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AGENDA

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CONFIDENTIAL

November 6, 1984

To: Members of the Executive Board
From: The Secretary
Subject: Brazil - Staff Report for Review Under Extended Arrangement

The attached supplement to the staff report for the review under the extended arrangement for Brazil has been prepared on the basis of additional information.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Ms. Jul (ext. (5)8611).

Att: (1)

INTERNATIONAL MONETARY FUND

BRAZIL

Staff Report for Review Under Extended Arrangement
Supplementary Information

Prepared by the Western Hemisphere and Exchange and Trade
Relations Departments

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

Approved by S. T. Beza and W. A. Beveridge

November 5, 1984

This paper updates information contained in EBS/84/218 (10/19/84) relating to prices, wages, and foreign trade in Brazil; provides data on Brazil's performance with regard to certain quantitative performance criteria under the extended arrangement during the third quarter of 1984; and presents a revised estimate of the balance of payments for 1984 and a projection of some elements of the balance of payments for 1985.

I. Latest Developments

The rate of inflation, which had stabilized at around 10.5 percent a month in the period July-September 1984, increased to 12.6 percent in October. Prices rose by 167 percent in the period January-October 1984, and by 211 percent in the 12 months ended October 1984.

A new wage law was recently approved by Congress with effect from October 1, 1984. The new law maintains the 100 percent adjustment for past inflation on the portion of wages up to 3 minimum wages, and establishes an 80 percent minimum adjustment for the portion of wages above that level; free negotiation for the remainder up to a total adjustment not to exceed 100 percent of past inflation is permitted. Previously, the minimum adjustment for the portion of wages in excess of 3 minimum wages was specified as a sliding scale with the adjustment factor dropping from 90 to 50 percent as wages moved to higher multiples of the minimum wage. On the basis of information on the distribution of wage earners by salary range, the average rate of wage adjustment is calculated to be at least 91 percent of past inflation under the new law, whereas previously it was 86 percent.

The trade surplus in the balance of payments in October 1984 was US\$1 billion, which brought the surplus for the first ten months of the year to US\$10.9 billion; the surplus was US\$5.5 billion in the same period of 1983. Exports in the period January-October 1984 were

US\$22.4 billion, up 23 percent from the corresponding period of 1983, while imports at US\$11.5 billion were 9 percent lower (non-oil imports were approximately unchanged from the same period of the previous year).

II. Performance Under the Extended Arrangement in the Third Quarter of 1984

1. Performance criteria

Preliminary information indicates that in the quarter ended September 1984 Brazil met the performance criteria relating to the external sector and to the net domestic assets of the monetary authorities (Table 1). Data for the overall public sector borrowing requirement (PSBR) and the operational budget result are not yet available.

The margin under the net domestic assets ceiling amounted to about Cr\$1.1 trillion. The accumulation of reserves in the third quarter of 1984 was some Cr\$1.6 trillion in excess of the amount contemplated in the program. About 70 percent of this additional accumulation was sterilized by larger than planned placements of government securities by the Central Bank, and as a result the monetary liabilities of the monetary authorities exceeded the amount programmed by some Cr\$500 billion.

The more rapid than planned accumulation of net international reserves (by about US\$800 million) reflected the achievement of a trade surplus larger than had been projected (by US\$900 million) and smaller than expected service payments. These factors more than offset a shortfall on capital account (of about US\$300 million), which occurred mainly in inflows from bilateral lenders and suppliers. Net disbursements of foreign credits were about US\$7.1 million in the first nine months of 1984, compared with the ceiling of US\$8.6 billion.

The percentage change in the cruzeiro value of the U.S. dollar from the end of 1983 to October 15, 1984 was 148.9 percent. The General Price Index (IGP-DI) rose by 136.8 percent during the nine-month period ended September 1984, and thus the performance criterion for the exchange rate was met.

