterion relating to the expansion of the net domestic assets of the monetary authorities was tightened considerably to reflect the authorities' intention to offset in part the increase in monetary liabilities stemming from the accumulation of reserves. The revised projection of the liabilities to the private sector is consistent with the target of an increase of 95 percent in the monetary base (Table 7). The projection of net international reserves 1/ is consistent with the projected balance of payments surplus of US$5.7 billion in 1984, and takes into account the fact that a part of these additional reserves is not monetized (as it represents an increase in the medium- and long-term foreign liabilities of the Central Bank). As achievement of the target specified for the monetary base implies a further cutback in credit and large open market sales, the ceiling on the stock of net domestic assets on September 30, 1984 was reduced to Cr$1.6 trillion instead of the previously specified ceiling of Cr$2.8 trillion, and the ceiling for December 31, 1984 was specified at negative Cr$50 billion.

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 175 percent, reflects largely the indexation to inflation of time and savings deposits as the growth of currency and demand deposits is expected to be limited to 95 percent. This targeted expansion of M-1 would imply an increase in the velocity of circulation of M-1 from 21 in 1983 to 34 in 1984. For the banking system as a whole, credit to the private sector is expected to decline by some 8 percent in real terms adding to the contraction by 20 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 by about 19 percent.

On August 21, 1984 the Monetary Council approved the broad outline of a fundamental reform of the financial system aimed at separating more clearly the functions and responsibilities of the Central Administration, 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 making changes in the total debt subject to congressional approval. The Central Bank would continue to rely on open market operations, but exclusively as a tool of monetary control. The Bank of Brazil would be separated from the monetary authority and would be organized as a regular commercial bank. The economic development and fiscal functions currently performed by the monetary authorities would be allocated to the pertinent agencies of the Central Administration. Thus, the overall arrangements of decision making and control in the public area would be streamlined, and the Central Bank would be freed to concentrate exclusively on its functions

1/ Expressed in cruzeiros at the rate of Cr$2,246 per U.S. dollar for September 30, 1984, and Cr$2,878 per U.S. dollar for December 31, 1984.

Table 7. Brazil: Summary Accounts of the Monetary Authorities

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

	1983		1984		
	Value	Real Rate of Change	Prel. June Value	Proj. Dec. Value	Real Rate of Change 1/
Liabilities to private sector	3,459	-35.9	4,986	7,756	-23.7
Monetary liabilities	2,710	-38.3	3,792	5,353	-32.8
Quasi-money	507	-19.3	930	2,031	36.3
Other liabilities	242	-35.2	264	372	-47.7
Net international reserves	-3,226	20.1	1,952	7,806	...
Net domestic assets	6,685	-17.3	3,034	-50	...
Net claims on public sector	3,747	402.0	2,979	-3,152	...
Credit to private sector	6,782	-35.7	9,374	13,215	-33.7
Other net foreign assets	4,460	70.3	8,645	15,365	17.2
Medium- and long-term foreign liabilities	-10,299	184.7	-20,892	-37,195	22.9
Deposits on foreign loans	-10,817	53.0	-22,584	-32,521	2.3
Official capital and surplus	9,366	138.3	20,002	35,263	28.1
Other	3,446	273.1	5,510	8,975	-11.4

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

1/ December 1984 relative to December 1983.

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

(In billions of cruzeiros, and in percent)

	1983		1984		
	Value	Real Rate of Change	Prel. June Value	Proj. Dec. Value	Real Rate of Change 1/
Liabilities to private sector	44,562	-10.8	77,103	122,716	-6.3
Monetary liabilities	7,499	-34.8	10,512	14,638	-33.6
Quasi-money	27,813	-0.7	50,878	81,769	--
Other liabilities 2/	9,250	-11.2	15,713	26,309	-3.3
Net international reserves	-950	-1.8	5,410	14,028	...
Net domestic assets	45,512	-10.6	71,693	108,688	-18.8
Net claims on public sector	26,190	9.6	39,298	62,023	-19.4
Credit to private sector	52,534	-19.8	91,591	141,413	-8.4
Net social security funds	-16,624	-6.2	-29,951	-49,413	1.1
Official capital and surplus	2,180	...	6,808	14,030	118.9
Medium- and long-term foreign liabilities	-28,416	56.9	-51,189	-89,358	7.0
Deposits on foreign loans	-10,818	53.0	-22,584	-32,521	2.2
Other	20,466	139.2	37,720	62,514	3.9

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

1/ December 1984 relative to December 1983.
2/ Import and "other" deposits, bonds, private capital and surplus.

of monetary regulation. The studies for the detailed implementation of this decision are fairly advanced and it is expected that the reform will be completed in early 1985.

4. External policies

a. Balance of payments projections

In view of the strong performance of the external sector in the first semester and the expected favorable evolution of most major components during the remainder of the year, the balance of payments in 1984 is projected to show a very marked improvement. Net international reserves are now projected to rise by US$5.7 billion, substantially more than the program target of a surplus of US$4.3 billion, and thus should make it possible to raise gross reserves to the equivalent of 3 1/2 *months of imports of goods and services* (Table 9). The performance criterion on the overall balance of payments result for 1984 as a whole has been revised in accordance with these new estimates, and for September it was raised from US$3.65 billion to US$5.1 billion. The better than expected performance reflects mainly the substantial adjustment achieved in the current account, with the deficit now expected to be only US$2.7 billion (about 1 percent of GDP) in 1984; such a deficit would be about half the one programmed and would represent a significant improvement over the external current deficit of US$6.2 billion (3 percent of GDP) recorded in 1983.

