FOR AGENDA

EBS/82/215

CONFIDENTIAL

November 24, 1982

To: Members of the Executive Board

From: The Secretary

Subject: Brazil - Use of Fund Resources - Compensatory Financing Facility

Attached for consideration by the Executive Directors is a paper on a request expected to be received from Brazil for a purchase equivalent to SDR 498.75 million under the compensatory financing facility. A draft decision appears on page 19.

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

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

BRAZIL

Use of Fund Resources-Compensatory Financing Facility

Prepared by the Research and the Western Hemisphere Departments

(In consultation with the Exchange and Trade Relations,
Legal, and Treasurer's Departments)

Approved by Wm. C. Hood and Sterie T. Beza

November 23, 1982

The Managing Director has been informed that the Brazilian authorities will shortly request a purchase equivalent to SDR 498.75 million (50 per cent of quota) under the compensatory financing decision. The request, the first by Brazil under the facility since June 1963, is being made with respect to a shortfall of SDR 920 million estimated for the 12 months ending December 1982. At present, the Fund's holdings of the member's currency are equivalent to 73.6 per cent of quota.

This paper, which is being circulated in advance of the formal request by Brazil, is presented in five sections and an annex. The sections deal with: (1) balance of payments position and cooperation with the Fund; (2) estimation of the export shortfall; (3) causes of the shortfall and earnings prospects; (4) repurchase; and (5) staff appraisal and proposed decision. The relations of Brazil with the Fund are summarized in the annex.

1. Balance of payments position and cooperation with the Fund

a. Balance of payments position

After a sharp deterioration during 1979-80, Brazil's balance of payments registered a significant improvement in 1981 (Table 1). The current account deficit, which had been equivalent to 4.6 per cent of GDP in both 1979 and 1980, was reduced to 3.9 per cent of GDP in 1981. That performance reflected an improvement of SDR 3.2 billion in the trade account, due mainly to an increase in the SDR value of exports of close to 28 per cent, but this was largely offset by an increase in interest payments of SDR 3 billion. Thus, the current account deficit remained practically constant at SDR 9.8 billion in 1981. (In U.S. dollar terms it improved by about US$1.2 billion.) Brazil had no major difficulty in finding foreign resources to finance such a deficit and in adding about SDR 1 billion to gross international reserves, which at the end of 1981 stood at almost SDR 6.5 billion, equivalent to more than four months of that year's imports. From a deficit of SDR 2.6 billion in 1980, the overall balance of payments swung to a surplus of SDR 727 million in 1981.

Table 1. Brazil: Summary Balance of Payments, 1979-82

(In millions of SDRs)

	1979	1980	1981	Proj. 1982 1/
A. Current account	-8,314	-9,840	-9,829	-12,858
Trade balance	-2,198	-2,169	1,020	634
Exports	(11,799)	(15,468)	(19,754)	(18,292)
Imports	(-13,997)	(-17,637)	(-18,734)	(-17,658)
Services and transfers (net)	-6,116	-7,671	-10,849	-13,492
Of which: interest payments	(-4,139)	(-5,729)	(-8,739)	(-10,776)
B. Capital account	6,331	7,500	11,112	12,134
Long-term loans	4,555	3,690	8,279	10,504
Other long-term capital 2/	909	1,226	1,479	1,177
Short-term capital	867	2,584	1,354	453
C. Errors and omissions	-101	-264	-556	--
D. Overall balance (A+B+C)	-2,084	-2,604	727	-724
Memorandum items:				
Gross international reserves at year end	7,355	5,420	6,449	5,300
Equivalent months of imports, c.i.f.	6.3	3.7	4.1	3.6
Equivalent months of current payments	3.9	2.3	2.3	1.8
Current account balance as per cent of GDP	-4.6	-4.6	-3.9	-4.6

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

1/ Estimated by the authorities in cooperation with the staff.
2/ Direct investment, Brazilian lending abroad, and SDR allocations.

In 1982, Brazil has had to confront a more difficult external environment. The recession in industrial countries coupled with the payments difficulties faced by most of the country's trading partners in the developing world, has contributed to a slowing down of the momentum gained by Brazil's exports, and their value in 1982 is expected to register the first decline since 1967. Moreover, interest payments on the country's growing external debt are estimated to rise by SDR 2 billion to about SDR 10.8 billion, because of the high rates that prevailed in international capital markets in the second half of 1981 and first half of 1982. Thus, in spite of a decline of almost 10 per cent in the SDR value of imports, the current account deficit in 1982 is estimated to rise to about SDR 12.9 billion, or 4.6 per cent of GDP. The balance of payments for 1982 is estimated to close with an overall deficit of the order of SDR 700 million. During the period January-August 1982, Brazil's gross international reserves fell by almost SDR 500 million and, on the basis of available estimates by the Brazilian authorities, they are estimated to decline by SDR 1.1 billion for the year as a whole.

b. Cooperation with the Fund

Brazil has not made use of the Fund's resources in recent years and Fund holdings of its currency have been used for purchases by other members. Its only previous purchase under the compensatory financing facility, of SDR 60 million, was made in June 1963. The last of eight consecutive one-year stand-by arrangements expired in March 1973. In view, however, of its improved external payments situation, Brazil refrained from making any purchases after May 1968 and made all outstanding repurchases by August 1970.

Brazil's economic and financial policies since 1974 have been dominated by the need to adjust to the steep increase in the price of oil during the period. The substantial progress achieved in that effort suffered a severe setback with the second sharp oil price increase in 1978. The authorities responded by adopting, in late 1979 and early 1980, a comprehensive package of measures that included a major devaluation of the cruzeiro, fiscal and monetary restraint, and a liberalization of the foreign trade system. As the difficult external situation was further compounded by rising interest rates and weakening external demand, the authorities adopted additional measures in late 1980 and 1981, including the partial freeing of interest rates, improved credit allocation, greater buoyancy of the tax system, tightened control over public spending, especially by state enterprises, and depreciation of the cruzeiro in line with the actual rather than projected rate of domestic inflation.

