

TECHNICAL MEMORANDUM OF UNDERSTANDING

In accordance with the authorities' letter of intent of December 2, 1991 this technical memorandum and attached tables define the concepts used in quantifying certain variables of the economic program and specify performance criteria for the first half of 1992 and indicative targets for the rest of the year. These performance criteria and indicative targets will be reviewed following an agreement between Brazil and its commercial bank creditors on a comprehensive restructuring of the country's bank debt. Performance criteria for the second half of 1992 will be established in a review to be completed by August 31, 1992 and those for the first half of 1993 will be established in a review to be completed by February 28, 1993.

I. Net International Reserves of the Central Bank of Brazil

1. The overall balance of payments deficit will be limited to US\$6 billion in 1991 (indicative limit). After the envisaged rescheduling and exceptional financing from official sources, the overall balance of payments will show a surplus of not less than US\$7.3 billion in 1992 and a deficit of not more than US\$0.3 billion in 1993. The overall balance of payments performance will be measured by changes in the net international reserves of the Central Bank of Brazil, as defined in line 5 of Table 1. Accordingly, the stock of net international reserves will increase by not less than US\$4,600 million from January 1, 1992 to March 31, 1992, will increase by not less than US\$5,400 million from January 1, 1992 to June 30, 1992, will increase by not less than US\$6,100 million from January 1, 1992 to September 30, 1992 and will increase by not less than US\$7,300 million from January 1, 1992 to December 31, 1992. These amounts will be: (i) increased by the cumulative total net disbursements of concerted lending (including interim financing, if any) from commercial bank creditors; (ii) decreased (increased) by shortfalls (excess) in the incremental disbursements from multilateral and official creditors that are referred to in paragraph 36.b. of the letter of intent, and are projected at US\$750 million a year in 1992-93; and (iii) increased by the excess of actual debt relief over the assumed amounts related to Paris Club pre-cutoff date debts, including arrears, in 1992 and 1993. Adjustments to the targets as a result of the use of reserves for debt and debt-service reduction operations will be subject to consultation with the Fund.

II. Net Domestic Assets of the Central Bank of Brazil

2. For purposes of the program, the stock of net domestic assets of the Central Bank of Brazil in each quarter is defined as currency in the hands of the public measured as the average of daily balances in the last month of the quarter, minus net international reserves (line 5 of Table 1) at the end of the last month of the quarter converted into cruzeiros at previously agreed accounting exchange rates. The change in the net domestic assets of

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the Central Bank of Brazil for the period after January 1, 1992 will not exceed negative Cr\$5.3 trillion by March 31, 1992 and negative Cr\$5.55 trillion by June 30, 1992. Indicative limits for the change in the net domestic assets of the Central Bank of Brazil from January 1, 1992 to September 30, 1992 and to December 31, 1992 will be negative Cr\$6.25 trillion and negative Cr\$7.75 trillion, respectively. These limits will be adjusted to reflect the adjustments to the net international reserve targets described in Section I, above.

III. Public Sector Borrowing Requirement

3. The public sector borrowing requirement (PSBR) is defined as the net financing obtained by the nonfinancial public sector and the Central Bank of Brazil from the domestic financial system (excluding the Central Bank of Brazil), from the nonfinancial private sector, and from foreign sources. It is calculated as the sum of the net change in the stock of public domestic debt plus the change in the monetary base plus net external financing, including the change in the net international reserves of the Central Bank of Brazil plus the net proceeds, at face value, from the privatization of public enterprises (Table 2). The nonfinancial public sector includes the Federal Government (Central Administration and social security), state and local governments, nonfinancial federal public enterprises, and nonfinancial state and local public enterprises. The domestic financial system includes the Bank of Brazil, the commercial banks, the multiple banks; and the nonmonetary financial institutions: BNDES, BEDES (including carteiras de desenvolvimento of commercial banks), CEF, CEEs, APE, SCI, SCFI, bancos de investimento, and SAM.

4. The stock of domestic debt consists of net credit extended by the domestic financial system to the nonfinancial public sector excluding all credit extended by the Central Bank of Brazil to the public (including the domestic financial system), debentures and suppliers' credits, treasury and state and local government securities (with the nominal interest on those securities to be included on an accrual basis) held by the public (including the domestic financial system) less those held by the nonfinancial public sector.