The principal element contributing to the better than projected current account result is the trade balance. The surplus on merchandise trade is expected to reach at least US$11.0 billion in 1984, up sharply from the surplus of US$6.5 billion registered in 1983. Despite the recent softening of some primary commodity prices, exports are projected to increase by about 18 percent to some US$26 billion. The growth of exports, which reflects mainly higher sales of semimanufactures and manufactures, is attributable to the improved competitive position of the Brazilian economy, the higher level of activity in principal industrial countries, and some recovery of markets in other developing countries. The growth of exports would have been still higher but for the impact of policies adopted by some industrial countries to limit imports of certain Brazilian products. The strengthening of the trade balance also will reflect a projected decline of about 4 percent in total imports in 1984. The reduction is due to lower purchases of crude oil and petroleum products as a result of higher domestic production and the effects of conservation efforts; non-oil imports are projected to rise by 13 percent from the low level recorded in 1983.

The deficit on services and transfers is expected to increase from US$12.6 billion in 1983 to close to US$14.0 billion in 1984. The deterioration is attributable to a rise in interest payments to US$11.7 billion (5.4 percent of GDP) in 1984 as a result of the larger stock of debt and a small increase in the average interest rate. The rise in

Table 9. Brazil: Balance of Payments

(In billions of U.S. dollars)

	1982	1983	1984 Prog.	1984 Rev.	Jan.-June 1983	Jan.-June 1984
Current account 1/	-14.7	-6.2	-5.3	-2.7	-3.9	-0.1
Merchandise trade	0.8	6.5	9.1	11.0	2.9	6.1
Exports	(20.2)	(21.9)	(24.6)	(25.8)	(10.4)	(12.7)
Imports	(-19.4)	(-15.4)	(-15.5)	(-14.8)	(-7.5)	(-6.6)
Oil	/-10.1/	/-8.2/	/-6.7/	/-6.6/	/-4.2/	/-3.6/
Other	/-9.3/	/-7.2/	/-8.8/	/-8.2/	/-3.3/	/-3.0/
Services and transfers	-15.5	-12.7	-14.4	-13.7	-6.8	-6.2
Interest	(-11.3)	(-9.6)	(-10.6)	(-10.8)	(-4.9)	(-5.0)
Receipts	/1.2/	/0.7/	/0.7/	/0.9/	/0.4/	/0.5/
Payments	/-12.5/	/-10.3/	/-11.3/	/-11.7/	/5.3/	/-5.5/
Other	(-4.2)	(-3.1)	(-3.8)	(-2.9)	(-1.9)	(-1.2)
Capital account	8.2	2.8	9.6	8.4	2.0	4.3
Direct investment 1/	1.0	0.7	0.7	0.9	0.2	0.6
Long-term capital	9.0	4.4	10.5	8.2	2.5	5.0
Banks	(8.9)	(3.8)	(6.9)	(6.9)	(2.7)	(5.1)
New loans	/13.6/	/3.4/	/6.5/	/6.5/	/2.5/	/4.8/
Refinancing	/--/	/4.5/	/5.4/	/5.4/	/2.2/	/3.0/
Amortization	/-4.7/	/-4.1/	/-5.0/	/-5.0/	/-2.0/	/-2.7/
Other (net)	(0.1)	(0.6)	(3.6)	(1.3)	(-0.2)	(-0.1)
Brazilian lending abroad	-0.6	0.1	-0.6	0.3	--	0.3
Short-term capital	-0.8	-1.9	-1.0	0.2	-1.1	-0.4
Errors and omissions	-0.4	-0.5	--	-1.2	0.4	-1.2
Overall balance	-6.5	-3.3	4.3	5.7	-1.9	4.2
Change in net international reserves (increase -)	6.5	3.3	-4.3	-5.7	1.9	-4.2
Assets	4.5	--	-3.8	-5.4	0.6	-3.1
Liabilities	2.0	3.3	-0.5	-0.3	1.3	-1.1
IMF	(0.5)	(2.2)	(1.8)	(1.8)	(0.9)	(1.0)
Other	(1.5)	(1.1)	(-2.3)	(-2.1)	(0.4)	(-2.1)
Memorandum items						
As percent of GDP						
Current account balance	(-7.1)	(-3.0)	(-2.4)	(-1.2)	(...)	(...)
Oil imports	(4.9)	(3.9)	(3.1)	(3.0)	(...)	(...)
Non-oil imports	(4.5)	(3.4)	(4.0)	(3.8)	(...)	(...)

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

1/ Excluding reinvested earnings.

interest rates during 1984 will begin to affect actual payments only toward the end of the year; however, the higher rates will have a substantial impact on interest expenditures in 1985. Net payments for other services and transfers are expected to show little change in 1984.