The last Article IV consultation with Brazil was concluded in November 1981. In their discussion, Executive Directors commended the Brazilian authorities for the substantial adjustment measures taken since late 1980 and concluded that Brazil's policies had been successful in bringing about substantial external adjustment. There was particular recognition of the lowered dependence on imported oil as a result of appropriate pricing policies and the active development of domestic energy sources. The Executive Directors urged the authorities to continue with these policies and to strengthen them as required to restore external and internal balance without unnecessary delay. Pending the next Article IV consultation, the staff has carried out two informal reviews of economic developments and prospects with the Brazilian authorities in February and July 1982. To stem the renewed deterioration of balance of payments and reduce the rising rate of inflation in 1982, the Brazilian authorities curtailed the expenditures of the central administration and state enterprises, tightened monetary policy, and adopted a number of restrictive exchange and trade measures.

Brazil maintains a number of exchange measures that require approval under Article VIII, Sections 2 and 3 of the Articles of Agreement. Such approval was given until December 31, 1982 for the measures in effect at the time of the last Article IV consultation discussion, 1/ except for discriminatory taxes on a number of manufactured exports to the United States that were intended to offset the effect of the tax credit system. Certain changes in the schedule for the phased elimination of tax credits granted to exporters of manufactured goods caused the Fund's approval of the multiple currency practice to lapse at the beginning of 1982. The practice resulting from the extension of a financial transactions tax to exchange purchases for tourism has not been approved by the Fund. For the reason that Hungary joined the Fund in May 1982, the exchange restriction arising under the bilateral payments agreement between the two members became subject to the Fund's approval at that time.

2. Estimation of the export shortfall

The calculation of the shortfall for calendar year 1982 is based on estimated data for the last three months of the year. 2/ Provisional

1/ The measures approved were: (1) limits on the availability of foreign exchange for outward remittances in respect of technical assistance fees and royalty payments; (2) multiple currency practices arising from (a) application of contribution quotas to exports of coffee, cacao, and hides, (b) export taxes on orange juice, corn meal, and hides, (c) tax credits given to exporters of manufactured goods, (d) extension of the financial transactions tax to specified imports of goods and services, and (3) imposition of a graduated supplementary tax on outward remittances of profits and dividends when such earnings average more than 12 per cent of nonresident capital over a three-year period; and (3) a bilateral payments agreement with a Fund member--Romania.

2/ Actual export data are available through September 1982, and the staff, in conjunction with the authorities, has estimated exports for the last three months of the shortfall year. The value of exports during the October-December 1982 period is estimated to average SDR 1,576 million per month, 14 per cent less than the monthly average of exports during the fourth quarter of 1981. The monthly average for the third quarter of 1982 based on actual data was 14 per cent less than the monthly average for the third quarter of 1981. Estimated export earnings for the fourth quarter of 1982 are equivalent to 26 per cent of total exports for 1982, which is equal to the average share of fourth quarter exports for the preceding five years, 1977 to 1981.

data available for the month of October suggest that the estimated data for October-December 1982 may be on the high side and that the shortfall based on actual data for the whole shortfall year will probably turn out to be substantially higher than the one estimated in this paper.

After expanding at an average annual rate of almost 30 per cent during 1980 and 1981, Brazil's export earnings are estimated to decline by 8 per cent to SDR 18,296 million in 1982. They are projected to recover by 11 per cent in 1983 and by 13 per cent in 1984. On the basis of these export movements, the shortfall for calendar year 1982 is estimated at SDR 920 million, which is nearly twice as large as the proposed purchase of SDR 498.75 million (Table 2).

Table 2. Brazil: Estimation of the Export Shortfall

(In millions of SDRs)

	Years Ending December				
				Projected Exports 1/	
	1980	1981	1982	1983	1984
Exports	15,459	19,784	18,296	20,376	22,977
Shortfall			920		
Proposed purchase			498.75		

1/ Based on the judgmental forecast of earnings given in Table 3.

3. Causes of the shortfall and export prospects

The total export shortfall of SDR 920 million is attributable largely to shortfalls in major primary commodities totaling SDR 738 million, including shortfalls in soybean products (SDR 356 million), sugar (196 million), coffee (SDR 155 million), cocoa (SDR 92 million), and paper pulp (SDR 31 million). Within the group of major manufactured products, for which a combined shortfall of SDR 209 million is estimated, the largest shortfalls are calculated for boilers and mechanical equipment (SDR 137 million) and transport equipment (SDR 83 million). Export excesses are calculated for refined petroleum (SDR 113 million), iron ore (SDR 53 million), orange juice (SDR 49 million), tobacco (SDR 35 million), and meat (SDR 5 million).

The shortfall in soybean products is mostly on account of volume, which is estimated to decline by 30 per cent in 1982 because of adverse weather. The shortfalls in sugar, coffee, and cocoa, on the other hand,

