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BRAZIL—TECHNICAL MEMORANDUM OF UNDERSTANDING

This Technical Memorandum of Understanding (TMU) sets out the specific performance criteria, indicative targets, and assumptions that will be applied under the arrangement for Brazil and details some specific daily data that the authorities will provide to the staff of the Fund. This TMU provides the technical details that underlie the government's plans as discussed in the government's Memorandum on Economic Policies (MEP), which has been sent separately.

During the first year of the program supported by the arrangement, Brazil will complete six reviews with the Fund. A first review will be completed no later than February 28, 1999, but no earlier than December 15, 1998; completion of this first review will make available to Brazil the second purchase under the SRF. A second review will be completed no later than May 31, 1999. The performance criteria for September 1999 and December 1999 will be established at the time of this second review. A third review will be completed no later than May 31, 1999 but no earlier than March 1, 1999; completion of this third review will make available to Brazil the third purchase under the SRF. A fourth review will be completed no later than August 31, 1999. A fifth review will be completed no later than August 31, 1999 but no earlier than June [illegible] 1999; completion of this fifth review will make available to Brazil the fourth purchase under the SRF. A sixth review will be completed no later than November 30, 1999; performance criteria, [illegible], benchmarks and number and timing of reviews during the second year of the program will be [illegible] the time of this sixth review.

I. QUANTITATIVE TARGETS

1. Fiscal Targets

a. Performance Criterion for the Public Sector Borrowing Requirement 1/

	Ceiling 2/ (In millions of R$)
Cumulative borrowing requirement of the consolidated public sector 1/	
January 1-December 31, 1998 (performance criterion)	72,879
January 1-March 31, 1999 (performance criterion)	17,145
January 1-June 30, 1999 (performance criterion)	28,565
January 1-September 30, 1999 (indicative target) 3/	32,127
January 1-December 31, 1999 (indicative target) 3/	42,561

1/ As defined below.
2/ Maximum cumulative borrowing requirement of the consolidated public sector.
3/ Performance criterion to be set at the time of the second review under the arrangement.

The cumulative borrowing requirement of the consolidated public sector (PSBR) is define the sum of the cumulative borrowing requirements of the federal government, state and municipal governments, and the public enterprises (including federal, state and municipal enterprises); the federal government includes the central government, the social security system, and the Brazilian Central Bank (BCB). The respective borrowing requirements are measured in Brazilian Reais (R$), as the sum of total net financing from all sources, includi among others, changes in cash balances of the public sector.

Receipts from concessions will be counted as revenue only if they derive from the sources listed in the Section V of this TMU. The receipts from concessions shown in Section V are based on a projected time path. Changes in projected amounts and timing of these receipts v be taken into account during the appropriate reviews.

b. Indicative Target on the Primary Balance of the Federal Government 1/

	Floor 2/ (In millions of R$)
Cumulative primary ba[illegible] the federal government 1/	
January 1-December 31, 19[illegible] (indicativ[illegible])	5,025
January 1-March 31, 1999 ([illegible]ative target)	2,982
January 1-June 30, 1999 (in[illegible]tive target)	5,907
January 1-September 30, 19[illegible] (indicative target)	12,604
January 1-December 31, 1999 (indicative target)	16,344

1/ The federal government is defined as above.
2/ Minimum primary surplus.

The primary balance of the federal government is measured as noninterest revenue minus noninterest expenditure. Receipts from concessions will be counted as revenue only if they derive from the sources listed in the Section V of this TMU. Changes in projected amounts and timing of these receipts will be taken into account during the appropriate reviews.

STRICTLY CONFI[illegible]

c. Indicative Target on the Recognition of Nonregistered Public Sector Debt N[illegible] Privatization Proceeds 1/

	Floor 2/ (Net)	Recognition of Nonregistered Debt	Priva[illegible] Proceed[illegible]
		(In millions of R$)	
Recognition of non-registered debt net of privatization proceeds (cumulative)			
November 1, 1998-December 31, 1998 (indicative target)	8,383	9,629	1,2[illegible]
November 1, 1998-March 31, 1999 (indicative target)	12,183	13,429	[illegible]24
November 1, 1998-June 30, 1999 (indicative target)	1,312	17,229	1[illegible]91
November 1, 1998-September 30, 1999 (indicative target)	2,466	21,029	16,56
November 1, 1998-December 31, 1999 (indicative target)	-884	24,829	2[illegible]1

1/ The public sector comprises the consolidated accounts of the nonfinancial public sector (i.e., central, state, municipal governments, the social security system, [illegible] public enterprises) and the federal financial ins[illegible] also including the BCB. [illegible] target refers [illegible] floor/ceiling [illegible] net [illegible] as defined above; gr[illegible] for the recognition of nonregistered debt and [illegible] are shown as explanatory sides only.