Net capital inflows are projected to recover from the extremely low level of 1983 to reach US$8.4 billion in 1984, but they will be considerably below program estimates. The improvement is attributable mainly to higher inflows from international banks and the elimination of the large short-term capital outflows that were experienced last year. A modest increase in direct foreign investment is projected, as is some additional inflow due to the shortening of the terms of Brazilian credits abroad to finance exports. Some growth is expected in nonbank medium- and long-term capital inflows, reflecting mainly higher disbursements by multilateral lending institutions and the longer period covered by bilateral debt rescheduling under the auspices of the Paris Club. However, little change is projected in other inflows from bilateral lenders and suppliers, representing a considerable shortfall from the large increase in disbursements that had been expected in 1984 on this account.

The outlook for the balance of payments in 1985 remains somewhat uncertain, and revised projections are not yet available. Developments in the trade balance will depend on the strength of economic activity in the principal foreign markets and on the impact of the recent measures taken by Brazil to reduce export incentives and liberalize imports. In addition there is considerable uncertainty about the magnitude of interest payments, in light of the recent movements of international interest rates. How the capital account will evolve will depend to an important extent on the magnitude of bilateral capital inflows, the size of a possible loan agreement with the commercial banks, and the arrangements for Brazilian lending abroad to finance exports.

b. Exchange and trade policies

The authorities intend to continue their policy of frequent but small depreciations of the cruzeiro in relation to the U.S. dollar in line with domestic inflation, thereby maintaining external competitiveness. They also intend to make further progress in the elimination of the remaining multiple currency practices and exchange restrictions, and will continue to work to simplify the exchange and trade system.

A number of measures were introduced in September 1984 to reduce the complexity and restrictiveness of the exchange and trade system, including several steps that had not been expected to be implemented before mid-1985. A schedule was adopted for phasing out the export tax credit (*credito-premio*), which currently gives rise to a multiple currency practice. The credit, which at present is 11 percent of the value of eligible exports, will be reduced in stages beginning November 1, 1984 and will be completely eliminated by end-April 1985. The financial

transactions tax (IOF) on sales of foreign exchange, also a multiple currency practice, was reduced in scope through the elimination of the tax on exchange sold for oil imports, which had been introduced in early 1984. In addition, the exchange restriction resulting from the required minimum financing terms for imports was relaxed substantially as the specified terms were altered to conform with prevailing market conditions and exceptions to the requirement were permitted for a number of important categories, including in particular small- and medium-sized firms which normally do not have ready access to the international financial markets. Furthermore, the list of prohibited imports was substantially shortened. A revised tariff schedule was adopted to replace the previous surcharges of 30 to 100 percentage points, with additions of 10 to 30 percentage points in the basic tariff rates, and the requirement that imports financed abroad should be subject to the requirement of national similarity (i.e., the nonexistence of a satisfactory domestic equivalent) was eliminated. These two latter measures will have little immediate economic impact, but are important steps toward a simplification of the system.

The authorities have undertaken to operate the import budgeting system so that it will be used for indicative purposes (i.e., non-binding) only, thereby eliminating the exchange restriction that this practice had previously involved. The authorities have also given assurances that the import licensing procedure itself is being administered so that no licenses are denied for reasons of use or availability of foreign exchange.1/ The restriction on the transfer of certain balances associated with the rescheduling of certain obligations under the Paris Club will be eliminated when all bilateral agreements have been signed. The authorities have also undertaken to restore by the end of 1984 the allotments of foreign exchange for foreign travel to at least the level prevailing before September 1983 and to replace the coffee contribution quota with an export tax by January 1985. After implementation of these measures and following the phasing out of the export tax credit, the remaining restrictive practices subject to Fund approval will have been reduced to the multiple currency practice arising from the imposition of the financial transaction tax (IOF) on the sale of foreign exchange for specified imports of goods and services, and the absence of an option for importers to choose not to obtain financing and purchase imports on a cash basis.

c. External debt policies

Total external debt (public and private, including short-term obligations) which amounted to US$83.2 billion or 40 percent of GDP at the end of 1982, rose to US$91.6 billion at end-1983 (44 percent of GDP) and is expected to be US$98.9 billion (45 percent of GDP) at the end of

1/ Import licenses continue to be used to prevent unauthorized transfers of capital. The joint import and exchange licensing requirement is being examined by the Fund staff to ensure that this restriction is confined to capital transfers only.

1984 (Table 10). Short-term debt declined sharply over this period as the external payments position was stabilized. The growth of total debt in 1984 is now projected to be considerably less than had been anticipated at the time the 1984 program was formulated, reflecting mainly the lower need for foreign borrowing owing to the more rapid than expected improvement of the current account. The performance criterion on external indebtedness has accordingly been tightened for September and has been set at a lower level for December than had been anticipated earlier.

Total debt service obligations (before rescheduling) which declined from the equivalent of 89 percent of the value of exports of goods and services in 1982 to 83 percent in 1983, are expected to fall to 69 percent of exports of goods and services in 1984. The drop reflects the strong performance of exports, stable international interest rates until mid-1984, and the slower growth of external debt. The ratio of total debt service payments (after rescheduling) to exports of goods and services declined to 52 percent in 1983 and is expected to fall further to 45 percent in 1984. If the current high international interest rates persist, the debt service ratio is likely to show some increase in 1985.

