

February 24, 1983

Mr. Jacques de Larosiere  
Managing Director  
International Monetary Fund  
700 19th Street N.W.  
Washington, D.C. 20431

Dear Mr. de Larosiere:

1. Effective February 21, 1983, Brazil depreciated its currency by 23 per cent in terms of U.S. dollars per cruzeiro and by 30 per cent in terms of cruzeiros per U.S. dollar. At the same time, temporary export taxes ranging from 10 per cent to 20 per cent, mainly on primary products, and a tax on certain capital gains deriving from the maxidevaluation were introduced. Furthermore, the National Monetary Council will decide at a later date a time schedule for the phasing out of the export taxes and reductions in the import tax and the export tax credit. In a separate decision, the Brazilian Coffee Institute raised the contribution quota on coffee by 38 per cent per bag of coffee.
2. This modification of exchange rate policy from that described in paragraph 24 of our letter of January 6, 1983 (hereafter called "letter") represents to some extent an advance of the real depreciation of the cruzeiro that was programed to take place gradually over the course of 1983. An acceleration in the pace of adjustment became necessary not only because of the disappointing trade results of January 1983 but also because of the importance of ensuring that the objectives of the economic program in general, and of the foreign sector program for 1983 in particular, will be achieved.
3. While the policy intentions described in the letter can be reaffirmed, some of the performance criteria and targets of the economic program will be affected by the recent change in exchange rate policy, and they have been modified as detailed below.
4. It is our view that the inflation targets described in paragraph 9 of the letter need to be modified only for 1983. After an initial surge in March 1983, we expect the monthly rate of inflation to decline, and by December of this year the monthly rate should be no higher than the one contemplated earlier. For 1983 as a whole, the end-of-period rate of inflation is expected to fall to some 85-90 per cent and the year-on-year rate to be about 100 per cent. The inflation expected for 1984 and 1985 has not been changed.

8. The recent change in exchange rate policy should lead to a reduction in real interest rates in the free segment of the credit market. To reinforce this trend and to assist in the restructuring of interest rates, the charges for agricultural loans, which had been fixed for the first half of 1983 on the basis of the then expected rate of inflation, will be increased on the basis of the new and higher inflation estimates at the moment the National Monetary Council will decide before June on the new set of interest rates for the second semester of this year according to the provisions of Resolution 782 of December 16, 1982. The limits on the net domestic assets of the monetary authorities, which were referred to in paragraph 3 of the memorandum, have been revised in the light of the new higher inflation estimate and the data now available for December 31, 1982. The net domestic assets, which on December 31, 1982 amounted to Cr\$5,122 billion, will not exceed Cr\$6,150 billion during the three-month period ending March 31, 1983; Cr\$6,950 billion during the three-month period ending June 30, 1983; Cr\$7,550 billion during the three-month period ending September 30, 1983; and Cr\$8,300 billion during the three-month period ending December 31, 1983. For purposes of calculating net domestic assets, medium- and long-term

7. The effect of the recent devaluation on the finances of the public sector is mixed. While the revenues of the Central Administration will be strengthened without much delay by the newly imposed temporary export taxes and other windfall taxes, the expenditures of the state enterprises are expected to rise significantly, because of higher interest payments (in terms of cruzeiros) on the external debt and the foreign exchange component of investment outlays. As a result of updated statistical information, the borrowing requirement of the nonfinancial public sector is now calculated to have amounted to 16.9 per cent of GDP in 1982, compared with an estimate of 13.8 per cent mentioned in paragraph 21 of the letter. This requirement is to be reduced by 8.1 percentage points of GDP to 8.8 per cent in 1983. On this basis, the ceilings on cumulative public sector borrowing that were referred to in paragraph 2 of the Technical Memorandum of Understanding dated January 6, 1983 (hereafter called "the memorandum") have been modified. The new ceilings are as follows: Cr\$2,800 billion during the three-month period ending March 31, 1983; Cr\$5,000 billion during the three-month period ending June 30, 1983; Cr\$6,600 billion during the three-month period ending September 30, 1983; and Cr\$8,800 billion during the three-month period ending December 31, 1983.

6. The adjustment effect of the recent devaluation will not be weakened through direct or indirect subsidies. The prices of imported goods, in particular fuels and wheat, are being adjusted so as to reflect in full the increase in the cruzeiro cost of importation; thereafter, they will be modified in line with the intentions expressed in paragraph 12 of the letter.

5. The recent devaluation should have a beneficial effect on employment and output because of the anticipated decline in real interest rates. Full implementation of the existing wage policy should help further in preserving employment.

57  
 1985  
 DOM/CENT  
 0.22

foreign liabilities will be included with net foreign assets; this provision modifies the method of calculation described in paragraph 3 and Table 3 of the memorandum.

9. With respect to the external sector, the intention continues to be to pursue policies that will ensure the achievement of the balance of payments targets and objectives that had been established, and which will permit the liberalization of the trade system and the elimination of multiple currency practices and exchange restrictions during the period of the requested arrangement. In view of the exchange rate action undertaken on February 21, 1983; the exchange rate policy referred to in paragraph 24 of the letter and paragraph 5 of the memorandum has been modified. It has been decided to depreciate the cruzeiro vis-a-vis the U.S. dollar through the system of minidevaluation at monthly rates that will be no less than the rate of domestic price increase in each calendar quarter. The recent adjustment of the cruzeiro and the exchange rate policy that is planned should help to create the conditions for the reduction and eventual elimination of the export subsidy and the import tax. Allowing for the customary lag in the publication of the relevant price index, this exchange rate policy will be implemented in such a way that the percentage change in the cruzeiro value of the U.S. dollar on April 15, 1983 over its value on February 28, 1983 will be no less than the percentage change in the General Price Index Domestic Supply (IGP-DI) during the month of March 1983; the percentage change in the cruzeiro value of the U.S. dollar on July 15, 1983 over its value on February 28, 1983 will be no less than the cumulative percentage change in the IGP-DI during the four-month period ending June 30, 1983; the percentage change in the cruzeiro value of the U.S. dollar on October 15, 1983 over its value on February 28, 1983 will be no less than the cumulative percentage change in the IGP-DI during the seven-month period ending September 30, 1983; and the percentage change in the cruzeiro value of the U.S. dollar on January 15, 1984 over its value on February 28, 1983 will be no less than the cumulative percentage change in the IGP-DI during the ten-month period ending December 31, 1983.

10. Brazil is experiencing difficulties in obtaining adequate foreign funding despite its much reduced balance of payments needs. To allow for a speedy disbursement of the bulk of the new loan of US\$4.4 billion recently agreed with a consortium of international banks, the limits established on the use of external credit, as referred to in paragraph 28 of the letter and as specified in paragraph 4 of the memorandum, have been modified among the calendar quarters of 1983, but not for the year as a whole. The new limits amount to US\$3.0 billion for the period ending March 31, 1983; US\$4.5 billion for the period ending June 30, 1983; US\$5.25 billion for the period ending September 30, 1983; and US\$6 billion for the period ending December 31, 1983.

Sincerely yours,

/s/  
Carlos Geraldo Langoni  
President of the Central  
Bank of Brazil

/s/  
Ernane Galveas  
Minister of Finance