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Operations of the Monetary Authorities-
August-September and Current Monetary Situation
(a) CERP B-2501; (b) Rio's A-359 of Nov. 24, 1967; (c) Rio 3544

Summary

1. Net Domestic Credit expanded in September by NCr$220 million, after a very moderate NCr$33 million expansion in August. The expansion for the third quarter, NCr$463 million, was NCr$210 million greater than projected in the revised monetary budget prepared in early July 1967. Although the Treasury improved its position with the Monetary Authorities by slightly more than projected for the third quarter, there was NCr$442 million unanticipated expansion from rediscounts, the minimum price program, private sector loans and coffee operations (taken together), which substantially exceeded the NCr$253 million "safety margin" built into the third quarter projections.

2. Commercial Bank Loans expanded by 14.3 percent during the third quarter, with monthly rates of increase of 4.8%, 5.6% and 3.4% in July, August and September, respectively. The rate of loan expansion exceeded substantially that projected in the July 1967 revision of the monetary budget because of a higher level of rediscounts and a substantial reduction of commercial bank liquidity; the overall operations (i.e., net domestic credit plus net foreign reserves, or monetary liabilities) of the Monetary Authorities were slightly less expansionary than projected for the quarter.

Enclosures:
1. Table I - Operations of the Monetary Authorities
2. Table II- Cash Fiscal Deficit and Financing
3. Table III-Coffee Operations Accounts
4. Table IV- Credit of Banking System and Money Supply

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3. The Money Supply expanded by 8.3 percent during the third quarter, with monthly rates of increase of 1.8%, 3.4% and 2.9% in July, August and September, respectively. The money supply at the end of September was 31.6 percent above the total at the end of 1966. The "money multiplier" was high for the whole quarter because of the net draw-down of commercial bank reserves; however, the NCr$253 million increase in currency held by the public (24% of the increase in the total money supply) and the (NCr$104 million) increase in banks' free reserves in September indicate a reversal of liquidity behavior from earlier months so that the money multiplier should be considerably smaller for the remainder of the year.

4. Recent Monetary/Credit Movements, implicit in the weekly estimates of the Central Bank, point to a rate of credit expansion for the banking system between the end of September and the middle of November well above the average monthly expansion during the third quarter (4.2% compared to 3.1 percent). The rate of expansion picked up sharply about the middle of October; loans of the banking system increased by 4.0% in the month ending November 14 -- commercial bank loans increased at a monthly rate of 4.3% during the first two weeks of November. The money supply expanded at a lower rate in the 6 weeks ending November 14, than the average for the third quarter; the increase was an estimated 2.4 percent in a 6-week period ending November 14, compared to an average monthly increase of 2.8 percent during the third quarter. The more moderate increase in the rate of expansion of the money supply is somewhat misleading however; as noted above banks' loans expanded by over 4 percent in this 6-week period and their sight deposits by 6 percent. There apparently was a sharp draw-down of autarquia deposits in the Bank of Brazil -- the Central Bank estimates the reduction at NCr$320 million -- with all other elements in the money supply (taken together) expanding by about 5 percent. The exchange speculation has not yet been a major offsetting factor to credit expansion because most of the speculation has been in forward operations and the monetary impact has not taken place as yet (see ref. b).

Discussion

1. The NCr$463 million expansion in net domestic credit was NCr$210 million higher than projected for the third quarter in the (July 1967) revised monetary budget; that monetary budget projected no expansion of net domestic credit items, but did include a NCr$253 million "safety margin". Therefore, the expansion of the individual net domestic credit items actually was NCr$463 larger than projected. The deviations from projections for major items were as follows:

(+ = excess expansion)

Treasury	-16
Private Sector Loans	+111
Rediscounts	+57
Minimum Prices	+43
Coffee Operations	+231
All others	+ 37
Total	+463
less: Safety Margin	-253
Excess Expansion Net Domestic Credit	+210