The broad parameters of external debt policies for 1985 will be determined in the context of discussions in the latter part of 1984 aimed at securing the financing needed for 1985. As noted above, there is some uncertainty about the magnitude of the overall financing requirement and the authorities' discussions with the major creditors regarding financing arrangements have not yet been completed. The authorities' objectives over the medium term are to continue to limit new borrowing so as to achieve a decline in the ratio of total indebtedness to GDP and to reduce the debt service burden to more manageable proportions.

IV. 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 1984 Article IV consultation report 1/ and subsequent changes are discussed 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;2/ (b) the imposition of the financial transactions tax (IOF) on the

1/ Brazil--Staff Report for 1984 Article IV Consultation and Review Under Extended Arrangement (EBS/84/84, 4/11/84), and Brazil--Recent Economic Developments (SM/84/87, 4/25/84).

2/ Approved until January 2, 1985, Decision No. 7643-(84/37), 3/9/84, when it is scheduled to be eliminated.

Table 10. Brazil: External Debt and Debt Service

	1981	1982	1983	Proj. 1984
(In billions of U.S. dollars)				
Total external debt	71.9	83.2	91.6	98.9
Medium- and long-term debt	61.4	69.7	78.7	87.1
Multilateral	3.6	3.9	4.3	5.4
Bilateral	3.9	4.1	4.9)	13.0
Suppliers	5.9	6.0	7.5)	
Banks	(4.2)	(3.9)	(4.2)	(3.8)
Nonbanks	(1.7)	(2.1)	(3.3)	(...)
Bank currency loans	42.9	51.0	57.7	64.6
Foreign	(37.0)	(44.2)	(50.5)	(57.2)
Brazilian	(5.9)	(6.8)	(7.2)	(7.4)
Bonds	2.9	2.6	2.2	1.9
Other	2.2	2.1	2.1	2.2
Short-term	10.5	13.0	10.3	7.2
Banks	10.5	6.6	3.6	...
Nonbanks	—	6.4	4.4	...
Arrears	—	—	2.3	—
IMF	—	0.5	2.6	4.5
Memorandum items				
(As percent of exports of goods and services)				
Total debt service	66.2	88.6	83.0	69.0
Amortization	(27.9)	(35.1)	(40.8)	(28.0)
Interest	(38.3)	(53.5)	(42.2)	(41.0)
(As percent of GDP)				
Total external debt	37.1	40.1	43.7	45.3

Sources: Data provided by the Brazilian authorities; and Fund staff estimates.

purchase of exchange for specified imports of goods and services; and (c) the tax credits granted on export proceeds from manufactured goods (credito-premio).1/

(2) Exchange restriction arising from the limitation on the availability of exchange for travel abroad.2/

(3) Exchange restriction arising from the requirement that certain imports be financed abroad.

(4) Restrictions on the transfer of certain balances, which arise until the completion of bilateral agreements pursuant to the recommendation adopted by the Paris Club.3/

V. Staff Appraisal

Substantial progress was made during the first half of 1984 in the economic program adopted by the Brazilian authorities and supported by an extended arrangement from the Fund. The external sector registered impressive gains and, consistent with the objectives of the program, important steps have been taken to liberalize the exchange and trade system. Similarly, an effort is underway to reduce the imbalance in the financial position of the public sector. However, fiscal and monetary policies have not been sufficiently restrictive to achieve a slowing of inflation, particularly in the context of a highly indexed economy.

The pervasiveness of indexation is one of the most serious obstacles in the way of a significant reduction of inflation. The formal or informal adjustment of most prices by past inflation and the indexation of the bulk of financial assets and liabilities, including the public sector debt, undoubtedly works to maintain a given pace of inflation. The continued existence of indexation, and the dangerous instability given by an inflation already at the 200 percent annual level, highlight the urgency of restrained financial policies which would not only prevent inflation from moving to higher levels, but which could be expected to help start a process toward slower rates of price increase.

Fiscal policy has to contend with the reduction in flexibility attendant on the growing share that the expenditures for maintenance of the real value of the public debt, are taking up in total expenditures. The staff welcomes the authorities' determination to achieve an operational surplus larger than targeted initially. Progress to this end

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1/ A schedule to phase out this practice by April 1985 has been adopted. The authorities are seeking approval in advance for the various modifications in the practice that this phasing out will entail.

2/ Certain intensifications of the restriction have been scheduled for elimination by the end of 1984.

3/ To be eliminated when the remaining bilateral agreements under the Paris Club have been signed.

has been particularly evident in the Central Administration and in the state enterprises. As regards the states and municipalities, the improvement in their revenues apparent since mid-1984 and the measures that will further strengthen their financial position, may enable the states and municipalities to return in 1985 to the operational surplus position they enjoyed in the past. The continued deterioration of the financial situation of the social security system is a matter of concern and the staff urges the authorities to adopt the measures required to restore a sound structure to the system.

