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AmEmbassy RIO DE JANEIRO August 30, 1963

ECONOMIC TRENDS REPORT - BRAZIL - SEPTEMBER 1968

CERP C-4; CA-9815, June 16, 1967

SPECIAL HANDLING PER CA-9315

1. The semi-annual Economic Trends Report - Brazil, due September 1, 1963 is enclosed.

2. The Embassy will reproduce some copies for internal distribution, but will appreciate receiving from the Department an additional 10 copies with the special heading indicated in CA-9315.

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KEY ECONOMIC INDICATORS: BRAZIL, SEPTEMBER 2, 1968

Exchange Rate Sept. 1, 1968
U.S. $1.00 = NCr$3.63

INDICATOR	UNIT	(LATEST '68DATA)	1966	1967	1968 to date	%change 68/7cml.
GNP, Current Prices	NCr$Mil	(68proj)	43,844	59,435	77,808	+30.8
Per Capita GNP, Current Prices	NCr$	(68 ")	526	673.8	832.3	+30.0
GNP, Constant '53 Prices	NCr$Mil	(68 ")	842.9	889.3	942.6	+ 6.0
Per Capita GNP, Const. '53 Prices	NCr$	(68 ")	10.05	10.31	10.63	+ 3.1
Fixed Investment as % of GNP		(68 ")	11	12	13	+ 8.3
Rio Cost of Living Index	%increase	(July)	41.1	24.5	15.7	-15.6
Wholesale Price Index(x-coffee)	%increase	(July)	41.4	21.0	14.2	- 4.7
General Price Index	%increase	(July)	39.1	25.0	14.3	+ 2.1
Total Exports, FOB	US $ Mil	(June)	1741	1651	844	+13.9
Coffee Exports, FOB	"	(June)	764	705	366	+17.3
Exports to U.S., FOB	"	(May)	581	548	243 1/	+32.1
Total Imports, CIF	"	(June)	1497	1667	980	+25.8
Total Imports, FOB	"	(June)	1303	1441	851	+24.1
Capital Goods Imports, CIF	"	(June)	381	475	308	+40.0
Imports from U.S., CIF	"	(May)	590	578	240 2/	+ 3.2
Imports from EEC, CIF	"	(April)	258	319	127	+39.6
Imports from LAFTA, CIF	"	(April)	167	226	67	-15.2
Motor Vehicle Prod.	'000units	(July)	223.9	224.9	151.5	+19.8
Steel Ingot Prod.	'000 MT	(June)	3767	3720	2078	+18.8
Cement Prod.	'000 MT	(June)	6002	6364	3502	+17.6
Refined Petroleum Prod.	Mil.BBL.	(May)	126.6	129.5	55.8	+10.4
Electric Power Prod. (Sao Paulo-Rio Light, CAEEB, CEMIG, CHESF, FURNAS)	Mil.Kwh	(July)	23,139	24,030	15,530	+15.1
Coffee	Mil bags	(68/9cropest)	21.0	25.0	18.5	- 26%
Sugar	Mil mt	(68/9 ")	4.1	4.1	4.3	+ 4.8
Corn	Mil mt	(67/8 ")	10.0	12.5	12.5	0%
Rice (rough)	Mil mt	(67/8 ")	4.6	5.6	6.2	+10.7%
Dry beans	Mil mt	(67/8 ")	1.6	2.2	1.8	-13.1%
Cotton	'000 mt	(68 crop est)	543	443	580	+30.3%
Notes Protested(S.Paulo&Rio)	'000	(April)	131.9	206.0	70.4	- 4.1
Bankruptcy Petit.(S.Paulo&Rio)	No.	(April)	1989	2633	842	- 3.3
Money Supply(end of year)	NCr$ Mil	(June)	10522	15004	13100	+ 20%
Private Sector Credit(end of year)	"	(June)	7053	11035	14129	+ 28%
Central Bank Rediscount Rate		(June)	4%	22%	22%	-
Interest Rates (monthly) 3/		(June)	28-44%	26-40%	24-38%	-
Ext.Debt:Pub.&Priv.(curt.curr.)	US $ Mil		3,480	3,508	3500e	-
External Debt Service Ratio			23.9%	27.2%	21.8e	-20.0%
Gold & For. Exchange Reserves	"	(June)	415	223	274	+22.9% 4/
Balance of Payments	"	(68proj)	299	-113	217	-