Table 3. Brazil: Export Earnings and Shortfalls by Major Commodities

	Years Ending December								Shortfall	
	1977	1978	1979	1980	1981	1982	1983	1984	Geometric	Arithmetic
	(In millions of SDRs)									
Total	10,382	10,108	11,799	15,459	19,784	18,296	20,376	22,977	920	1,082
Primary commodities	6,629	5,798	6,331	8,219	9,220	8,560	9,784	10,948	738	786
Soybean products	1,828	1,202	1,268	1,732	2,617	1,645	1,936	2,223	356	386
Soybean meal	(1,594)	(975)	(1,014)	(1,416)	(2,156)	(1,492)	(1,621)	(1,806)	(187)	(206)
Unprocessed soybean oil	(234)	(227)	(254)	(316)	(461)	(153)	(315)	(417)	(158)	(179)
Sugar	396	279	281	987	899	508	551	695	196	220
Beverages	3,150	2,846	3,004	3,039	2,186	2,498	2,970	3,215	256	284
Coffee	(2,255)	(1,826)	(1,796)	(2,136)	(1,486)	(1,857)	(2,306)	(2,427)	(155)	(185)
Cocoa	(895)	(1,020)	(1,208)	(903)	(700)	(641)	(664)	(788)	(92)	(98)
Meat	129	115	161	338	551	562	657	778	-5	15
Poultry	(27)	(37)	(63)	(159)	(302)	(317)	(370)	(417)	(-19)	(-4)
Processed meat	(102)	(78)	(98)	(179)	(249)	(245)	(287)	(361)	(12)	(19)
Orange juice	151	262	218	260	558	542	574	648	-49	-26
Tobacco	160	191	221	218	303	406	491	537	-35	-15
Paper pulp	17	45	139	296	309	271	290	352	31	33
Iron ore	777	821	995	1,199	1,483	1,675	1,852	2,037	-53	-26
Refined petroleum	21	37	44	150	314	453	463	463	-113	-84
Manufactures	1,018	1,673	2,227	3,019	4,259	3,643	3,920	4,621	209	249
Footwear	149	233	285	313	498	461	505	602	4	15
Transport equipment	420	659	847	1,163	1,760	1,401	1,471	1,709	83	100
Boilers & mechanical	362	612	750	1,063	1,315	1,040	1,124	1,384	137	145
Steel goods	87	169	345	480	686	741	820	926	-27	-10
Other exports	2,735	2,637	3,241	4,221	6,305	6,093	6,672	7,408	-57	47
		(Percentage change)								
Total		-3	17	31	28	-8	11	13		
Primary commodities		-13	9	30	12	-7	14	12		
Soybean products		-34	5	37	51	-37	18	15		
Soybean meal		(-39)	(4)	(40)	(52)	(-31)	(9)	(11)		
Unprocessed soybean oil		(-3)	(12)	(24)	(46)	(-67)	(106)	(32)		
Sugar		-30	1	251	-9	-43	8	26		
Beverages		-10	6	1	-28	14	19	8		
Coffee		(-19)	(-2)	(19)	(-30)	(25)	(24)	(5)		
Cocoa		(14)	(18)	(-25)	(-22)	(-8)	(4)	(19)		
Meat		-11	40	110	63	2	17	18		
Poultry		(37)	(70)	(152)	(90)	(5)	(17)	(13)		
Processed meat		(-24)	(26)	(83)	(39)	(-2)	(17)	(26)		
Orange juice		74	-17	19	115	-3	6	13		
Tobacco		19	16	-1	39	34	21	9		
Paper pulp		165	209	113	4	-12	7	21		
Iron ore		6	21	21	24	13	11	10		
Refined petroleum		76	19	241	109	44	2	--		
Manufactures		64	33	36	41	-14	8	18		
Footwear		56	22	10	59	-7	10	19		
Transport equipment		57	29	37	51	-20	5	16		
Boilers equipment		69	23	42	24	-21	8	23		
Steel goods		94	104	39	43	8	11	13		
Other exports		-4	23	30	49	-3	10	11		

Table 4. Brazil: Value, Volume and Unit Value Indices by Major Commodities

(1982=100: In terms of SDRs)

	Value Share in Total Exports in 1982 (In Per Cent)	Years Ending December 1977	1978	1979	1980	1981	1982	1983	1984	Shortfall in Per Cent of Level in Shortfall Year
Value	66.8	63	61	70	92	110	100	112	128	7.7
Primary commodities	46.8	77	68	74	96	108	100	114	128	8.6
Soybean products	9.0	111	73	77	105	158	100	117	135	21.2
Soybean meal	(8.2)	(107)	(65)	(68)	(95)	(145)	(100)	(109)	(121)	(12.7)
Unprocessed soybean oil	(0.8)	(153)	(148)	(166)	(206)	(301)	(100)	(206)	(272)	(103.3)
Sugar	2.8	78	55	55	194	177	100	108	137	38.4
Beverages	13.6	126	114	120	122	88	100	119	129	10.5
Coffee	(10.1)	(121)	(98)	(97)	(115)	(80)	(100)	(124)	(131)	(8.4)
Cocoa	(3.5)	(140)	(159)	(189)	(141)	(109)	(100)	(104)	(123)	(14.5)
Meat	3.0	23	21	29	60	98	100	117	138	-1.0 (excess)
Poultry	(1.7)	(8)	(12)	(20)	(50)	(95)	(100)	(117)	(131)	-6.2 (excess)
Processed meat	(1.3)	(42)	(32)	(40)	(73)	(102)	(100)	(117)	(148)	5.2
Orange juice	3.0	28	48	40	48	103	100	106	120	-8.9 (excess)
Tobacco	2.2	39	47	54	54	75	100	121	132	-8.3 (excess)
Paper pulp	1.5	6	17	51	109	114	100	107	130	11.6
Iron ore	9.2	46	49	59	72	89	100	111	122	-2.8 (excess)
Refined petroleum	2.5	5	8	10	33	69	100	102	102	-25.0 (excess)
Manufactures	20.0	28	46	61	83	117	100	108	127	5.9
Footwear	2.5	32	50	62	68	108	100	110	131	1.1
Transport equipment	7.7	30	47	60	83	126	100	105	122	6.0
Boilers & mechanical	5.7	35	59	72	102	126	100	108	133	13.0
Steel goods	4.1	12	23	47	65	93	100	111	125	-3.5 (excess)
Volume		60	68	74	92	111	100	106	112	3.9
Primary commodities		65	68	71	86	106	100	108	112	2.0
Soybean products		102	80	78	98	143	100	121	131	17.3
Soybean meal		(99)	(76)	(73)	(89)	(129)	(100)	(112)	(119)	(8.9)
Unprocessed soybean oil		(125)	(125)	(134)	(188)	(284)	(100)	(205)	(256)	(94.8)
Sugar		94	75	70	97	104	100	104	104	1.8
Beverages		61	74	75	89	95	100	105	106	-1.2 (excess)
Coffee		(59)	(72)	(66)	(96)	(96)	(100)	(102)	(103)	(-2.1)(excess)
Cocoa		(67)	(83)	(99)	(90)	(93)	(100)	(111)	(115)	1.3
Meat		32	29	31	56	86	100	112	120	-8.3 (excess)
Poultry		(9)	(15)	(23)	(48)	(84)	(100)	(114)	(114)	(-12.1)(excess)
Processed meat		(62)	(49)	(42)	(66)	(89)	(100)	(109)	(127)	-4.1 (excess)
Orange juice		39	61	53	73	116	100	104	109	-0.8 (excess)
Tobacco		72	78	90	92	94	100	107	107	-0.2 (excess)
Paper pulp		11	32	69	107	114	100	103	115	7.6
Iron ore		68	77	88	92	100	100	105	107	0.7
Refined petroleum		10	18	12	36	73	100	100	100	-23.5 (excess)
Manufactures		46	69	82	106	122	100	103	113	8.5
Footwear		49	76	74	76	97	100	105	119	-1.6 (excess)
Transport equipment		50	75	86	123	145	100	100	108	14.0
Boilers & mechanical		65	86	105	130	132	100	105	120	16.7
Steel goods		13	28	48	60	81	100	103	109	-11.4 (excess)
Unit value		105	90	95	100	100	100	106	114	3.9
Primary commodities		119	99	105	111	102	100	106	114	6.5
Soybean products		109	91	98	107	111	100	97	103	3.5
Soybean meal		(108)	(86)	(94)	(106)	(112)	(100)	(97)	(102)	(3.3)
Unprocessed soybean oil		(123)	(119)	(124)	(110)	(106)	(100)	(100)	(106)	(4.3)
Sugar		82	73	79	201	170	100	104	132	36.2
Beverages		208	153	161	137	92	100	114	121	11.7
Coffee		(208)	(138)	(146)	(130)	(83)	(100)	(122)	(127)	(10.8)
Cocoa		(207)	(193)	(191)	(156)	(118)	(100)	(93)	(107)	(12.9)
Meat		71	70	92	108	114	100	104	115	8.0
Poultry		(90)	(81)	(85)	(104)	(113)	(100)	(102)	(115)	(6.6)
Processed meat		(67)	(66)	(97)	(111)	(114)	(100)	(108)	(116)	(9.7)
Orange juice		72	79	76	66	89	100	102	110	-8.0 (excess)
Tobacco		55	60	60	59	80	100	113	124	-7.9 (excess)
Paper pulp		54	52	74	102	100	100	104	113	3.7
Iron ore		68	64	68	78	89	100	106	114	-3.5 (excess)
Refined petroleum		49	47	78	93	95	100	102	102	-1.7 (excess)
Manufactures		60	67	75	78	96	100	105	112	-2.5 (excess)
Footwear		66	66	84	89	111	100	104	110	2.5
Transport equipment		60	63	71	68	86	100	105	113	-7.0 (excess)
Boilers & mechanical		53	68	69	78	96	100	103	111	-3.1 (excess)
Steel goods		93	80	97	108	114	100	108	114	8.7

