PRESIDÊNCIA DA REPÚBLICA

Secretaria de Planejamento

November 14, 1983

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

Dear Mr. de Larosière:

1. We have conducted a review of Brazil's economic policy in the light of latest economic developments. Inflation has continued much higher than had been projected, even after policies were strengthened, owing both to the effects of large relative price changes in an economy that is highly indexed and to natural disasters in the agricultural sector.

2. To regain the basic thrust of the economic program and to assure in particular a break in the rate of inflation, we have re-examined economic policies and have taken the measures considered necessary. The conclusions of our policy review and the actions adopted are described below. It should be noted that specific quantitative aims of the economic program have been established through the first quarter of 1984. Reviews of the program will take place in February, August, and November 1984, to examine economic performance and policies and to establish quantitative aims for the period of 1984 after the first quarter and for 1985.

3. In the area of monetary policy, it has been decided to maintain the targets established for 1983. Thus, the expansion of M-1 will continue to be limited to 90 percent for 1983 as a whole, with the increase in the monetary base limited to 87 percent. To ensure achievement of a major reduction in inflation, the expansion in M-1 during 1984 is to be held to no more than 50 percent, with the increase in the monetary base limited to 50 percent; from December 1983 to March 1984, and in view of seasonal factors, M-1 is expected to decrease by 3.8 percent, and the monetary base is expected to increase by 2 percent. For that purpose of the program, these aims in respect of monetary policy have been translated into a set of limits on the net domestic assets of the monetary authorities as defined in paragraph 4 of the Technical Memorandum of Understanding attached to the letter of September 15, 1983. Accordingly, the net domestic assets, which on September 30, 1983 amounted to Cr$5,379 billion, will not exceed Cr$3,540 billion on December 31, 1983 and Cr$3,300 billion on March 31, 1984. These limits are based on certain projections for the disbursement of loans by foreign commercial banks.

4. To increase the efficacy of monetary control, an active interest rate policy will be pursued which will ensure positive real rates of interest. Accordingly, the monetary correction factor which is used to adjust the value of financial obligations will be determined at the end of each month to be no less than the rate of inflation (as measured by the General Price Index Domestic Supply adjusted for accidental factors) corresponding to that month. Furthermore, the authorities intend to examine the existing reserve requirement provisions with a view to strengthening their enforcement. Progress in this area will be assessed at the time of the February review with the Fund.

5. The adjustment of the public finances continues to be central to the overall adjustment program. It is the intention of the authorities to maintain the degree of real adjustment of public sector finances contemplated in paragraphs 10 and 11 of the letter of September 15, 1983. Accordingly, the deficit in the public sector's operational budget will not exceed 2.7 percent of GDP in 1983. For 1984, a surplus in the operational budget of at least 0.3 percent of GDP will be achieved. To ensure these results in the operational budget, the Government has adopted the following measures:

(a) increases in tax rates on corporate income, dividends, capital gains on open market operations, rents, and certain interest earnings;

(b) income tax brackets have been adjusted by 100 percent;

(c) a 60 percent income tax bracket has been added, and some tax incentives have been eliminated;

(d) the assessment date of individual income tax liabilities has been advanced;

(e) higher assessment of the value of government debt paper held by corporations;

(f) elimination, or lowering, of certain tax exemptions; and

(g) tightening of tax administration procedures.

In addition, the Government will be adopting the following measures:

(a) appropriation by the Treasury of profits resulting from the reduction of interest rate subsidies;

(b) elimination of fringe benefits and reduction of categories of additional remuneration in state enterprises; and

(c) further cuts in investment by state enterprises. Furthermore, the Government will submit to the Senate a draft resolution enabling the States to increase by 2 percentage points the value added tax (ICM), starting January 1, 1984.

6. Notwithstanding these measures, the public sector borrowing requirement in 1983 is now expected to amount to 18.6 percent of GDP because the correction of public sector debt for domestic inflation and the depreciation of the exchange rate will be higher than described in the letter of September 15, 1983. For 1984, the authorities intend to reduce the public sector borrowing requirement to no more than 9.0 percent of GDP, although it should be stressed that the actual result will very much depend on the speed at which inflation is reduced. The public sector borrowing requirement, as defined in paragraph 2 of the Technical Memorandum of Understanding attached to the letter of September 15, 1983, will not exceed Cr$24,600 billion during the three-month period ending December 31, 1983 and Cr$11,750 billion during the three-month period ending March 31, 1984. The corresponding targets for the operational performance of the public sector will be a deficit not to exceed Cr$3,600 billion by December 31, 1983 and Cr$1,300 billion by March 31, 1984. To help ensure compliance with these budgetary targets, monthly targets for the borrowing requirements of the Central Government, the state enterprises, and the state and municipal governments for the period until March 31, 1984 are set out in the attached table and will be subject to consultation as agreed in the Technical Memorandum of Understanding.

7. With respect to external sector policies, the Government reaffirms the intentions expressed in paragraphs 15 and 16 of the letter of September 15, 1983, and these policies shall continue in 1984. Accordingly, the percentage change in the cruzeiro value of the U.S. dollar on April 15, 1984 over its value on February 28, 1983 will be no less than the percentage change in the General Price Index Domestic Supply adjusted for accidental factors during the thirteen-month period ending March 31, 1984; for subsequent three-month periods the exchange rate policy will be subject to the same principle. The overall balance of payments target for the three-month period ending March 31, 1984 is a surplus of at least US$100 million, and new net external indebtedness will be limited to US$2.5 billion in the three-month period ending March 31, 1984. The Government reaffirms its intention to pursue external policies that will allow for the elimination of remaining exchange restrictions. Those bilateral payments arrangements which for certain transactions in 1983 have been operated in a discriminatory fashion will be eliminated by December 31, 1983. The authorities intend to introduce during the period of the arrangement

a trade system that would provide protection to domestic activity through tariffs rather than through quantitative restrictions. The authorities have already begun the technical work required for the implementation of such a policy and intend to submit to the Congress the relevant legislation by mid-1984. Progress in regard to import liberalization will be assessed in the August review.

Sincerely yours,

/s/	/s/	/s/
Affonso Celso Pastore President Central Bank of Brazil	Antonio Delfim Netto Minister of Planning	Ernane Galveas Minister of Finance

Attachment

ATTACHMENT

Brazil: Monthly Targets for Public Sector Borrowing Requirements

(Stocks at the end of the period; in billions of cruzeiros)

	Central Government	States and Municipal Governments	State Enterprises 1/
1983			
September	7,909	7,927	11,158
October	8,300	9,305	13,000
November	9,050	9,820	14,250
December	9,400	10,415	17,155
1984			
January	10,405	12,340	18,100
February	11,550	13,125	19,565
March	12,560	13,915	21,020

1/ Total accumulated flows of foreign financing during the year added to the stocks of domestic financing.