1/ Main exports to US: Green coffee($82 million), Soluble coffee($5.6 million), Sugar($18 million), Iron ore($3 million), Castor oil($2 million).

2/ Main imports from US: Wheat($27 million), Track laying tractors and construction machinery($3.5 million), Electrical Control, regulating and distributing apparatus ($4.3 million), Coal($4 million), Aircraft and parts($3 million), Lubricating oil ($3 million), Sulfur($2.4 million).

3/ Rates for commercial acceptances of finance companies, which most accurately reflects market trends. (The first figure is what the lender receives, the second is what the borrower pays, the difference going to the finance company.)

4/ Percentage changes in reserves from December 1967 to June 1968.

SUMMARY

The Brazilian economy is expected to grow about 6% in real terms in 1968 (compared to 5% in 1967), and barring adverse climatic conditions, this growth rate should be maintained or exceeded in 1969.

The main factors influencing this promising economic situation are:

a) Very high levels of investment in productive enterprise, not experienced in Brazil since the late 1950's;

b) Another good year for agricultural crops in 1968, benefiting from reasonably good weather, and a policy of adequate price supports and expanding credit for the agricultural sector;

c) High levels of exports, resulting in part from the Government's agricultural policies and export incentive measures;

d) Sharp increases in home construction financed by the social security pension fund and the National Housing Bank;

e) Increasing consumer demand resulting from higher employment levels and farm income;

f) Growing faith in the Government's determination and ability to keep the rate of inflation under control.

Investment Increasing Sharply

Recent observations of investments financed by specific institutions reveals a sharp upward trend beginning in 1967, following several years of relative stagnation. Investments financed by three major sources (the National Housing Bank, the Bank of the Northeast, and international lending institutions) increased roughly threefold in 1967 over 1966 ($325 million vs. $116 million), should double in 1968 (to approximately $600 million) and continue to increase, but at a lower rate in 1969. The increased output generated by these institutions stimulated further investment in the industrial sector as output started pushing against capacity.

Investment in housing in Brazil by the National Housing Bank (BNH), plus private investment that was directly induced by BNH participation in the financing of civil construction, was equivalent to 2.6 percent of GNP in 1967 compared to only .6 percent of GNP in 1966. This has caused a boom in construction, with greatly increased demand for building materials and labor.

Through 1966, the Bank of the Northeast disbursed a little under NCr$50 million for private sector investments in that area. In 1967 disbursements were NCr$157 million, and are expected to be more than double this amount in 1968. As these disbursements will be supplemented with an equal amount of private capital, there should be a total investment of about U.S. $200 million this year, mostly in industry.

Official capital inflow from all international lending institutions is expected to increase from $295 million in 1967 to $377 million in 1968. This financing will benefit mining, agriculture, electric power generation, and transportation among others and create further export opportunities for U.S. industry.

Industrial investment projects by the private sector approved by the Ministry of Commerce and Industry under the Federal Government's development incentive program increased from 62 (involving total investment of $132 million) in 1965, to 172 ($356 million) in 1966, to 271 ($493 million) in 1967. The figures for the first seven months of 1968 are 233 projects involving $133 million. These investments are concentrated largely in the following sectors: automotive, steel, construction materials, textiles, leather goods, paper products, rubber, chemicals and electrical appliances. In addition to these investments, the Government's merchant marine policy, adopted in 1967, has caused a boom in shipbuilding, with every major shipyard in Brazil operating at full capacity and a total of over 600,000 tons of ships presently under construction.