are almost entirely caused by low prices resulting from large surpluses in world supplies. The shortfall in paper pulp is caused by both low price and volume stemming from depressed demand conditions. Finally, the shortfalls in boilers and mechanical equipment and transport equipment are attributable to low volumes in 1982 which reflect the weak industrial demand prevailing in Brazil's major markets.

a. Primary commodities

Major primary commodities account for an estimated 47 per cent of total exports in 1982. After increasing at an average annual rate of 24 per cent during the two pre-shortfall years, earnings from them are estimated to decline by 7 per cent in 1982, as a result of both lower prices and volumes. They are projected to recover by 14 per cent in 1982 and by 12 per cent in 1984, with increases expected from both prices and volumes.

(1) Soybean products

The share of soybean products in Brazil's export earnings has been rising rapidly in the past few years, reaching a peak of 13 per cent in 1981, but then falling to an estimated 9 per cent in the shortfall year. Production reached 15 million tons in 1980, 48 per cent higher than the preceding year, and remained virtually unchanged in 1981; this was followed by a 16 per cent decline in 1982, largely due to a drought in the Rio Grande do Sul area. Brazil's share in world production of soybeans increased from 10 per cent in 1973 to nearly 19 per cent in 1981, but the poor weather conditions are expected to lower its share to 15 per cent in 1982.

Earnings from exports of soybean products increased at an average rate of 41 per cent per annum in the two pre-shortfall years, largely because of a 35 per cent volume increase per annum. A fall of 37 per cent in earnings is estimated for 1982 owing to a 30 per cent decline in export volume associated with the adverse weather conditions. Yield per hectare declined sharply in 1982 to 1.56 tons compared with an average of 1.75 tons during the preceding two years--a decline of 11 per cent on average, with a fall of 24 per cent recorded in Rio Grande do Sul. Export unit value is estimated to decline by nearly 10 per cent in 1982, reflecting lower international prices largely as a result of higher U.S. and Argentine output, which more than offset the drop in Brazilian production.

In the first post-shortfall year, Brazil's earnings from soybean exports are projected to recover by 18 per cent. A partial recovery in production is expected to make possible a 21 per cent increase in volume, while unit value is projected to decline by 3 per cent, mainly because of an estimated 13 per cent increase in world production of soybeans. For 1984, a further rise of 15 per cent in earnings from soybean products is projected to the second highest level ever earned from this commodity, but 15 per cent below the record high level realized in 1981. Unit prices are projected to recover by 6 per cent, while export volume is expected to increase by 8 per cent. The shortfall for soybean products in 1982 is estimated at SDR 356 million.

(a) Soybean meal

By far the largest proportion of export earnings from soybean products is accounted for by soybean meal. The share averaged 82 per cent over the period 1977-81, then rose sharply, to 91 per cent in the shortfall year because of the more substantial decline in soybean oil exports. Brazil overtook the United States as the world's largest exporter in 1981 (accounting for 43.5 per cent of world exports), and is estimated to account for over 40 per cent in 1982, exceeding the U.S. share by over 8 percentage points. Domestic consumption, which has been increasing rapidly owing to its expanding use as poultry food, averaged 2.3 million tons per annum over the 1980-82 period.

The shortfall in earnings from soybean meal in 1982 is estimated at SDR 187 million, equivalent to about half of the total shortfall for soybean products. After increasing by an average of 44 per cent per annum in the two pre-shortfall years, earnings from meal fell by 31 per cent in 1982, due to a 22 per cent drop in export volume and an 11 per cent decline in unit value. Despite the substantial fall in the export volume of the world's leading exporter, the world export volume of soybean meal is estimated to rise by about 1 per cent in 1982. Average earnings by Brazil in the two post-shortfall years are projected at SDR 1,711 million, an increase of 15 per cent over earnings in the shortfall year. In 1983, they are projected to rise by 9 per cent in 1983 following a partial return to normal production and crushing levels, with an export volume increase of 12 per cent more than offsetting a unit value decline of 3 per cent. In 1984, unit values are projected to recover in 1984 by 6 per cent, and export volume by 6 per cent, resulting in an increase in earnings of over 11 per cent.