2. Monthly targets

To assist in the monitoring of the program, indicative monthly targets have been established for the borrowing requirements of the Central Administration, the state and municipal governments, the state enterprises, and the social security system (Table 2). Preliminary information shows that the cumulative monthly borrowing targets for these sectors were exceeded at the end of August. However, there is information to the effect that certain other institutions in the public

Table 1. Brazil: Extended Arrangement, Quantitative Performance
Criteria for the Third Quarter of 1984

	1984		
	Jan.-June Actual	July-September	
		Ceiling 1/	Prel. Actual
(In billions of cruzeiros)			
Borrowing requirement of the nonfinancial public sector <u>2/</u>	22,926	44,500	...
Operational result of the public sector <u>2/</u>	1,815	-1,100	...
Net domestic assets of the monetary authorities <u>3/</u>	3,034	1,600	497
(In millions of U.S. dollars)			
Change in net international reserves of the monetary authorities <u>2/</u>	4,220	5,100	5,900
Net disbursements of medium- and long-term, and selected short-term, external debt of the public and private sectors <u>2/</u>	5,084	8,600	7,100

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

1/ As specified in EBS/84/218. Floor in the case of net international reserves.

2/ Cumulative change in the calendar year.

3/ Stock at end of period.

Table 2. Brazil: Extended Arrangement--Monthly Indicative Targets for the Third Quarter of 1984

	July	August		September	
	Actual	Target	Actual	Target	Actual
<u>(Cumulative flows up to the end of the period; in billions of cruzeiros)</u>					
A. <u>Public sector borrowing requirement</u> ^{1/}					
Central Government	6,055	8,725	8,953	12,200	...
State and municipal governments ^{2/}	11,832	13,200	13,440	14,600	...
State enterprises ^{2/}	14,168	15,800	16,118	17,800	...
Social security system	325	460	735	660	...
<u>(Stock at end of period; in billions of cruzeiros)</u>					
B. <u>Monetary aggregates</u>					
Monetary base ^{3/}	7,463	...	8,105	8,040	9,113
Money supply (M-1) (average) ^{4/}	12,287	...	13,066	13,500	14,415

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

^{1/} No monthly targets are established for the borrowing of certain other institutions in the public sector. These are nonetheless included in the overall public sector borrowing requirement, which is subject to the performance criterion.

^{2/} Includes foreign financing.

^{3/} Adjusted to reflect 100 percent compliance with legal reserve requirements.

^{4/} According to Brazilian definition of M-1, which includes public sector demand deposits.

sector--such as funds and programs administered by the banking system on behalf of the Government--for which no targets have been specified are providing offsets to the deviations just mentioned.

Monthly indicative targets also have been established to monitor the expansion of the monetary base and the money supply (M-1). The monetary base expanded by 109 percent in the period January-September 1984 and 167 percent in the 12-month period ended September, which compares with targets of 84 percent and 136 percent, respectively. The expansion of narrow money (M-1) also exceeded the program targets; M-1 grew by 80 percent in the first nine months of 1984 and by 151 percent in the 12-month period ended September, which compares with targets of 69 percent and 135 percent, respectively.

III. Balance of Payments Projections for 1984 and 1985

The balance of payments projections for 1984 have been revised to reflect developments during the first three quarters (Table 3). The surplus on merchandise trade is now expected to exceed US\$12 billion, compared with a projected surplus of US\$9.1 billion in the original program and one of US\$6.5 billion recorded in 1983. Exports are projected to grow by about 20 percent to more than US\$26 billion, while imports are expected to decline by about 9 percent, reflecting both a slower pickup of non-oil imports than had been expected and a larger than projected drop in oil imports. The external current account deficit is now estimated to be about US\$1.3 billion (0.6 percent of GDP) in 1984, compared with a deficit of US\$5.3 billion in the original program and one of US\$6.2 billion in 1983.