The implementation of monetary policy thus far in 1984 has not been as steady and firm as it was required by the program. The task of neutralizing the impact on liquidity of the large unexpected inflow of international reserves was greatly hampered by the substantial reserve deficiencies incurred by state banks and by weaknesses of certain institutions in the domestic financial markets which limited the authorities in their use of open market sales. These problems need to be dealt with if the authorities are to be in a position to achieve effective monetary control. The planned reform of the financial system should be of assistance to this end. However, it needs to be emphasized that achievement of the required degree of monetary control will in all likelihood require substantial upward pressure on interest rates, which can only be tempered through the pursuit of a fiscal policy that raises national savings.

The partial relaxation of price controls effected thus far this year is welcome, as is the continued progress made in the elimination of subsidies. In this respect, however, the staff is concerned about the authorities inability to eliminate the subsidy on wheat. Fear of the immediate impact on the general price level of the withdrawal of this subsidy has prevented fulfillment of the stated intentions of the authorities in this regard; however, the maintenance of this subsidy has had longer lasting and more pervasive consequences on inflation through its adverse effects on the public finances. The staff urges the authorities to proceed with the prompt elimination of this subsidy. The wage legislation adopted in late 1983 has provided a measure of wage flexibility needed to help sustain employment and economic activity. However, the failure of inflation to decline and the continued erosion of the real wage has created growing resistance to the continued implementation of this legislation. The staff is concerned about the effects an undue relaxation of the wage law could have on the level of employment and the competitiveness of exports.

The active exchange rate policy pursued by the authorities together with favorable demand conditions in markets abroad produced a marked strengthening of the balance of payments. The significant import substitution effort in petroleum, but also in other goods, contributed to this outcome. Still, the uncertainties about the immediate future, particularly as regards demand conditions abroad and the level of international interest rates, suggests the need for caution in the projection of the 1985 balance of payments. In this context, the staff

would emphasize that access for Brazilian exports to international markets is a critical requirement for the continued success of Brazil's economic adjustment program.

The persistence of inflationary pressures in the Brazilian economy and the difficulties in steering monetary aggregates to the intended target stemmed in part from the presence of substantial exchange and trade restrictions; the considerable progress made thus far in 1984 toward the liberalization of the restrictive system is therefore to be welcomed. The elimination of restrictions that has been effected should not only contribute to the abatement of inflationary pressures, but should also increase the overall efficiency of the economy. In particular, the staff welcomes the elimination of external payments arrears and the centralized system of foreign exchange allocation effected in March 1984, and the recent elimination of most of the restrictive features of the exchange budgets and the minimum financing requirements. The staff considers that the authorities have exercised their best efforts to conclude the bilateral arrangements pertaining to the agreements under the Paris Club. The authorities are increasing their reliance on tariffs as an instrument of protection of domestic activity instead of quantitative exchange and trade restrictions, and studies aimed at an overhaul of the tariff system are under way. Similarly, the decision to move to a system of free trade in agricultural products in 1985 will contribute to the further simplification and efficiency of Brazil's trade system. The substantive progress made thus 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 temporary approval for the remaining measures.

In sum, thus far in 1984 further significant progress has been made toward the necessary adjustment of the Brazilian economy. However, the permanence of these achievements is subject to doubt by the continuing high rate of inflation. Notwithstanding the disappointing results with regard to inflation, and despite the continuing difficulties faced by monetary and fiscal policy, the adjustment program being pursued by the authorities is producing decisive results in terms of a strengthening of the balance of payments and the elimination of restrictions on external trade and payments. In these circumstances, the staff considers that the requested modifications are warranted and recommends that they be approved. The Brazilian authorities have taken actions to reinforce their policies, the staff is satisfied that these actions are appropriate.

VI. Proposed Decisions

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

I. Exchange Measures

The Fund notes the authorities' intentions for the phasing out and elimination of the credito premio as described on page 26 in EBS/84/218 (10/19/84). 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) through 3 on pages 28 and 30 in EBS/84/218, until May 31, 1985, or the conclusion of the 1985 Article IV consultation with Brazil, whichever is earlier.

II. Extended Arrangement

1. Brazil has consulted with the Fund in accordance with paragraph 4(b)(ii) 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, to propose modifications of the performance criteria for the calendar quarter ending September of the second year of the arrangement, and to reach understandings with the Fund regarding policies, measures and performance clauses for the calendar quarter ending December of the second year of the arrangement.

2. The letter dated September 28, 1984, together with the attached technical memorandum of understanding, 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, (h) the quantitative performance criteria specified in Table 2 of EBS/84/39 (3/2/84) for the period ending March 31, 1984, and (i) the letter dated March 15, 1984, with attached memorandum, from the President of the Central Bank from the Minister of Planning and the Minister of Finance shall be read as modified and supplemented by the letter dated September 28, 1984, with attached memorandum.