(b) Soybean oil

Earnings from oil as a proportion of total earnings from soybean products ranged from 13 per cent in 1977 to 20 per cent in 1979, before reaching the 1982 low figure of 9 per cent. Brazil's share of world soybean oil exports rose from 19 per cent in 1979 to 37 per cent in 1981, but the poor harvest in 1982 reduced this share to 27 per cent. The country is now the second largest exporter of soybean oil (after the United States). Fluctuations in export volume can be largely explained by fluctuations in production, as domestic consumption has remained relatively stable at 1.5 million tons per year.

Earnings from soybean oil increased by an average of 35 per cent in the two pre-shortfall years, but fell by 67 per cent in the shortfall year, owing to a two thirds decline in export volume. Despite the substantial fall in the volume of Brazil's exports, downward pressure on soybean oil prices continued in 1982 because of a 2 per cent increase in world export volume in the face of depressed demand. Average earnings in the two post-shortfall years are projected at SDR 362 million, an increase of 137 per cent over the level of the shortfall year, but still 5 per cent below the average level of earnings recorded in the two pre-shortfall years. Earnings are projected to more than double in 1983, entirely on account of a recovery in export volume. A 6 per cent rise in unit value projected for 1984, together with a further projected increase in export volume of 25 per cent, is expected to raise earnings by 32 per cent in that year. Export volume in 1984 is projected to reach 90 per cent of the volume exported in 1981. On this basis, the shortfall for soybean oil exports in 1982 is estimated at SDR 158 million.

(2) Sugar

After reaching a peak of nearly SDR 990 million in calendar year 1980, earnings from sugar exports fell by SDR 88 million (9 per cent) in 1981 and are estimated to drop by a further SDR 390 million (43 per cent) in the shortfall year. The substantial decline in the shortfall year is very largely attributable to lower prices. Following the movement of prices in the free market, Brazil's average export unit values dropped by 15 per cent in 1981 and are estimated to fall by a further 41 per cent in 1982. The current world surplus of sugar is expected to persist through 1982/83, but is projected to decline significantly as producers switch acreage to other crops or decide not to harvest all the cane because of the very low prices prevailing in the world market. Prices are projected to recover slightly by 4 per cent in 1983 and to increase by about 27 per cent in 1984, to a price still about one third of the average price recorded in 1980.

Brazil is the largest producer of cane sugar in the world and one of the leading exporters. As an exporting member of the International Sugar Agreement (ISA), Brazil's exports have been and will continue to be constrained by the export quotas which came into effect in May 1981. Its Basic Export Tonnage (BET) is 3.3 million metric tons, and its annual quota currently in effect is 2.8 million tons or 85 per cent of its BET. The volume of exports in 1982 is estimated at 2.6 million tons, some 200,000 tons below quota, mainly because of the reduction in exports to the United States following the imposition of import quotas in that market in May 1982. Brazil's share in the U.S. market has been set at 14.5 per cent of the total U.S. sugar import quota, and its quota for the year beginning October 1, 1982 is equal to 368,000 metric tons, compared with average annual shipments of 875,000 tons to the U.S. in 1980-81. The volume of exports in the two post-shortfall years is projected at 2.7 million tons per year, about 100,000 tons below Brazil's present quota under the terms of the ISA.

Brazil's sugar production in 1981/82 (crop year ended May) is estimated at 8.4 million tons, slightly below the 8.5 million tons harvested in 1980/81. About two thirds of production is normally needed for domestic consumption and the balance is exported. In terms of the ISA, Brazil is obligated to constitute 401,970 tons of special stocks of sugar by the end of December 1983, as part of the market stabilization measures being taken by the ISO.

The minimum quantity to be constituted during the 12 months ended June 1982, equivalent to 160,788 tons, was accumulated by Brazil by the end of June 1982. The steep decline in prices and the difficulties in marketing sugar has led to an increase in Brazilian production of alcohol, with output in 1982/83 expected to reach 5.2 billion liters, compared with 4.2 billion liters in 1981/82.

Export earnings from sugar are projected to recover by 8 per cent in the first post-shortfall year and by 26 per cent in the second. The average projected value for 1983-84, at SDR 619 million, is still be some 34 per cent below average realizations in the two pre-shortfall years (1980-81). On the basis of these movements, an export shortfall of SDR 196 million is estimated for sugar in 1982.

(3) Beverages

Brazil is the world's largest producer of coffee and the second largest producer of cocoa. Earnings from these two commodities accounted for 14 per cent of total export earnings in the shortfall year. Lower prices caused by world surpluses are the main cause of the combined shortfall of SDR 256 million estimated for the two commodities. For both coffee and cocoa, volume increases were recorded in the two pre-shortfall years as well as in the shortfall year itself.

(a) Coffee

After declining to 9.3 million bags (60 kgs.) in the 1976/77 coffee year (October/September) because of the severe 1975 frost, Brazil's coffee production recovered gradually, attaining the pre-1975 level of 33 million bags in 1981/82. Another frost which hit the major coffee growing areas in July 1981 is expected to reduce the 1982/83 crop to about 17.8 million bags, but recovery from the effects of the 1981 frost is expected to be more rapid than from the previous one.

In 1982, the value of Brazil's coffee exports is estimated to increase by 25 per cent on account of a 20 per cent increase in export unit value and a 4 per cent increase in export volume. The unit value increase is in line with the higher international prices (10 per cent in U.S. dollar terms or 17 per cent in SDR terms) resulting from the combined effects of the 1981 Brazilian frost and the continuation of export quotas under the International Coffee Agreement (ICA). During the two post-shortfall years, export unit values are projected to increase at an annual rate of 16 per cent in terms of SDRs. As export quotas are expected to remain in effect during the two post-shortfall years, the volume of Brazil's coffee exports is projected to increase at an annual rate of only 1 per cent. On the basis of these price and volume prospects, earnings from coffee are projected to increase by 24 per cent in the first post-shortfall year and by a further 5 per cent in the second.