2. The coffee operations account was very expansionary (NCr$198 million) during the third quarter. This was the outcome of a NCr$200.2 million increase in coffee loans and rediscounts outstanding, and a contractionary impact from the coffee defense fund of only about NCr$ 2 million. (See item 8 of Table I and Table III.) On the other hand, part of the expansionary impact was illusory, as there was a substantial build-up of coffee defense fund (contribution quota) receipts (NCr$77 million)in tran during the third quarter, and these should be credited to the coffee defense fund account in October and November. The large build up of receipts in transit was in September, when coffee exports were very large, but the bulk of which was sold on 60-90 day terms. At the same time, there were large purchases of surplus coffee by the IBC in September (NCr$153 million), or probably close to 3 million bags. It is likely that purchases of surplus will be less during the last quarter, as in most instances it will pay producers to carry over the coffee until after January 1, 1968, to take advantage of the price increase at this time. In short, coffee operations should provide an offset for the last quarter, but with some expansionary impact for the first half of the coffee year.

3. Superficially, it appears as if the Treasury performance vis a vis its position with the Central Bank was better for the third quarter than projected in the (July 1967) monetary budget. This would appear to be true in spite of the fact that the cash deficit was NCr$218 million for the quarter, as compared with a projected surplus of NCr$169 million. However, it will be noted from Table II that the Treasury received NCr$409 million of financing for the deficit "outside" the Monetary Authorities; this included an unknown amount of bond sales to the Bank of the Northeast and the National Housing Bank. These institutions keep their idle cash in the Bank of Brasil -- deposits of autarquias and other public entities -- so that selling bonds to them *ceteris paribus*, has the same monetary impact as borrowing directly from

the Monetary Authorities. In fact, therefore, the monetary contractionary impact of Treasury operations during the quarter was less than shown in the Treasury account by the amount of such sales.

4. The expansion of monetary liabilities during the third quarter (NCr$422 million) was somewhat less than projected in the revised monetary budget (NCr$485 million); however, the money supply expanded by almost 9%, compared to a projected expansion of just under 5 percent. In other words, the "money multiplier" (ratio of change in money supply to change in monetary liabilities) was much higher than projected for this period. The basic reason for the high multiplier was the desire and ability of commercial banks to reduce sharply the ratio of free reserves to their own deposits. The ratio of free reserves to sight deposits, which was 17.4% at the end of June, was down to 14.0% by the end of August; during this two-month period, free reserves fell absolutely by NCr$216 million, whereas the increase in compulsory reserves was only NCr$43 million. This tendency began to be reversed during September, when banks increased their free reserve holdings by over NCr$100 million. However, the operations of the Monetary Authorities were quite expansionary in September, so that commercial banks were able to expand their lending operations significantly while at the same time restoring their cash reserve positions. The tendency of banks to increase their cash reserves appears to have continued; the Central Bank estimates show an increase of NCr$134 million between the end of September and the middle of November. At the middle of November the ratio of free reserves to sight deposits was up to 15.6 percent which, based on historical data, would appear to be about normal.

5. The data point to continued bank credit expansion through the middle of November, with total loans of the banking system on November 14 about 19.6 percent above the end of June, and 41.5 percent above December, 1966. Bank loans (commercial banks plus Monetary Authorities) expanded by about 6.3 percent in the 6-week period between the end of September and November 14; the money supply expanded by only about 2.4 percent in the same period. The reason for the sharp divergence between the rates of monetary and credit expansion does not appear to have been the result of an offsetting impact from foreign exchange operations 1/, but rather has resulted from a sharp draw-down of autarquia deposits in the Bank of Brasil. The Central Bank estimates that these deposits were reduced by NCr$320 million during the 6-week period ending November 14. All other components of the money supply then increased by 5.0 percent in the 6-week period referred to. A draw down of autarquia deposits adds to the reserve base of commercial banks

1/ As discussed in reftel (b), most of the speculation was in forward operations and the monetary contractionary impact has not been felt as yet.

and ultimately has an expansionary impact on the money supply -- i.e., if autarquia deposits with the Monetary Authorities are drawn down by 100, the money supply will fall by that amount in the very short run, but eventually the money supply will tend to increase by a net 60 or 70. Excluding autarquia deposits from the definition, the money supply on November 14 was 14.5% above June and 36.7 percent above December 1966; including them in the definition, the rates of expansion for the two periods were 10.9 percent and 34.8 percent, respectively.

