

# AIRGRAM

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		5
E	P	IO
4		
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		9
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	10	3
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TR	XMB	AIR
4	4	
ARMY	CIA	NAVY
3	20	5
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29		3

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ANALYSIS BRANCH

FROM : Amembassy RIO DE JANEIRO

DATE: February 23, 1968

SUBJECT : Operations of the Monetary Authorities -  
December 1967 and Current Credit Situation

DEPARTMENT OF STATE  
BUREAU OF  
INTER-AMERICAN AFFAIRS

REF : CERP B-2501

MAR 7 - 1968

1. Net Domestic Credit expanded by NCr\$313 during December 1967, bringing the expansion for the second semester to NCr\$1,200 million and NCr\$2,054 for the year. In spite of the NCr\$253 million "safety margin", the actual expansion for the second semester exceeded the NCr\$651 target established in the revised (July 1967) monetary budget by NCr\$549 million. The excess expansion took place in all the major accounts -- Treasury, rediscounts, private loans, and coffee operations -- and an additional problem was created by a very sharp (NCr\$334 million) draw-down in autarquia deposits in December. In fact, all other accounts taken together were contractionary during December. Central Bank estimates indicate a partial restoration of autarquia deposits during January 1968 and a decline in net domestic credit on the order of NCr\$200 million.

2. The Money Supply expanded by less than 1.6 percent during December following an increase of almost 5% during November. The expansion for the year was 42.7% -- for the second semester the expansion was 17.4% divided about equally between the third and fourth quarters. The estimated expansion in January 1968 was 2.4%. In view of the new credit controls in effect, the January expansion requires additional explanation; the estimated consolidated position of the banking system shown in Table IV is suggestive in this regard. That table shows that

- Attach.: Table I - Operations of the Monetary Authorities-CY 1967  
Table II- Projections in (July) Revised Monetary Budget and Actuals - July/December 1967  
Table III-Money Multiplier: Projection and Actuals-July/Dec.1967  
Table IV- Domestic Credit of the Banking System  
Table V - Monetary Liabilities of the Monetary Authorities

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Drafted by:

FINATT: RCWilliams/tw

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DESyvruud-FINATT

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Minister S. Van Dyke

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the operations of the Monetary Authorities -- including foreign exchange operations -- were contractionary during January with an increase in commercial bank net domestic assets "explaining" all of the increase in the money supply. The increase in commercial bank assets was not for the most part an increase in private loans, but rather an increase of NCr\$467 million (33%) increase in other assets (net). This consolidated account in the table is estimated as a residual item, and includes various asset and non-monetary liability accounts, including savings deposits and capital and surplus accounts. It is probable -- but by no means completely clear -- that a good part of the January expansion resulted from a distribution of profits, i.e., a shift from capital and surplus "above the line" to sight and short-term deposits "below the line".

3. Private Loans of commercial banks expanded by 6.3% in December 1967, bringing the expansion for the second semester to 34.3% and the expansion for CY 1967 to 65.1%. The estimated expansion during January 1968 was 0.9%. Bank of Brazil private loans expanded during the second semester of 1967 by 27.5% and 38.3% for CY 1967. These loans are estimated to have expanded by an additional 2.8% during January 1968. Total private sector credit through the banking system thus appears to have expanded by about 1.4% during January 1968.

4. As shown in Table II, net domestic credit expanded at almost twice the rate during the second semester than projected in the revised monetary budget (of July 1967). The important deviations were in the Treasury account, rediscounts, coffee operations and autarquia deposits which, together, expanded by NCr\$878 million more than projected -- by more than the total net credit expansion projected for the period. There was, however, a built in "safety margin" of NCr\$253 million and "other accounts" (item 10) was less expansionary than projected by NCr\$267 million. Of the resulting NCr\$549 million excess credit expansion, NCr\$355 million was offset by a contractionary swing in net foreign reserves of NCr\$355 million (NCr\$166 million equivalent deterioration compared to NCr\$189 million equivalent improvement projected in the revised program). The unanticipated expansion of monetary liabilities was thus only NCr\$194 million. Nevertheless, the money supply expanded by 17.4% as compared to the 10.4% projected in the revised monetary budget.