(b) Cocoa

In response to increasing real producer prices and other government policies designed to encourage production, cocoa production in Brazil increased at an annual rate of 9.7 per cent in the period between 1970 and 1982. The high cocoa prices of the mid-1970s, which were a consequence of declining production in such major supplying countries as Ghana and Nigeria and rising world consumption, dampened demand and stimulated a lagged increase in production. For the last five years, world cocoa production has exceeded consumption, and cocoa prices have declined from 165 cents per pound in 1976/77 (October/September) to 85 cents per pound in 1981/82.

The shortfall in earnings from cocoa is caused entirely by lower prices; Brazil's export unit values, which declined at an annual rate of 20 per cent per annum in the two pre-shortfall years, are estimated to decline by a further 15 per cent in the shortfall year. Because the world cocoa surplus is expected to continue in 1983, export unit values are expected to decline by 7 per cent in the first post-shortfall year.

The International Cocoa Agreement has so far not succeeded in raising the price of cocoa even to the floor level set under the Agreement, in spite of purchases of 100 thousand tons by the buffer stock. The resources of the buffer stock are limited and, even with those generated by a levy on exports, are likely to be insufficient to enable the Agreement to exert an effect on cocoa prices in the two post-shortfall years 1983-84. As the low prices discourage production and encourage consumption, world cocoa supply and demand are expected to be in better balance by 1984, and export unit values are consequently projected to recover by 15 per cent in the second post-shortfall year. The volume of Brazil's cocoa exports, which is estimated to increase by 8 per cent in the shortfall year is projected to increase at the same annual rate in the two post-shortfall years, as new plantings come into bearing and increasing yields from hybrid strains more than offset the declining productivity from older trees. Based on these price and volume movements, earnings from cocoa exports are projected to increase by 4 per cent in the first post-shortfall year and by 19 per cent in the second.

(4) Meat

After growing at an average annual rate of 93 per cent in the two pre-shortfall years, the rate of growth of meat exports decelerated to only 2 per cent in the shortfall year. An estimated increase in volume of 16 per cent in 1982 is offset by an estimated 12 per cent decline in price. The volume increase represents a continuation of the strong upward trend that began in the late 1970s, while the decline in the world price of meat during 1982 has been caused by ample world supplies and weak demand.

Poultry accounts for an estimated 56 per cent of meat exports in 1982 and processed beef exports for the remainder. Poultry exports grew at an average annual rate of 88 per cent from 1977 to 1981 before slowing to about 5 per cent in the shortfall year. The Middle East accounts for over 80 per cent of this fast-growing market.

Brazil was a major beef exporter until 1973, when its principal market, the European Community, was virtually closed. Exports did not recover until 1977, but since then have grown rapidly. The major markets now are the United Kingdom and the United States, which together account for almost two thirds of Brazil's beef exports.

World meat prices have begun to recover in the latter part of 1982 and are expected to increase by 4 per cent in 1983 and 10 per cent in 1984 as world demand strengthens. Brazil's meat exports are forecast to increase by an average of 17 per cent in the post-shortfall period, far below the rate of increase achieved in the pre-shortfall period, as volume increases decelerate. An excess of SDR 5 million is estimated for meat exports as a group in 1982.

(5) Orange juice

The volume of Brazilian frozen orange juice exports approximately tripled from 1977 to 1981 as production capacity was substantially increased, and output almost doubled as the result of increases in both acreage and yield. During 1981 and 1982, when orange production in the United States was damaged by two successive frosts, Brazil was well prepared to increase its exports in response to this shortfall. The frosts in the United States also put upward pressure on prices, which increased 35 per cent in 1981 and an estimated 12 per cent in 1982. As a result of these volume and price increases, orange juice exports in the shortfall year are estimated to reach SDR 542 million, more than double the level in 1980.

With the low level of carryover stocks in the United States, the volume of Brazil's exports to that market is not expected to decline in 1983. Growth in exports to the EC, Brazil's largest market, is expected to contribute to an average annual volume growth of 4 per cent in the post-shortfall period, which is far less than the annual increases recorded in the pre-shortfall period. With export earnings forecast to increase at an average rate of 9 per cent during this period, an excess of SDR 49 million is estimated for orange juice exports in 1982.

(6) Tobacco

Tobacco exports increased by 39 per cent in 1981 and by an estimated 34 per cent in 1982. Export volume has increased substantially in recent years primarily as a result of better yields which have risen by about 30 per cent since 1976. The EC is the major market for Brazilian tobacco, followed by the United States. Both price and volume are expected to maintain an upward trend in the post-shortfall period, though at a slower pace than in past years. An excess of SDR 35 million is estimated.

(7) Paper pulp

Brazil's production of cellulose products expanded sharply during the 1970s, as its share in the world market increased from 0.2 per cent in 1970 to 4 per cent in 1980. The annual rate of growth from 1977 to 1980 averaged 164 per cent. The depressed condition of the world pulp and paper industry during 1981 and 1982, however, resulted in these exports growing by only 4 per cent in 1981 and declining by an estimated 12 per cent in 1982. Volume is estimated to decrease by 12 per cent in 1982 as paper producers draw down the abnormally high level of inventories they had accumulated by the first part of 1982.

With world demand forecast to recover gradually in 1983 and with greater strength in 1984, export earnings are expected to increase by 7 per cent in 1983 and by 21 per cent in 1984. Increased capacity is expected to contribute to a 12 per cent volume increase projected for 1984. A shortfall of SDR 31 million is estimated for paper pulp in exports in 1982.

(8) Iron ore

After coffee, iron ore is Brazil's most valuable single commodity export and in 1982 is estimated to incur an export excess of nearly SDR 53 million.