2/ Indicates minimum net [illegible].

3/ Net of concession revenue [illegible] including [illegible] the private sector.

The government will continue to incorporate into its registered debt various unregister[illegible] liabilities that are currently outstanding. The expected [illegible] privatization will [illegible] the government to pay off these liabilities. Net of privatization proceeds, the governmen[illegible] to recognize these unregistered liabilities according to the minimum net targets set out abo[illegible]

STRICTLY CONFIDEN[illegible]

2. External Sector Targets

a. Performance Criterion on External Debt of the Nonfinancial Public Sector 1/

	Ceiling (In millions of US$)
Stock of total external debt of the nonfinancial public sector at	
End-September 1998 (estimate)	85,766
End-December 1998 (performance criterion)	87,765
End-March 1999 (performance criterion)	91,215
End-June 1999 (performance criterion)	93,235
End-September 1999 (indicative target) 2/	94,610
End-December 1999 (indicative target) 2/	97,675

1/ The data in this table apply to all external debt of the nonfinancial public sector that is disbursed and outstanding. The nonfinancial public sector includes the central, state, and municipal governments, the public enterprises, and the social [illegible] system. Exclude[illegible] measured [illegible] any liabilities incurred in the context of the propose[illegible] package, either [illegible] the Fund [illegible]ers.

2/ Performance criter[illegible] to [illegible] at the time [illegible] review under the [illegible]ement.

For any given quarter, t[illegible]ock of [illegible] disb[illegible]ed and outst[illegible] is defined as the stock of debt disbursed and outst[illegible]ing at [illegible] previou[illegible]ter, plus gross disbursements that take place during th[illegible] quarter in questio[illegible]ss the [illegible]tion payments made during the quarter in question.

The above limits will be adjusted upward to accommodate new external borrowing that is made in order to undertake an early or advance repurchase to the Fund or to the bilateral sources of support for the proposed financing package. Should the authorities wish to make any advance payments to other contributors to the proposed financing package, they would make advance repurchases to the Fund on at least a proportional basis.

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b. Performance Criterion on New Publicly Guaranteed External Debt 1/

Stock of publicly guaranteed external debt outstanding	Ceiling (In millions of US$)
End-December 1997 (actual)	492
End-December 1998 (performance criterion)	1,000
End-March 1999 (performance criterion)	1,000
End-June 1999 (performance criterion)	1,000
End-September 1999 (indicative target) 2/	1,000
End-December 1999 (indicative target) 2/	1,000

1/ The limit applies to all private external debt guaranteed by the public sector. The public sector includes the nonfinancial public sector (as defined above), the Central Bank and the financial public sector.
2/ Performance criterion to be set at the time of the second review under the arrangement.

For any given quarter, the stock of external debt guaranteed by the public sector is defined as the stock of external debt guaranteed by the public sector that is outstanding at the end of the previous quarter, plus the net additions to external debt that is guaranteed by the public sector during the quarter in question.

c. Indicative Ceiling on Total Short-Term External Debt Disbursed and Outstanding

Stock of total short-term external debt as of	Ceiling (In millions of US$)
End-September 1998 (estimate)	30,062
End-December 1998 (indicative target)	31,610
End-March 1999 (indicative target)	33,285
End-June 1999 (indicative target)	34,770
End-September 1999 (indicative target)	38,710
End-December 1999 (indicative target)	43,080

1/ All external debt (private and public) with original maturities of strictly less than one year. Excluded from measured debt stocks are liabilities that are incurred, in the context of this arrangement, either from the Fund or the bilateral sources of support.

Short-term debt is defined as all debt with an original maturity of strictly less than one year. For any given quarter, the stock of short-term debt disbursed and outstanding is defined as the stock of short-term debt disbursed and outstanding at the end of the previous quarter, plus the net flows associated with the disbursements and amortizations of short-term debt that take place during the quarter in question.