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TABLE I

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Attach. 1
Rio de Janeiro

OPERATIONS OF THE MONETARY AUTHORITIES
(NCr$ millions)

	(end of Period) Sept. 1967	(Change in Period) August	September	July-Sept.
I. Net Domestic Credit	7,546	+33	+220	+463
1. Treasury	2,630	-47	-7	-191
2. Minimum Prices	379	+11	-7	+68
3. Autarquias	175	-7	+40	+22
4. State/Local Gvts.	14	-	-	-
5. Rediscounts	260	+24	-13	+107
6. Private Sector Loans	2,604	+70	+169	+263
7. Miscellaneous Assets	1,313	-65	+186	+259
8. Coffee	-130	+92	+120	+198
9. Counterpart	-169	+5	+24	+43
10. Exchange Burden	-1,302	-1	+1	-
11. Autarquia Deposits	-1,307	-60	+9	-55
12. Other Assets (net)	1,909	+11	-304	-251
II. Net Foreign Reserves	-912	-144	+165	-41
III. Monetary Liabilities	6,634	-111	+385	+422
13. Banks Free Reserves	1,285	-67	+104	-109
-currency	(415)	(+50)	(-38)	(-52)
-deposits	(870)	(-117)	(+142)	(-57)
14. Compulsory Reserves	1,389	-29	+62	+105
15. Currency Hands Public	2,556	-10	+111	+253
16. Deposits of Public	1,404	-5	+108	+173

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TABLE II

CASH FISCAL DEFICIT AND FINANCING
(NCr$ millions)

	July-September	January-September
I. Cash Deficit	217.8	1,329.8
II. Financing	217.8	1,329.8
A. Monetary Authorities	-190.8	+581.3
B. Others	+408.6	+748.5
1. Res. 21 Repayments	(+51.2)	(+198.1)
2. Repayments State Gvts.	(+41.2)	(+163.1)
3. Circular 85 Bonds	(+14.4)	(+196.8)
4. Others 1/	(+301.8)	(+190.5)

1/ Includes bonds sold to the public, to the Bank of the Northeast, to the National Housing Bank and to Commercial Banks.

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TABLE III

COFFEE OPERATIONS ACCOUNTS
(NCr$ millions)

	Flows in Period-1967	
	July-September	January-September
(+ = monetary expansion) (- = monetary contraction)		
A. Receipts (inc is -)	-365.3	-848.5
1. Contribution Quota	-321.1	-696.5
2. Sales from Stocks	-30.7	-102.7
3. "Reintegro"	-13.5	-49.3
B. Expenditures (inc is +)	+268.4	+670.8
1. Purchase of Surplus	+190.3	+330.9
2. Importer Price Guarantee	+1.8	+4.7
3. Exchange Contract Expenses	+1.7	+9.4
4. GERCA-erradication	-	+117.5
5. Advertising Expenses	+3.1	+6.8
6. IBC Administration	+30.7	+107.0
7. Capital Expenditures	+36.8	+85.1
8. Miscellaneous	+4.0	+9.4
C. Coffee Defense Fund (A+B)	-96.9	-177.7
D. Fund for Rationalization Coffee Culture	+18.0	-5.4
E. Loans/Rediscounts	+200.2	+91.3
F. Monetary Impact Coffee Operations	+121.3	-91.8
less: Contribution Quota Receipts in transit	(-77.0)	(-78.3)
G. Monetary Impact Coffee Operations as Included in Net Domestic Credit Concept (Table I, item 8)	+198.3	-13.5

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TABLE IV

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Attach. 4
Rio de Janeiro

CREDIT OF BANKING SYSTEM AND MONEY SUPPLY

	Percentage Change		
		Loans of Banking System	
	Money Supply	Total	Private Sector
Jan-Sept.			
1963	+26.4	46.9	+25.7
1964	+50.4	80.5	+56.6
1965	+48.4	34.6	+38.7
1966	+6.8	13.9	+23.1
1967	+31.7	34.5	+35.5
Year Ending Sept.			
1963	+56.6	+51.2	+49.1
1964	+95.2	+103.7	+93.1
1965	+83.4	+35.0	+59.7
1966	+26.3	+25.8	+39.7
1967	+42.4	+47.1	+47.1
July-September			
1966	+2.6	+9.4	+10.2
1967	+8.3	+9.8	+14.3

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