One half of the unexpectedly large improvement in the current account in 1984 is expected to be offset by lower capital inflows, owing mainly to a large shortfall in long-term capital receipts from nonbank sources (particularly bilateral lenders and suppliers) and a larger outflow than had been estimated in the short-term capital account (including errors and omissions). This higher short-term capital outflow reflects increased financing of exports by Brazilian commercial banks and certain measurement problems related to service payments and certain capital items. The improvement in net international reserves during 1984 is now estimated to be US\$6.3 billion, compared with the original estimate of a gain of US\$4.3 billion.

The outlook for the balance of payments in 1985 is uncertain in a number of respects. On balance, little change is expected in the trade account, but higher interest payments 1/ may lead to some deterioration in the external current account in relation to 1984. Capital inflows

1/ The six-month LIBOR rate in the period July 1983 to June 1984, which (given the lags) was an important determinant of interest payments in 1984, averaged 10 3/4 percent. Thus far in the second half of 1984 this rate has averaged 12 1/8 percent.

Table 3. Brazil: Balance of Payments

(In billions of U.S. dollars)

	1983	1984		1985 Proj.
		Original ^{1/} Estimate	Revised Estimate	
<u>Current account</u> ^{2/}	-6.2	-5.3	-1.3	-2.6
Merchandise trade	6.5	9.1	12.3	12.5
Exports	(21.9)	(24.6)	(26.3)	(28.0)
Imports	(-15.4)	(-15.5)	(-14.0)	(-15.5)
Oil	/-8.2/	/-6.7/	/-6.4/	/-6.4/
Other	/-7.2/	/-8.8/	/-7.6/	/-9.1/
Services and transfers	-12.7	-14.4	-13.6	-15.1
Interest	(-9.6)	(-10.6)	(-10.7)	(-11.8)
Receipts	/0.7/	/0.7/	/1.0/	/1.4/
Payments	/-10.3/	/-11.3/	/-11.7/	/-13.2/
Other ^{2/}	(-3.1)	(-3.8)	(-2.9)	(-3.3)
<u>Capital account</u>	2.8	9.6	7.6	...
Direct investment ^{2/}	0.7	0.7	1.0	1.0
Long-term capital	4.4	10.5	8.0	2.1
Multilateral	(1.0)	(1.4)	(1.1)	(1.1)
Bilateral and suppliers ^{3/}	(0.7)	(2.6)	(1.2)	(1.5)
Banks	(3.8)	(6.9)	(6.9)	(...)
New loans	/3.4/	/6.5/	/6.5/	/.../
Refinancing	/4.5/	/5.4/	/5.4/	/6.9/
Amortization	/-4.1/	/-5.0/	/-5.0/	/-6.9/
Other	(-1.1)	(-0.4)	(-1.2)	(-0.5)
Brazilian lending abroad	0.1	-0.6	0.5	-0.5
Short-term capital and errors and omissions	-2.4	-1.0	-1.9	--
<u>Overall balance</u>	<u>-3.3</u>	<u>4.3</u>	<u>6.3</u>	<u>...</u>
<u>Change in net international reserves (increase -)</u>	<u>3.3</u>	<u>-4.3</u>	<u>-6.3</u>	<u>...</u>
Assets	--	-3.8	-6.0	...
Liabilities	3.3	-0.5	-0.3	1.4
IMF	(2.2)	(1.8)	(1.8)	(1.2)
Other	(1.1)	(-2.3)	(-2.1)	(0.2)
<u>Memorandum items</u>				
As percent of GDP				
Current account balance ^{2/}	-3.0	-2.4	-0.6	-1.1
Oil imports	3.9	3.1	2.9	2.8
Non-oil imports	3.4	4.0	3.5	4.0

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

^{1/} As specified on EBS/84/84 (4/11/84).

^{2/} Excluding reinvested earnings.

^{3/} Includes rescheduling of principal and interest under auspices of the Paris Club.

may well be lower than is suggested in Table 3, with the result depending importantly on whether the use of official credits is stepped up, the degree to which Brazil finances its exports, and the financing arrangements reached with the commercial banks.