The above limits will be adjusted upward to accommodate new external borrowing that is made in order to undertake an early or advance repurchase to the Fund or to the bilateral sources of support for the proposed financing package.

d. Floor on Net International Reserves in the BCB

The net international reserves (NIR) in the BCB are measured in terms of the balance-of-payments concept of net international reserves *(reservas internacionais líquidas ajustadas)* and include gross official reserves minus gross official liabilities. The floor on NIR in the BCB for the period through December 1999 is set at US$20,000 million.

3. Monetary Targets

a. Performance Criterion on Net Domestic Assets in the BCB

142

	Ceiling 1/ (in millions of R$)
Outstanding stock as of:	
September 1998 (actual)	-31,548
December 1998 (performance criterion)	-9,506
March 1999 (performance criterion)	-7,376
June 1999 (performance criterion)	-6,130
September 1999 (indicative target) 2/	-12,644
December 1999 (indicative target) 2/	-19,070

1/ Calculated on the basis of the definitions set out below; indicates the maximum level of net domestic assets in the BCB; i.e., numbers that are more negative are within the ceiling.
2/ Performance criterion to be set at the time of the second review under the arrangement.

The net domestic assets in the BCB (NDA) are defined as the difference between the monetary base and the net international reserves in the BCB (NIR) valued in Brazilian Reais (R$). The monetary base consists of currency issued and total reserves on demand deposits of financial institutions. Total reserves on demand deposits include both required reserves and free reserves. The NIR are equal to the balance-of-payments concept of net international reserves in the BCB *(reservas líquidas ajustadas)*. The monetary base of any given month is measured as the average of the daily closing positions during the working days of that month *(média nos dias úteis do mês)*.

For any given month, the NIR are measured as the average of the NIR in the BCB at the close of business on the last business day of each complete week (usually a Friday) of a given month. The resulting U.S. dollar number will be converted into R$ using the average of the agreed-upon end-of-period accounting exchange rates for the current and the previous month, as shown in Section V of this TMU.

The following adjusters for the NDA ceilings will apply:[1]

- *Adjuster for an increase in the rate of the contribution on funds transfers.*

The NDA ceilings above are based on a baseline path of the demand for base money that [illegible] not take into account the monetary impact of any changes in the *contribution on funds transfers* (CPMF). In particular, any increase in the rate of the CPMF (which is current[illegible] 0.20 percent) will reduce the return on financial assets that are invested short-term and increase the demand for base money through a shift toward demand deposits *(depósitos à vista)*; the shift toward demand deposits is likely to occur already in anticipation of the increase in the rate of the CPMF. To take account of this, following an increase of the rate [illegible] the CPMF above 0.20 percent, the established ceilings for NDA will be increased relative to the baseline as follows:

—*In the month prior to the introduction of the higher rate of the CPMF (i.e., in t-1)* by th[illegible] lesser of:

142

a. the absolute difference between the stock of demand deposits in period t-1 and th[illegible] established baseline path for demand deposits (as set out in Section V) multiplied by the statutory reserve ratio on demand deposits that prevails in that month; the stock of demand deposits is measured as the average of the [illegible] closing positions during the working days [illegible] the relevant month;

b. 75 percent of the observed absolute decline in short-term fixed investment funds *(F[illegible] curto prazo)* from the second month prior to the month the higher rate for the CPMF [illegible] into effect (i.e., t-2) to the month prior to the month the higher rate for the CPMF enter[illegible] in effect (i.e., t-1), multiplied by the statutory reserve requirement on demand deposits that prevails in t-1; the adjustment is based on end-of-month observations for the stocks of the short-term investment funds.