5. The fact that the excess expansion in the money supply was much greater in percentage terms (67%) than the unanticipated expansion of monetary liabilities (23%) points up the fact that the "money multiplier"  $\frac{1}{\text{ratio}}$  was much higher for the period than assumed in the revised monetary program.

1/ Ratio of change in money supply to change in monetary liabilities of the monetary authorities, with autarquia deposits included in the definition.

As shown in Table III, the money multiplier actually was 2.95 during the period rather than the 1.50 assumed in the program. Had the estimated parameters held, the actual expansion of monetary liabilities in the period would have resulted in an increase in the money supply of 12.1% rather than the actual 17.4%. The two most important factors explaining this great divergence from projections are: (a) commercial banks undoubtedly had substantial excess reserves (on the order of NCr\$200 million) at the end of June and (b) there was a sharp relative shift in deposit business -- related primarily to a draw-down of autarquia deposits -- from the Bank of Brazil to the commercial banking system. While the effective marginal compulsory reserve ratio also was lower than projected, this was more than offset by a stronger demand (on the margin) for currency by the public.

6. Even in the absence of the recent credit measures (Res. 79) the money multiplier should be smaller during 1968 than during 1967 (it was 2.66 for CY 1967 as a whole). The most important element in this equation is the free reserve position of commercial banks. At the end of 1966 the ratio of voluntary reserves to banks' sight deposits was 19.8%, whereas that ratio was only 14.0% at the end of 1967. In addition, the addition to the public's relative currency holdings late in 1967 were substantially less than in the closing months of 1966. During the last quarter of 1966 increases in currency holdings represented about 58% of the increase in the money supply, whereas in the last quarter of 1967 this proportion was only 33.5%. Taking into account these factors and assuming that the special marginal reserve requirements will be kept in effect during the first 4 months of 1968 <sup>1/</sup>, the multiplier (as defined above) for 1968 should not exceed about 1.6.

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1/ Assuming, of course, that the additional compulsory deposits are not returned to banks during the last 8 months of the year.

TABLE I

OPERATIONS OF THE MONETARY AUTHORITIES-CY 1967  
( NCr\$ millions)

	(End Period)	(Change in Period- 1967)	
	Dec. 1967	Dec.	Jan - Dec
<u>I. Net Domestic Credit</u>	<u>8,283</u>	<u>+313</u>	<u>+2,054</u>
1. Treasury (net)	2,537	-94	+699
2. Minimum Prices	317	-10	+45
3. Autarquia and State/Local Gvts.	262	+24	+85
4. Rediscounts	283	+36	+16
5. Private Loans	2,984	+219	+827
6. Coffee Operations	-102	+11	+15
7. Counterpart	-224	-5	-54
8. Exchange Burden	-146	-8	-13
9. Autarquia Deposits	-972	+334	+65
10. Other Assets (net)	3,344	-194	+369
- Exchange Dept.	(3,724)	(-44)	(+171)
- Misc. & Others (net)	(-380)	(-150)	(+198)
<u>II. Net Foreign Reserves</u> <sup>1/</sup>	<u>1,037</u>	<u>+23</u>	<u>-299</u>
<u>III. Monetary Liabilities</u>	<u>7,246</u>	<u>+336</u>	<u>+1,755</u>
11. Compulsory Bank Deposits	1,494	+58	+505
12. Free Bank Reserves	1,352	+124	+127
13. Currency Hands Public	2,934	+138	+592
14. Public's Deposits	1,466	+16	+532

<sup>1/</sup> At NCr\$2.7/US\$.