In spite of the world recession, especially in the steel industry which has been severely affected, the volume of Brazil's iron ore exports did not fall in 1982, although the steady increases of previous years were not realized. Production and domestic use are estimated to remain at about the same depressed level as in 1981. Export unit values for iron ore continued to rise at the same annual rate of about 12 per cent that has been experienced since 1980. Much of Brazil's iron ore is exported under annual supply contracts which take into account reasonable increases in production costs, and these are accepted by overseas purchasers in order to ensure continuity of supply. Usually during periods of weak demand for iron ore, it is export quantities that are reduced, while prices continue to rise moderately.

Over the next two years (1983-84), no substantial increases in Brazil's output and domestic consumption are envisaged. In anticipation, however, of a gradual recovery of the world steel industry, Brazil expects to increase the volume of its iron ore exports by 5 per cent in 1983 and by a further 2 per cent in 1984. Conservative price increases of between 6 per cent and 7 per cent are forecast for the post-shortfall period. On these assumptions, the value of iron ore exports which, despite the recession increased by 13 per cent in 1982, are projected to increase at an annual rate of between 11 per cent and 10 per cent in 1983-84. The export excess of SDR 53 million estimated for 1982 is attributable to price developments.

(9) Refined petroleum

Exports of refined petroleum have increased substantially in recent years from a level of SDR 21 million in 1977 to an estimated SDR 453 million in 1982. Volume has increased tenfold over this period, while prices have approximately doubled. The volume increases resulted mainly from greater refining capacity, but more recently also from reduced domestic consumption because of conservation measures and depressed industrial activity. The largest market for Brazil's refined petroleum exports is the United States, which accounts for almost half of the total market. With a leveling off of both volume and price forecast for the post-shortfall period, an excess of SDR 113 million is estimated for refined petroleum exports.

b. Manufactures

In recent years, Brazil has emerged as a highly competitive exporter of manufactured goods, and earnings from these products have advanced rapidly. In 1982 a number of factors have combined to affect many of Brazil's manufactured exports adversely. The downturn in economic activity in industrial countries and the mounting economic difficulties encountered by major regional and African trading partners has resulted in a sharp drop in foreign demand. In addition, the appreciation in real terms of Brazil's currency during the first eight months of 1982 adversely affected Brazil's competitiveness. Despite an acceleration of the rate of cruzeiro depreciation since September, the growth of earnings in the post-shortfall period is projected to be moderate. Import restrictions and policies to constrain domestic demand initiated by Brazil's main trading partners are expected to dampen the growth of consumer goods exports. The overall export shortfall for the group in 1982 is estimated at SDR 209 million.

(1) Footwear

Exports of footwear, one of Brazil's traditional exports, are estimated to account for only 3 per cent of total export earnings in 1982 and to contribute a shortfall of SDR 4 million.

Earnings have exhibited strong growth over the last half of the 1970's as Brazilian products competed successfully with other major suppliers in the United States and Europe, assisted, in part, by a flexible exchange rate policy and by the introduction of fiscal tax credits to encourage exports. In the two pre-shortfall years, earnings rose at an average annual rate of 24 per cent but are estimated to decline by 7 per cent in 1982. The downturn in world economic activity curtailed the growth of demand for Brazilian shoes. In order to retain its market share, particularly in European countries where sales were also affected by the relative appreciation of the U.S. dollar to which the Brazilian currency is linked, substantial price discounts were offered.

Export earnings in the post-shortfall period are projected to recover, but their growth is expected to be moderate compared to earlier years, averaging 13 per cent per annum. Appreciable further penetration into foreign markets is not expected. Thus, the projected volume increase of 8 per cent per annum on average in the post-shortfall period reflects a recovery in the demand for footwear in industrial countries rather than any increase of Brazil's market share.

(2) Transport equipment

Exports of transportation equipment, primarily automobiles, have been a rapidly expanding source of foreign exchange, and in 1982 are estimated to account for 8 per cent of total export earnings.

The principal outlet for Brazilian automobiles has been in other Latin American Free Trade Association countries (ALADI), primarily Argentina, Chile, Columbia and Peru, but inroads have recently been made into large African markets--in particular Nigeria. Earnings from these exports advanced at an average annual rate of 42 per cent in the pre-shortfall period, reflecting mainly strong growth in the volume of sales, but in 1982, export earnings are estimated to decline by 20 per cent. The downturn in economic activity during 1981-82 and the adoption of economic adjustment programs caused Brazil's major Latin American and African trading partners to cut back sharply on their imports.

Recovery in export earnings from these products is projected to be gradual and to reflect, for the most part, price increases. In the first post-shortfall year, the volume of exports is expected to remain at the depressed level of 1982 and to increase by only 8 per cent in the second post-shortfall year as foreign demand gradually picks up.

Exports of transportation equipment are calculated to contribute SDR 83 million to the overall shortfall.

(3) Boilers and mechanical equipment

This category of exports includes a diverse range of medium- and small-sized machinery products which are sold throughout the world. In recent years, aggressive marketing strategies have assisted rapid export growth in regional markets and penetration of African and Middle Eastern markets. The growth of these exports also has been facilitated by the development of Brazilian construction and oil exploration abroad, which utilize mostly Brazilian-manufactured products. In 1982, earnings from these products are estimated to account for 6 per cent of total export earnings.

Export earnings from these products are estimated to decline by 21 per cent in 1982, after registering a 35 per cent annual average rate of growth in 1980-81. The recession in industrial countries, the emergence of severe economic difficulties in neighboring countries, and the general stagnation of construction activity resulted in a curtailment of demand. Demand for these products is expected to recover, however, once economic activity in industrial countries resumes a more normal course. Export earnings are projected to average SDR 1.2 billion in 1983-84, slightly less than the level realized in 1981. The export shortfall on account of boilers and mechanical equipment in 1982 is calculated at SDR 137 million.

(4) Manufactured steel goods

Brazil, a highly competitive producer of steel and specialized steel products, has become an increasingly important supplier and is facing increased resistence from domestic producers in importing countries. Thus, after almost doubling in both 1978 and 1979, the rate of growth of export earnings moderated to 41 per cent per annum in 1980-81 following bilateral arrangements aimed at protecting these domestic producers. Despite the downturn in economic activity in industrial countries, Brazilian exports in 1982 are estimated to have advanced by 8 per cent. Only moderate growth is projected for the post-shortfall period despite large additions to productive capacity. The steel arrangement recently negotiated between the EEC and the United States, which limits market shares, combined with the initiation of preliminary investigations by the United States into the possible dumping of steel imports by Brazil, suggest that the growth in export volume will be constrained until economic recovery in industrial countries is well underway.