The impact of these investments, together with increased consumption demand resulting primarily from three consecutive good agricultural harvests, is reflected in the substantial increase of production in the industrial sector, the very high level of capital goods imports, the general increase in business activity, and the increase in industrial job offers.

__Business Confidence Up__

A survey of 733 manufacturing firms in July 1968, which together employ half a million people and account for close to four billion dollars in sales annually, revealed that 95% of these firms find demand levels of production in the third quarter of this year. This would make it the sixth consecutive quarter of increased output for the manufacturing sector.

__Agriculture Stimulation Policy Intensified__

Looking toward the need for sustained high level agricultural production and increased exports of non-traditional agricultural products, the Government has taken several measures to stimulate activity in this sector.

Apart from continuing the policy of minimum price supports for key crops, the Government has taken steps to improve the flow of credit to producers, and to improve export earnings potential through a new policy of frequent exchange rate adjustments so as to maintain a realistic exchange rate. In the credit field, the Central Bank recently modified Resolution 69 which requires commercial banks to reserve 10% of their sight deposits for rural credit applications. Since, in practice, most of these funds were applied either in the marketing process or used by very large producers, the Central Bank issued in August Resolution 97 requiring that at least one third of the total credit extended to the agricultural sector be extended directly to the producer and that 70% of the latter amount be reserved for medium and small producers. The effects of this credit policy should begin to be felt next year as the banks develop administrative machinery to channel loans to individual producers.

Export Trend is Up

Brazil's coffee exports during the 1967-68 marketing year (July-June) set an all-time record of 18.9 million bags. May and June exports were stimulated beyond normal expectations when the Brazilian Coffee Institute (IBC) made its 1968-69 coffee crop marketing regulations and prices effective May 2 instead of the traditional date of July 1. May exports set an all-time record for that month. Prospects are good that Brazil will fill its annual export quota of 17.6 million bags during the International Coffee Organization's quota year (October-September). Coffee prices are down however, so export earnings are not at record levels. Also, soluble coffee exports are likely to drop below the 1967 total because one plant which accounts for half of Brazil's volume has been in financial difficulties and has been idle since May.

Cocoa export earnings should be slightly lower than last year, in spite of better international market prices, because of a sizable drop in production. Export earnings for sugar, corn, rice and beef are expected to be considerably more in 1968 than 1967 while cotton exports are fairly stable and soybeans exports will decline sharply.

Central Bank Resolution 71 (issued late last year) makes a special line of credit available to industries who wish to produce for export. About NCr$70 million is now available for these loans which are repayable in one year at 12% interest and available for rediscount at 8% interest, compared to current bank credit rates of 30-40% annually. Exports of industrialized products are currently running at the same level as last year but are expected to increase in the second half of this year.

Notwithstanding declining steel exports, due to increased domestic demand at higher prices, the various tax, credit and exchange rate incentives to export industrial products have been sufficiently effective to offset the decline in steel exports and maintain the upward trend in overall exports of industrial products.

Imports Should Continue at High Levels

Imports are up sharply in 1968 over 1967, but the U.S. share of the Brazilian market, after hitting a peak of approximately 39% in 1966 dropped to 34% in 1967 and to 30.5% for the first five months of 1968.

International competition has become increasingly intense in fighting for the large, expanding Brazilian market for capital goods and raw materials, particularly for those industries mentioned in item 1 which are experiencing rapid development, but also in the civil aviation, telecommunications, electric power and mass transportation fields. European and Japanese concerns, and subsidiaries or licensees of U.S. firms in Europe, are picking up most of the new business because they are offering better credit terms, and in some cases better prices. Given the generally high regard for U.S. produced manufactured goods, there is a ready market for these if U.S. credit terms can be made competitive, and if U.S. business will take at least as active an interest in selling to Brazil as do our competitors. Brazil's international credit rating is improving rapidly. Private British banks and those of other countries have extending sizable loans and lines of credit to the Brazilian Government, and negotiations are well underway between the Brazilian Government and several private U.S. investment houses to float a $40 million bond issue in the U.S. With growing Export Import Bank interest in the expanding Brazilian economy, it is time for U.S. business to take a fresh look at the Brazilian economic scene.