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

"Brazil will not make purchases under this arrangement:

(a) during any period in which the data at the end of the preceding period indicate that

(i) 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 28, 1984, or

(ii) the limit the public sector borrowing requirement, as specified in paragraph 2 of the Technical Memorandum of Understanding dated September 28, 1984, or

(iii) the limit on the operational deficit of the public sector, as specified in paragraph 3 of the Technical Memorandum of Understanding dated September 28, 1984, or

(iv) the limit on the net domestic assets of the Brazilian Monetary Authorities, as specified in paragraph 5 of the Technical Memorandum of Understanding dated September 28, 1984, or

(v) the limit on the use of external credit, as specified in paragraph 7 of the Technical Memorandum of Understanding dated September 28, 1984, or

(vi) the cumulative quarterly target on the depreciation of the cruzeiro, as specified in paragraph 8 of the Technical Memorandum of Understanding dated September 28, 1984, or the intention with respect to avoidance of external arrears, which is specified in paragraph 11, third sentence, of the letter dated September 28, 1984, is not observed, or

(b) if the intentions to phase out and 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, or

(c) 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."

Accordingly subparagraphs (b) and (c) of paragraph 4 shall be designated as (d) and (e), of the same paragraph of the extended arrangement.

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

Brazil - Fund Relations
(As of September 30, 1984)

I. Membership Status

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

A. Financial Relations

II. General Resources Account
(Position as of September 30, 1984)

		Millions of SDRs	Percent of Quota
(a)	Quota:	1,461.30	100.00
(b)	Fund holdings of Brazilian cruzeiros:	5,356.99	366.59
(c)	Fund credit:	3,895.62	266.58
	Of which: CFF	1,212.90	83.00
	Buffer stock	64.47	4.41
	Credit tranche	249.37	17.06
	EFF	1,184.44	81.05
	Enlarged access under EFF	1,184.44	81.05
(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 2,368.9 million
- (iv) Undrawn balance: SDR 1,870.5 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.
- CFF purchase in the amount of SDR 247.9 million was approved on May 9, 1984.
- 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:	SDR 1.28 million
(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 a 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:

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 last Article IV consultation was concluded by the Executive Board on May 9, 1984. The review under the program was completed on the same occasion (EBD 7695-96-(84/75), 5/9/84).

IX. Technical Assistance:

None.

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 186.6 billion US$199.5 billion Cr$114.7 trillion
GNP per capita (1983)	SDR 1,435.0

Origin of GNP	1982	Prel. 1983	Proj. 1984
		(percent)	
Agriculture	11.6	...	...
Industry	35.1	...	...
Commerce	16.8	...	...
Transport and communications	5.8	...	...
Other	30.7	...	...
Ratios to GDP			
Exports of goods and services	11.3	11.6	13.4
Imports of goods and services	19.1	14.9	15.1
Current account of the balance of payments 1/	-7.9	-3.3	-1.6
Federal Treasury revenues	9.4	9.7	9.3
Federal Treasury expenditures	8.0	7.6	7.0
Public sector overall surplus or deficit (-)2/	-15.8	-18.5	-17.8
Total external debt (end of period)	40.1	43.7	45.3
Total external debt service payments	10.0	6.2	6.1
Gross domestic savings	21.2	19.8	21.5
Fixed capital formation	21.1	17.9	17.4
Money and quasi-money 3/ (end of year)	25.0	29.2	25.4
Annual changes in selected economic indicators			
Real GDP per capita	-1.5	-5.6	-1.4
Real GDP	0.9	-3.2	1.0
GDP at current prices	98.3	138.0	214.0
Domestic expenditures (at current prices)	97.0	131.1	203.5
Fixed capital formation	(89.4)	(99.0)	(207.8)
Consumption 4/	(99.0)	(140.6)	(202.7)
GDP deflator	95.4	159.9	211.0
Wholesale prices (annual averages)	94.0	164.9	234.9
Cost of living (annual averages)	98.0	142.0	229.6
Federal Treasury revenues	103.0	146.7	200.7
Federal Treasury expenditures	99.0	126.1	186.0
Money and quasi-money	113.5	177.8	173.0
Money	(77.4)	(102.7)	(95.2)
Quasi-money	(132.6)	(208.7)	(194.0)
Net domestic bank assets 5/	135.7	181.5	141.8
Credit to public sector (net)5/	(64.6)	(115.3)	(80.4)
Credit to private sector 5/	(147.2)	(195.9)	(199.5)
Merchandise exports (f.o.b., in U.S. dollars)	-13.3	8.5	17.8
Merchandise imports (f.o.b., in U.S. dollars)	-12.2	-20.4	-4.0

Federal Treasury finances	1982	1983	Proj. 1984
	(billions of cruzeiros)		
Revenues	4,775	11,782	35,430
Expenditures	4,089	9,244	26,345
Overall surplus or deficit (-)	686	2,538	9,085
Internal financing (net)	-686	-2,696	9,085
Balance of payments	(millions of U.S. dollars)		
Merchandise exports (f.o.b.)	20,175	21,899	25,800
Merchandise imports (f.o.b.)	19,397	15,429	14,800
Investment income (net)6/	-13,478	-11,010	-12,300
Other services and transfers (net)	-3,579	-2,328	-2,100
Balance on current account 6/	-16,279	-6,868	-3,400
Long-term capital (net)	10,827	5,891	10,064
Short-term capital (net)	-797	-1,822	566
Errors and omissions	-368	-531	-1,530
Net official international reserves (increase -)7/	6,617	3,330	-5,700
International reserve position	Dec. 31 1982	Dec. 31 1983	June 30 1984
	(millions of SDRs)		
Monetary authorities (gross)	2,946	3,588	7,600
Monetary authorities (net)	-494	-3,199	1,400

1/ Includes reinvested earnings.
2/ Identified financing.
3/ Banking system.
4/ Includes changes in stocks.
5/ In relation to the stock of liabilities to the private sector at the beginning of the period.
6/ Includes reinvested earnings: US$411 million in 1980; US$741 million in 1981; US$1,556 million in 1982; US$697 million in 1983; and US$700 million in 1984.
7/ Excludes valuation changes and acquisition of gold.