5. Net credit extended to the nonfinancial public sector and the Central Bank of Brazil by the domestic financial system, excluding the Central Bank of Brazil, is defined as the sum of (a) the stock of treasury securities held by these financial institutions, (b) any other credit extended to the nonfinancial public sector by these financial institutions, less (c) deposits of the nonfinancial public sector with these financial institutions, less (d) tax collection liabilities of these financial institutions to the Treasury or state and municipal governments.

6. Net credit extended to the nonfinancial public sector and the Central Bank of Brazil by the nonfinancial private sector is defined as (a) suppliers' credit, and debentures held by the nonfinancial private sector and

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(b) treasury securities held by the nonfinancial private sector defined in turn as total securities issued including accrued nominal interest (as reported by the Departamento do Tesouro Nacional - DTN) less those held by the domestic financial system, the social security system, and the public enterprises.

7. Net external financing of the nonfinancial public sector and the Central Bank of Brazil is defined as the sum of the monthly net flows (disbursements less amortizations) in foreign currencies converted at actual average monthly exchange rates of (a) deposits registered in foreign currencies of the nonfinancial public sector, and (b) other foreign financing (including short-term financing) to the nonfinancial public sector and the Central Bank of Brazil and the change in the net international reserves of the Central Bank of Brazil. Net external financing is to be adjusted by any capital gains resulting from debt and debt-service reduction operations, including debt conversions.

8. As an indicative limit, the PSBR measured from January 1, 1991 to December 31, 1991 will not exceed Cr\$63 trillion. The PSBR measured from January 1, 1992 onwards will not exceed Cr\$59 trillion as of March 31, 1992 and from January 1, 1992 onward the cumulative PSBR will not exceed Cr\$120 trillion as of June 30, 1992. Indicative cumulative PSBR limits also have been set for the rest of 1992: from January 1, 1992 onward the cumulative PSBR will not exceed Cr\$173 trillion as of September 30, 1992 and Cr\$202 trillion as of December 31, 1992.

IV. Public Sector Operational Result

9. The operational result of the nonfinancial public sector and the Central Bank of Brazil is estimated as the PSBR (as defined in Section III, above) less the adjustment for inflation and exchange rate change on the stock of domestic public debt included in that borrowing requirement.

10. (a) The adjustment for inflation for stocks denominated in domestic currency is calculated by multiplying the corresponding stock at the end of the previous month by the change in an index based on the geometric average of the IGP-DI of the current and the following months.

(b) On securities, loans, and other domestic public sector assets or liabilities denominated in foreign exchange, exchange rate correction for a given month is calculated by multiplying the stock at the end of the previous month by the percentage change in the cruzeiro value of the U.S. dollar (venda) for commercial transactions prevailing at the end of the month.

11. As an indicative limit, the operational cumulative deficit from January 1, 1991 to December 31, 1991 will not exceed Cr\$3.9 trillion. The operational cumulative deficit of the nonfinancial public sector and the Central Bank of Brazil for the period after January 1, 1992 will not exceed

Cr\$5.6 trillion as of March 31, 1992 and Cr\$11.4 trillion as of June 30, 1992. Indicative limits for the operational cumulative deficit for the period after January 1, 1992 will be Cr\$22 trillion as of September 30, 1992 and Cr\$30 trillion as of December 31, 1992.

V. Public Sector Primary Result

12. The primary result of the nonfinancial public sector and the Central Bank of Brazil is defined as the PSBR (as defined in Section III, above) less the estimate of the nominal interest payments on the stock of external public debt, less the nominal interest payments on the stock of domestic public debt, plus the interest receipts on net international reserves and other foreign assets of the public sector, plus the interest receipts on cruzeiro denominated assets of the public sector. Performance criteria on the primary result will be established following the development of the methodology to measure the nominal interest payments on the domestic public debt of the nonfinancial public sector. On that occasion, performance criteria of the operational result will be converted into indicative targets. As indicative floors the primary cumulative surplus of the nonfinancial public sector and the Central Bank of Brazil measured from January 1, 1992 onwards will be not less than Cr\$6.5 trillion as of March 31, 1992; Cr\$14.8 trillion as of June 30, 1992; Cr\$24 trillion as of September 30, 1992; and Cr\$32.5 trillion as of December 31, 1992.