An export excess of SDR 27 million is calculated for steel and steel products in 1982.

c. Other exports

Other exports account for about one third of Brazil's total exports in 1982. They consist primarily of a wide range of manufactured and semi-manufactured goods, (e.g., textiles, chemical products, and electrical machinery), but also some minor agricultural and mineral commodities. These exports increased at annual rates of 30 and 49 per cent in 1980 and 1981 before declining by an estimated 3 per cent in 1982. This decline is due to reduced economic activity in Brazil's major markets, lower prices for primary commodities, and the appreciation of Brazil's currency during the first part of 1982.

With a recovery in world demand forecast during 1983 and 1984, other exports are projected to rise at an annual average rate of 10 per cent during this period, well below the pre-shortfall growth rates. As a result of these movements in other exports, an excess of SDR 57 million is estimated for 1982.

4. Repurchase

In accordance with paragraph 7 of the compensatory financing decision, the Brazilian authorities are expected to represent that they will make a prompt repurchase in respect of any outstanding part of this purchase, if the amount purchased on the basis of partly estimated data (i.e., estimates for the three-month period October-December 1982) exceeds the amount that could have been purchased on the basis of actual data for the entire shortfall year. The amount to be repurchased would be equivalent to the excess purchased by using partly estimated, rather than actual, data for the entire shortfall year.

5. Staff appraisal and proposed decision

The Brazilian authorities are expected to request a purchase of SDR 498.75 million (equivalent to 50 per cent of quota) under the compensatory financing facility in respect of a shortfall of SDR 920 million estimated for the year ending December 1982. The shortfall is based on estimated data for the last three months of the shortfall year, and, in accordance with paragraph 7 of the 1979 CF decision (Executive Board Decision No. 6224-(79/135)), the request is expected to include a representation that Brazil will make a prompt repurchase of the amount, if any, by which the proposed purchase exceeds the amount that could have been purchased on the basis of actual, rather than estimated, exports for the entire shortfall year.

After improving in 1981, Brazil's balance of payments has deteriorated sharply during 1982. The value of exports in 1982 is estimated to decline for the first time since 1967, mainly as a result of the slowdown in economic activity in industrial countries, combined with the external problems of most of Brazil's trading partners in the developing world. In addition, interest payments are expected to rise by SDR 2 billion in 1982. Thus, in spite of an expected decline of almost 10 per cent in the value of imports in 1982, the current account deficit is estimated to rise to about SDR 12.9 billion (4.6 per cent of GDP) from SDR 9.8 billion in 1981 (3.9 per cent of GDP). The overall balance of payments is estimated to register a deficit of some SDR 720 million compared with a surplus of approximately the same amount in 1981. Brazil's gross international reserves fell by almost SDR 500 million from January to August 1982, and for the year as a whole, the available estimates by the Brazilian authorities indicate a decline of SDR 1.1 billion. The staff considers that the balance of payments need of Brazil justifies the proposal purchase under the compensatory financing decision.

Brazil maintains a number of exchange measures that require Fund approval under Sections 2 and 3 of Article VIII of the Articles of Agreement. Since November 1981 Brazil has adopted new, and modified existing, multiple currency practices. The exchange practices subject to the Fund's approval will be a subject of the upcoming 1982 Article IV consultation with Brazil. The staff will stress that cooperation with the Fund involves understandings regarding the eventual elimination of the unapproved exchange practices. As is usual in all CF requests, the request by Brazil is expected to include a statement that it will cooperate with the Fund in efforts to find, where required, appropriate solutions for its balance of payments difficulties.

Export earnings in the shortfall year ending December 1982 are estimated to decline by 8 per cent to SDR 18,296 million after expanding at an average annual rate of almost 30 per cent in both 1980 and 1981. They are projected to recover by 11 and 13 per cent in 1983 and 1984, respectively. The shortfall in total export earnings for the calendar year 1982 is estimated at SDR 920 million. Major primary commodities account for a shortfall estimated at SDR 738 million, including shortfalls for soybean products (SDR 356 million), sugar (SDR 196 million), coffee (SDR 155 million), cocoa (SDR 92 million), and paper pulp (SDR 31 million). Low volume because of adverse weather is mainly responsible for the shortfall in soybean products, while low prices are almost entirely responsible for the shortfalls in sugar, coffee, and cocoa. A shortfall of SDR 209 million estimated for major manufactured products is mainly attributable to low volumes associated primarily with the world recession. Export excesses are calculated for refined petroleum products, iron ore, orange juice, tobacco and meat. Since the shortfall in Brazil's export earnings is caused primarily by weak world demand and low prices, the staff considers that it is largely attributable to factors beyond Brazil's control, and in view of the expected recovery, that it is temporary in character.

The staff considers that the expected request will meet all the requirements set forth in the compensatory financing decision. Accordingly, the following draft decision is proposed for adoption by the Executive Board after a duly authenticated request has been received:

1. The Fund has received a request from the Government of Brazil for a purchase of SDR 498.75 million under the Decision on Compensatory Financing of Export Fluctuations (Executive Board Decision No. 6224-(79/135), adopted August 2, 1979).

2. The Fund notes the representations of Brazil and approves the purchase in accordance with the request.

Fund Relations with Brazil
(As of October 31, 1982)

Quota:	SDR 997.5 million
Fund holdings of Brazilian cruzeiros:	SDR 734.6 million, or 73.6 per cent of quota. The reserve position amounts to SDR 262.9 million.
SDR Department:	SDR 1.8 million, or 0.5 per cent of net cumulative allocation of SDR 358.7 million.
Gold distribution:	Brazil has acquired 376,565.569 ounces of fine gold in four distributions.
Direct distribution of profits from gold sales:	US$69.9 million.
Exchange rate (November 4, 1982):	Cr$224.49 per U.S. dollar buying and Cr$225.61 per U.S. dollar selling.
Last consultation (Article IV):	August-September 1981, completed by the Executive Board on November 13, 1981.