TABIE II

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Attach. 2  
Rio de Janeiro

PROJECTIONS IN (JULY) REVISED MONETARY BUDGET AND ACTUALS - JULY/DEC. 1967  
(NCR\$ millions)

	Change in Period		Excess Expansion (+) or contraction (-) (2) - (1)
	(1) <u>Projected</u>	(2) <u>Actuals</u>	
<u>I. Net Domestic Credit</u>	<u>+651</u>	<u>+1,200</u>	<u>+549</u>
1. Treasury (net)	-435	-230	+205
2. Minimum Prices	+10	+6	-4
3. Autarquias & State/Local Gvts.	+42	-10	-52
4. Rediscounts	+30	+130	+100
5. Coffee Operations	-36	+226	+262
6. Private Sector Loans	+354	+643	+289
7. Counterpart	+16	-12	-28
8. Exchange Burden	0	-14	-14
9. Autarquia Deposits	-31	+280	+311
10. Other Accounts (net)	+448	+181	-267
- Exchange Dept.	(+236)	(-63)	(-299)
- Others	(+212)	(+244)	(+32)
11. "Safety Margin"	+253	-	-253
 <u>II. Net Foreign Reserves</u>	 <u>+189</u>	 <u>-166</u>	 <u>-355</u>
 <u>III. Monetary Liabilities</u> (I + II)	 <u>+840</u>	 <u>+1,034</u>	 <u>+194</u>

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TABLE IIIMONEY MULTIPLIER: PROJECTION AND ACTUALS - JULY/DEC. 1967

	Value of Coefficients	
	<u>Projected</u>	<u>Actuals</u>
1. Change in currency in hands public to change in money supply (c)	0.216	0.283
2. Marginal compulsory cash reserve ratio on banks' sight deposits (r)	0.169	0.128
3. Ratio of change in free reserves to change in banks' sight deposits (r')	0.241	-0.018
4. Proportion of increment in total sight deposits held with the Bank of Brazil ( ) $\frac{1}{2}$	0.278	-0.029
5. Money multiplier - the ratio of the change in the money supply to the change in the monetary liabilities of the monetary authorities (m): formulated as follows with above parameters	<u>1.50</u>	<u>2.95</u>

$$m = \frac{1}{c + \alpha = \alpha c + (r + r') (1 - \alpha) (1 - c)}$$

includes autarquia deposits.

TABLE IV

DOMESTIC CREDIT OF THE BANKING SYSTEM  
(NCR\$ millions)

	End of Period		Estim. Change in Period
	(Actual)	(Estimate)	Jan. 1968
	<u>Dec. 1967</u>	<u>Jan. 1968</u>	
I. <u>Domestic Credit</u>	<u>16,068</u>	<u>16,356</u>	<u>+288</u> (+1.8%)
A. Monetary Authorities	6,573	6,316	-257 (-3.9%)
1. Treasury <sup>1/</sup>	(2,537)	(2,537)	(-)
2. Private Sector Loans	(2,984)	(3,067)	(+83)
3. Others (net)	(1,052)	(712)	(-340)
B. Commercial Banks	9,495	10,040	+545 (+5.7%)
4. Private Sector Loans	(8,081)	(8,159)	(+78)
5. Others (net)	(1,414)	(1,881)	(+467)
II. <u>Net Foreign Reserves</u> <sup>2/</sup>	<u>-1,048</u>	<u>-976</u>	<u>+72</u>
III. <u>Means of Payment</u> (I + II)	<u>15,020</u>	<u>15,380</u>	<u>+360</u> (+2.4%)

<sup>1/</sup> Repeated for lack of data

<sup>2/</sup> Converted at NCR\$3.2 per US\$.

TABLE V

MONETARY LIABILITIES OF THE MONETARY AUTHORITIES  
(NCR\$ millions)

	End of Period		Estim. Change Period
	(Actual) Dec. 1967	(Estimate) Jan. 1968	Jan. 1968
I. <u>Monetary Liabilities</u>	<u>8,218</u>	<u>8,254</u>	<u>+36</u>
1. Currency held by public	2,934	2,835	-99
2. Deposits of public	1,466	1,222	-244
3. Autarquia deposits	972	1,130	+158
4. Banks' compulsory reserves	1,494	1,611	+117
5. Banks' free reserves	1,352	1,456	+104
II. <u>Net Foreign Reserves</u> <sup>1/</sup>	<u>- 1,229</u>	<u>-1,157</u>	<u>+72</u>
III. Less: Autarquia Deposits	972	1,130	+158
IV. <u>Net Domestic Credit</u> (I - III - II)	<u>8,475</u>	<u>8,281</u>	<u>-194</u>

1/ Converted at NCR\$3.2 per US\$ dollar.

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