VI. Net External Borrowing of the Public Sector

13. The limits on total net external borrowing of the public sector will be defined as the difference between disbursements and amortization, excluding amortization through debt and debt-service reduction and debt-conversion operations, of medium and long-term external debt of the public sector, plus changes in the stock of short-term external debt of the nonfinancial public sector, as described in the attached Table 3. Net external borrowing thus defined will not exceed US\$6.2 billion during the 3-month period ending March 31, 1992; US\$6.7 billion during the 6-month period ending June 30, 1992; US\$7.6 billion during the 9-month period ending September 30, 1992; and US\$8 billion during the 12-month period ending December 31, 1992. These amounts will be: (i) increased by the cumulative total net disbursements of concerted lending (including interim financing, if any) from commercial bank creditors; (ii) decreased (increased) by shortfalls (excesses) in the incremental disbursements from multilateral and official creditors that are referred to in paragraph 36.b. of the letter of intent; and (iii) increased by the excess of actual rescheduling over the assumed amounts. The net short-term external debt of the nonfinancial public sector included in the amounts mentioned above are projected not to exceed US\$1.5 billion during the 12-month period ending December 31, 1992.

Table 1. Brazil: Net International Reserves - Adjusted

(In millions of U.S. dollars)

	December 31, 1990
1. <u>Assets</u>	9,175
Spot assets	1,772
Short-term assets	7,378
Medium- and long-term assets	25
2. <u>Liabilities</u>	16,298
Short-term liabilities	1,763
Medium- and long-term liabilities (IMF)	1,821
Arrears <u>1/</u>	12,714
3. <u>Assets less liabilities (1-2)</u>	<u>-7,123</u>
4. <u>Valuation gains or losses 2/</u>	
Assets	...
Liabilities	...
5. <u>Net international reserves (3-4)</u>	<u>-7,123</u>

1/ Includes an estimated US\$580 million of interest accrued on arrears. Arrears for 1991-1993, to be calculated as arrears at end-1990, plus scheduled debt service of the nonfinancial public sector and the Central Bank of Brazil, plus estimated interest on arrears, less payments actually made by the nonfinancial public sector and the Central Bank of Brazil.

2/ For the purpose of this table, valuation adjustments reflect changes in the value of gold and nondollar assets and liabilities due to prices and exchange rates different from those in effect on December 31, 1990.

Table 2. Brazil: Net Public Sector Debt

(In billions of cruzeiros)

	June 30, 1991
<u>Total debt</u>	<u>49,229</u>
Federal Government <u>1/</u>	18,407
State and municipal governments	9,901
Public enterprises	20,991
<u>Domestic debt</u>	<u>22,167</u>
<u>Federal government <u>1/</u></u>	<u>1,735</u>
Federal bonded debt held by the public	3,061
Bank debt	-2,491
Accounts receivable and bank deposits	-359
Social security system	-266
Decentralized agencies	450
MF-30	-7,603
Base money	2,475
State and municipal titles held by the Central Bank	-1,015
Blocked financial assets	6,590
Special deposits accounts	...
Other deposits held by the Central Bank	1,693
Credit to financial institutions	-1,151
Other	351
<u>State and municipal governments</u>	<u>8,583</u>
State and municipal titles held by the public	1,976
State and municipal titles held by the Central Bank	1,015
Bank debt	4,566
Tax receipts in banks	-33
Demand deposits	-293
MF-30	1,352
<u>Public enterprises</u>	<u>11,849</u>
Bank debt	4,631
Demand deposits	-109
Supplier's credit	295
Debentures	1,108
Bonded debt held by public enterprises	-327
MF-30	6,251
<u>Foreign debt</u>	<u>27,132</u>
Federal government <u>1/</u>	16,672
State and municipal governments	1,318
Public enterprises	9,142

1/ Comprises Central Government, social security system, decentralized agencies, and Central Bank.

Table 3. Brazil: Net Disbursements of the
Public Sector External Debt

(In millions of U. S. dollars)

	Proj. 1991
1. <u>Disbursements (medium and long term)</u>	<u>2,490</u>
Refinancing	--
Commercial banks	--
Brazilian abroad	--
Foreign	--
Official creditors	--
Other disbursements	2,490
Multilateral	1,400
Bilateral	100
Suppliers/buyers	490
Banks	--
Intercompany and other	500
2. <u>Amortizations (medium and long term) 1/</u>	<u>5,281</u>
Multilateral	1,340
Bilateral	2,402
Suppliers	458
Banks	1,022
Intercompany and other	59
3. <u>Short-term capital (net) 2/</u>	<u>-700</u>
4. <u>Net disbursements of external debt (1-2+3)</u>	<u>-3,491</u>

1/ Excludes amortization due to debt equity conversions.

2/ Short-term debt of the nonfinancial public sector.