—*In the month of the introduction of the higher rate of the CPMF (i.e., in t)* by the less[illegible]

a. the absolute difference between the stock of demand deposits in period t and the established baseline path for demand deposits (as set out in Section V) multiplied by th[illegible] statutory reserve ratio on demand deposits that prevails in that month; the stock of demand deposits is measured as the average of the daily closing positions during the working day[illegible] o[illegible] the relevant month;

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[1]In each and every case where reference is made to a reserve ratio (or "r" as in any of the formulas set out), it is defined strictly as the sum of the relevant reserve ratio in the form of cash in vault and the relevant reserve ratio in the form of deposits at the central bank. All changes in the reserve ratio are measured with respect to the relevant reserve ratio that [illegible] in effect on October 31, 1998.

b. 75 percent of the observed absolute decline in short-term fixed investment funds *(FIF curto prazo)* from the second month prior to the month the higher rate for the CPMF enters into effect (i.e., t-2) to the month the higher rate for the CPMF enters into effect (i.e., t), multiplied by the statutory reserve requirement on demand deposits that prevails in the month the higher rate of the CPMF enters into effect; the adjustment is based on end-of-month observations for the stocks of the short-term investment funds.

—*In the month following the introduction of the higher rate of the CPMF (i.e. in t+1) and all subsequent periods* by the lesser of:

a. the absolute difference between the stock of demand deposits in period t+1 and the established baseline path for demand deposits (as set out in Section V) multiplied by the statutory reserve ratio on demand deposits that prevails in the month the CPMF enters into effect; the stock of demand deposits is measured as the average of the daily closing positions during the working days of the relevant month;

142

b. 75 percent of the observed absolute decline in short-term fixed investment funds *(FIF curto prazo)* from the second month prior to the month the higher rate for the CPMF enters into effect (i.e., t-2) to the month immediately following the month the higher rate for the CPMF enters into effect (i.e., t+1), multiplied by the statutory reserve requirement on demand deposits that prevails in the month the rate of the CPMF enters into effect; the adjustment is based on end-of-month observations for the stocks of the short-term investment funds.

In any period, the maximum permissible total adjustment to the NDA ceiling vis-à-vis the baseline for that period, as a result of an increase in the rate of the CPMF is R$4.7 billion.

- ***Adjuster for changes in the required reserve ratio on demand deposits.***

For any change to the required reserve ratio on the *stock of demand deposits*, the NDA ceilings will be adjusted by $\Delta NDA = D(r_n - r_o)$, where r_n and r_o denote the new and the old reserve ratio respectively, and D denotes the stock of demand deposits subject to the relevant reserve ratio at the time of the change. In the formula, D is measured as the average of the daily closing positions in the last month for which the old reserve requirement is still in effect.

For any change to the required reserve ratio on *changes in the stock of demand deposits*, the NDA ceiling, in any period t subsequent to the change in reserve requirements, will be adjusted by $\Delta NDA = (D_t - D_c - (\Delta NDA_{CPMF}/r_{CPMF}))(r_n - r_o)$, where D_t and D_c denote the stock of demand deposits subject to the relevant reserve ratio at time t and at the time of the change, respectively; ΔNDA_{CPMF} represents the amount by which the CPMF adjuster (described above) has changed the NDA ceiling at time t (if there has been an increase in the rate of the CPMF between time 0 and time t, and r_{CPMF} represents the relevant reserve ratio on demand deposits that prevailed in the month in which the increase in the CPMF entered into effect. In the formula, D_0 is measured as the average of the daily closing positions in the last month which the old reserve requirement is still in effect, and D_t is measured as the average of the daily closing positions in month t.

- *Adjuster for changes in the reservable base of demand deposits.*

For any change to the definition of the *reservable base* for any category of demand deposits the NDA ceilings will be adjusted by $\Delta NDA = r\Delta D$, where ΔD represents the difference in the reservable base as a result of the change in definition, and r is the relevant reserve ratio that applies to the reservable base; ΔD is measured using the data for the close of business on the day immediately prior to the day the change enters into effect.

- *Adjuster for an unforeseen loss of NIR*

The NDA ceilings above are calculated on a baseline path for the NIR. In case of an unforeseen loss of NIR, [illegible] established [illegible] ceilings will [illegible] as follows using the following marginal [illegible] parameters:

Loss of NIR Relative to Baseline 1/ (In US$ billion)	Marginal [illegible] of NDA Ceiling 2/ ([illegible] percent of observed NIR loss)
$0 < \pi \leq 1$	90 percent
$1 < \pi \leq 2$	[illegible] percent
$2 < \pi \leq 3$	70 percent
$3 < \pi \leq 4$	50 percent
$4 < \pi \leq 5$	30 percent
$5 < \pi \leq 6$	10 percent
$6 < \pi$	0 percent

1/ The loss of NIR relative to the baseline is denoted by π; the magnitude of the loss relative to the baseline is determined on the basis of the average of the NIR in the BCB at the close of business on the last business day of each complete week (usually a Friday) of a given month, as described above.