Brazil: Selected Economic and Financial Indicators

	1982	1983 Orig. Prog.1/	1983 Rev. Prog.2/	1983 Prel. Actual	1984 Orig. Prog.1/	1984 Rev. Prog.3/	1984 Proj.
(Annual percent changes, unless otherwise specified)							
National income and prices							
GDP at constant prices	1.4	-3.5	-4.0	-3.3	2.0	--	1.0
GDP deflator	95.4	101.0	159.0	159.9	58.0	178.3	211.0
General price index (end of period)	99.7	87.0	223.0	211.0	40.0	100.0-130.0	194.0
External sector (on the basis of U.S. dollars)							
Exports, f.o.b.	-13.3	8.9	10.4	8.6	16.8	12.3	17.8
Imports, f.o.b.	-12.2	-17.5	-17.5	-20.4	10.6	0.6	-4.1
Non-oil imports, f.o.b.	-16.4	-20.9	-15.1	-21.8	36.1	22.2	13.1
Export volume	-13.3	...	...	9.9	...	5.9	11.5
Import volume	-8.9	...	...	-16.2	...	-0.6	-3.6
Terms of trade	3.6	...	...	3.8	...	5.4	5.0
Private and public external debt (end of period)4/	11.2	10.8	12.1	5.6	7.6	10.1	10.2
Central Administration							
Revenues	103.0	160.6	138.5	146.7	...	178.2	200.7
Expenditures	99.0	99.8	115.2	126.1	...	191.6	186.0
Money and credit							
Domestic credit 5/	121.3	65.1	164.4	178.0	...	81.1	138.9
Public sector	(162.7)	(35.4)	(215.6)	(240.8)	(...)	(116.5)	(136.8)
Private sector	(106.0)	(108.7)	(193.5)	(149.3)	(...)	(116.8)	(169.2)
Money and quasi-money (M-2)6/	113.5	90.7	171.0	177.5	...	113.3	175.4
Velocity (GDP relative to average M-2)	4.3	3.9	5.7	4.0	...	5.5	4.5
(In percent of GDP, unless otherwise specified)							
Public sector borrowing requirement	15.8	8.8	19.3	18.5	5.5	11.3-13.3	17.8
Domestic financing	(13.0)	(6.7)	(18.2)	(18.2)	(4.2)	(10.3-12.3)	(16.9)
Direct foreign financing	(2.8)	(2.1)	(1.1)	(0.3)	(1.3)	(1.0)	(0.9)
Balance of payments current account deficit 7/	7.1	3.1	3.7	2.9	2.1	2.4	1.2
Private and public external debt (period average)4/	37.4	39.3	43.3	41.7	40.7	43.9	43.7
(In percent of exports of goods and services)							
Debt service 8/	88.6	78.5	79.8	83.0	59.4	71.6	69.0
Interest payments 8/	53.5	41.5	39.7	42.2	34.7	41.2	41.0
(In billions of U.S. dollars)							
Overall balance of payments	-6.6	--	--	-3.3	1.0	4.3	5.7
GDP	207.3	229.0	206.9	209.8	245.1	222.6	218.2
(In millions of SDRs)							
Gross official reserves (end of period)	2,946	...	...	3,588	...	7,600	9,100
(1980 = 100; end of period)							
Effective exchange rate 9/							
Nominal	33.3	...	...	10.1	...	...	6.1
Real	126.8	...	...	102.3	...	...	99.4

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), but adjusted for revised GDP numbers and PSBR definition.
3/ Revised program projections as specified in EBS/84/84 (4/11/84) and Sup. 1 (5/7/84), but adjusted for revised GDP numbers and PSBR definition.
4/ Includes short-term debt and use of Fund resources.
5/ Net domestic assets of the banking system.
6/ Banking system liabilities vis-a-vis private sector.
7/ Excludes reinvested earnings.
8/ Scheduled payments before renegotiation.
9/ Values for the fourth quarter of 1982 and 1983 and for second quarter of 1984. An increase in the index indicates appreciation of the cruzeiro.

Changes in the Technical Definition of Public Sector Performance Criteria

A number of changes were introduced to the definition by which the PSBR is measured. Most modifications affect the definition of the overall public sector borrowing requirement, others the breakdown between the operational outcome and monetary and exchange correction. The changes would become effective with the September test date. A quantification of the net effect of each change is provided in Table 11.