Balance of Payments Situation Improving

Although the total value of imports (CIF) is likely to be somewhat higher than exports this year and next, a growing percentage of imports are covered by long term financing, resulting in a probable increase rather than a decrease in exchange reserves for these years. This factor, plus the anticipated reflows of foreign exchange following the recent currency devaluation should lead to an estimated balance of payments surplus this year of approximately $217 million after normal repayments on the external debt. In view of increased exports, the debt service burden in relation to foreign exchange earnings has dropped from 27% to 22%.

Fiscal Performance Good

Increased economic activity during the semester resulted in higher than anticipated revenues (an increase of 26 percent in constant prices over the corresponding period of 1967 and 14% over the budgeted figure for the first semester of 1968), stemming largely from the Tax on Industrial Products (value added tax), and from increased income tax and customs duties collections. Expenditures were also over budget (7.6%) partly due to earmarking of funds on a percentage of revenue basis, notably transfers to state and municipal governments. These developments enabled the government to hold the first semester fiscal deficit to less than the budgeted amount. Thanks to these transfers and to good sales tax revenues, State Governments are in good financial condition and may in some cases (São Paulo and Paraná) increase public works expenditures. Less encouraging is the fact that the deficit was wholly financed through monetary expansion and that the fiscal incentive to reduce excess public servants and, therefore, current government expenditure, has not succeeded.

Rate of Inflation Holds Steady

The general wholesale price level was up 14.6% for the first seven months of 1968, compared to an increase of 15.1% during the same period last year. Prices of industrial products were up 23.5% (17.9% last year) despite the restraining effect of the Government's policy to monitor prices, and were counterbalanced only by the very modest increase in the prices of agricultural products which rose 6.2% (11.8% last year). Thus the good 1967/68 crop year has been decisive in overall price performance thus far in 1968, and points up the crucial need for a good 1968/69 crop year to counteract the upward trend in industrial prices which is likely to continue well into 1969 until increased industrial capacity can relieve some of the pressure.

Credit Policy Crucial in Second Semester

Credit to the private sector expanded at a high average monthly rate of 4% during the first semester; money supply expanded by 20 percent during the same period. However, as a result of the outflow of capital in anticipation of currency devaluation, a tight credit situation developed beginning in mid-May and continued through August, in spite of a Central Bank Resolution (issued August 1) reducing compulsory reserve requirements from 30% to 27%. Credit resources should expand again in September as re-flows of foreign exchange follow the August 27 currency devaluation.

The current heavy demand for commercial loans is likely to continue throughout the year and there are signs that total demand is pushing against productive capacity in practically all major sectors. Under these circumstances, if credit expansion is not held well below the 4% average of the earlier months, it will be difficult to maintain the rate of inflation below the 25% figure for 1967.

Modification of Exchange System

Brazil's recent action in the area of foreign exchange is of greater significance than the 14.3% devaluation alone might indicate. Concurrent with the devaluation of the cruzeiro the government announced the establishment of a new exchange system. Henceforth the monetary authorities anticipate changing the exchange rate more frequently than the approximately annual devaluations of the past several years. The new "flexible" rate will not be freely fluctuating but will be fixed by the authorities. The adjustments of the rate are expected to be small and will be based on consideration of relevant price trends and the level of foreign reserves. Alteration of the exchange system is aimed primarily at eliminating the exchange speculation which arose from the substantial disparities between domestic and external prices. Thus, while the devaluation itself will contribute to the declared policy of encouraging exports, the change in the exchange system will also provide a longer term stimulus for producing for export and is expected to eliminate the deleterious effects of speculative capital movements on the balance of payments, domestic credit conditions, and economic development in general.