2/ These refer to the marginal adjustment of the NDA ceiling for each successive US$1 bn loss of NIR relative the baseline. For example, a loss of NIR relative to the baseline of US$2 billion would result in an adjustment of NDA ceiling by US$1.7 billion (US$0.9 billion for the first US$1 billion and US$0.8 billion for the second US$1 billion). To determine the exact magnitude of the rise in the NDA ceiling, the NIR loss relative to the baseline is determined on the basis of the average of the NIR in the BCB at the close of business on the last business day of each complete week (usually a Friday) of a given month, as described above.

II. Prior Actions

1. By end-November 1998

- Increase in the rate of the CPMF to 0.38 percent for 1999, as described in paragraph 12 the MEP, to be under consideration in congress.

2. For the completion of the first review

- Enactment of revenue and expenditure measures sufficient to give confidence that the fiscal program targets for 1999 are likely to be met.
- Enactment of the constitutional amendment for social security reform, for both the priva sector social security system (RGPS) and the federal public sector social security system (RJU-Federal).

III. Disclosure of Some Specific Daily Data

The authorities will provide to Fund staff daily data on international reserves in the BCB under the liquidity concept (*posição liquidez*); these will be provided the following business day.

IV. Baselines and Conversion Rates Used for Selected Variables

The following table sets out baseline and conversion rates used for selected variables.

142

STRICTLY CONFI[illegible]

1. **Program Baselines for Selected Variables (in R$ million)**

	Est. Sep 1998	Nov 1998	Dec 1998	Jan 1999	Feb 1999	Mar 1999	Apr 1999	May 1999	[illegible]	Jul 1999	Aug 1999	Sep 1999	Oct 1999	Nov 1999	Dec 1999
Demand deposits 1/	27,809	26,516	29,350	29,299	28,053	26,609	26,445	26,538	26,671	26,844	26,987	27,216	27,373	27,511	30,384
Concession receipts (cumul.) 2/	0	0	105	105	2,105	3,405	3,405	[illegible]	4,153	4,153	7,390	7,390	7,744	7,916	8,150

1/ Average of daily closing positions during the business days of the month.
2/ Comprises receipts from the following sources: Telebrás-Celular (Banda A) (Telemig, Tele [illegible], Te[illegible] Celular Sul, Tele Centro-Oeste, Tele Norte, Tele Leste, Tele Nordeste); Telebrás-Fixa (Tele Norte Leste, Tele Centro Sul, Telesp); Telebrás-Longa Dist[illegible] companies including Celular Banda B (Área 1, Área 2, Área 3, Área 4, Área 5, Área 6, Área 7, Área 8, Área 9, Área 10), Fixa (Norte Leste, Centro S[illegible] [illegible]cia (Brasil); Agência Nacional do Petróleo ("Bonus assinatura - União: TN", "Aluguel de Área 100% União: ANP"); railway concessions; "Distribuidora Si[illegible] Multip. Multi-MMD", "TV a cabo", "Outorga Serv. Radiodifusão."

2. **Assumptions on Accounting Exchange Rates and Gold Prices for the Program (End-of-period) 1/**

	Est. Sep 1998	Nov 1998	Dec 1998	Jan 1999	Feb 1999	Mar 1999	[illegible]	May 1999	[illegible]	Jul 1999	Aug 1999	Sep 1999	Oct 1999	Nov 1999	Dec 1999
U.S. Dollar (R$/US$)	1.186	1.199	1.205	1.212	1.220	1.227	[illegible]	[illegible]	[illegible]	1.157	1.264	1.272	1.279	1.287	1.295
Gold Price (US$/ounce)	–	298.5	298.5	298.5	298.5	298.5	298.5	298.5	298.5	298.5	298.5	298.5	298.5	298.5	298.5

1/ Currencies not shown here will first be converted into U.S. dollars using the official rate used by the Fund's Treasurer's Department on October 31, 1998.
The exchange rate and gold price conversion rates for the second half of 1999 will be reviewed in the context of the second review under the arrangement, and, if needed, adjusted accordingly.