I. Changes in Some Elements of the Public Sector Borrowing Requirement

1. Equity participation of Bank of Brazil in public sector enterprises

Changes in Bank of Brazil holdings of shares in public sector enterprises were part of the PSBR definition under the old definition as it had been assumed that these enterprises were in most cases nonfinancial public enterprises. However, a detailed examination of the account revealed that most of these operations consist of participation in financial public sector institutions, domestically and abroad. The new definition for the PSBR includes only participation in nonfinancial public sector institutions.

2. Holdings of government securities by public nonfinancial enterprises

Certain public nonfinancial enterprises, such as PETROBRAS, hold their short-term excess balances in the form of government securities. Under the old definition these holdings were classified among private sector holdings of government paper and thus were not consolidated within the nonfinancial public sector. Information was obtained on these holdings and the new definition consolidates them and imputes monetary correction on them.

3. Social security system

Under the old definition, only changes in the system's deposits entered into the definition of the PSBR since information on commercial bank lending to the system was not available. However, this information is now available and thus changes in the net position are included in the new definition of the PSBR. In addition, deposits of the Fondo de Garantia de Tempo de Servico (FGTS, a private fund for unemployment compensation) are now excluded from among the deposits of the social security system.

Table 11. Brazil: Summary of the Net Effects on the Public Sector Borrowing Requirement of the Changes in Definition 1/

(In billions of cruzeiros)

		1982	1983	1984
I.	Total Effect on PSBR	-328	-1,479	-1,818
	a. Effect on operational result	(-203)	(-943)	(457)
	b. Effect on monetary correction	(-125)	(-536)	(2,275)
1.	Equity participation of Bank of Brazil in public enterprises	-56	-293	-694
2.	Holdings of government securities by public nonfinancial enterprises	-197	-389	-1,904
3.	Social security system	68	286	939
	Financing by commercial banks	(-32)	(51)	(293)
	FGTS deposits	(100)	(235)	(646)
4.	Funds and programs	-302	-747	-1,189
5.	Foreign borrowing	-159	-336	1,030
II.	Breakdown Between Operational and Monetary and Exchange Corrections	-153	-317	-907
1.	Wheat subsidy	-55	-339	-762
2.	Loans to the Central Government for housing	-38	-137	-828
3.	Treasury bills	--	--	-231
4.	Social security system	-215	-566	-886
5.	Funds and programs	155	725	1,800
III.	Total Effect on Operational Result (I.a + II)	-356	-1,260	-450

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

1/ A negative sign means less financing under the new definition.

4. Funds and programs

All lending done by the funds and programs managed by the Central Bank was included under the old definition of the PSBR. However, certain loans to the private sector were included in this total. As only subsidies (that is, grants) to the private sector should be considered as part of public expenditure, information on those grants was obtained and the new definition excludes loans to the private sector.

5. Foreign borrowing

Foreign borrowing by public sector institutions gives rise to deposits with the Central Bank, partly on a compulsory and partly on a voluntary basis. These institutions can therefore obtain resources either by borrowing abroad, by drawing down their voluntary deposit holdings, or by the release of compulsory deposits. Thus far, public sector foreign borrowing was estimated only on the basis of flows of foreign financing without taking into account public sector deposits denominated in foreign currency. Under the new definition of the PSBR, changes in the deposits denominated in foreign currency are included along with the foreign borrowing operations. In addition, the new definition includes changes in the outstanding external short-term credit lines to PETROBRAS and changes in this enterprise's deposits on account of exchange operations with the Central Bank.

II. Changes that Affect the Breakdown Between Operational Outcome and Monetary and Exchange Correction

1. Wheat subsidy

Changes in the balance of the wheat account at the Central Bank were viewed as contributing to the operational result in its entirety under the old definition. In fact, part of that account constitutes exchange correction applied to the financing of purchases of imported wheat. The new definition excludes that exchange correction when calculating the operational result.

2. Loans to the Central Government for housing

Under the old definition changes in these loans were considered as not being subject to monetary correction. However, these loans have quarterly monetary correction and thus the new definition takes account of it when calculating the operational result. In addition, since these loans generally are channeled to housing cooperatives at the state and municipal governments level, the sectorial distribution was changed under the new definition; this modification does not affect the totals.

3. Treasury bills

Treasury bills (LTNs) do not have monetary correction but sell at a discount which includes a fraction that corresponds to expected inflation. In their effect on the PSBR, treasury bills should be equivalent to indexed treasury bonds (ORTNs) which carry monetary correction. To avoid difference in treatment it was decided to impute monetary correction to LTNs under the new definition. This modification affects only 1984 as information on the maturity of LTNs placed was not readily available for previous years. However, the error involved in not including this imputed monetary correction for those years should be small, as placements of this type of paper were not very large in 1982 and 1983.

4. Social security system

Under the old definition, monetary correction was imputed to the deposits of the social security system with the financial system. However, it has now become clear that these deposits do not carry monetary correction, and the new definition does not include such monetary correction when calculating the operational result.

5. Funds and programs

Deposits of the funds and programs with the commercial banks were assumed not to carry monetary correction. However, it has been ascertained that these deposits do receive quarterly monetary correction, and the new definition takes account of it when calculating the operational result.