No. E 38/49
CONFIDENTIAL

This report is restricted to those members of the staff to whose work it directly relates.

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

EXTERNAL CREDIT OF BRAZIL

May 6, 1949

Economic Department
Prepared by Dr. Harold Larsen

BRAZIL

ESSENTIAL STATISTICS[1]

Area:	3.29 million square miles
Population (1948):	48 million
Currency:	
Unit:	Cruzeiro
Parity:	18.50 cruzeiros per dollar (5.405 cents/cruzeiro)
National Income (1948):	US$ 6.7 - 7.0 billion
Income per head:	US$ 140 - 146
Trade:	
Imports 1948:	US$ 1134 million
Exports 1948:	US$ 1173 million
External Debt:	
Outstanding, December 1948:	US$ 739 million
Undisbursed Eximbank:	US$ 35 million
Undisbursed IBRD:	US$ 75 million
Peak Service (on US$ 849):	US$ 58.4 million (1951)
Net Gold and Exchange Reserves:	
December 1938:	US$ 50.5 million
December 1946:	US$ 784 million
December 1947:	US$ 758 million
December 1948:[2]	US$ 655 million
Federal Finance:	
1947: Revenues:	US$ 750 million; Surplus: US$ 25 million
1948 (Jan-Oct): Revenues:	US$ 670 million; Surplus: US$ 60 million
Internal Funded Debt of Federal Government (1947):	US$ 542 million
Money Supply (1937 = 100)	
December 1946:	418
December 1947:	462
October 1948:	473
Cost of Living: (1937 = 100)	
1946:	296
1947:	351
1948, June:	399
1948, December:	368

1/ Cruzeiros converted at 18.50 per dollar.

2/ Net of known liabilities except US$ 60 million gold pledged against (N.Y.F.R.B.) Stabilization Loan; and backlog upon exchange remittances.

Studies made in the Economic Department yield the following conclusions:

CONCLUSIONS

1. Many changes are probable in the Brazilian balance of payments and in Government economic policies. Export receipts will probably fall; European import sources are re-opening; the Salte Plan is being discussed in the Brazilian Senate; the President of Brazil will visit Washington in mid-May, where he will presumably discuss the findings of the Abbink Commission with the United States Government, and seek financial and perhaps technical aid.

2. Until these matters are clarified, heavy additional lending cannot be recommended. In the meantime, relatively small loans (to a total level of around US$ 50 million) repayable in United States dollars could be undertaken this year, particularly if their service begins in 1954 or later.

3. US$ 50 million is suggested because:

(1) Annual service would be about US$ 4 million upon a 20-year loan of this amount.

(2) By 1954 total annual external service on all loans now committed to Brazil will fall US$ 6.5 million from the peak (1951) level of US$ 58.4 million (paragraph 23).

(3) Peak (1951) debt service is not an unduly high proportion of recent exports (paragraph 24).

(4) Even if dollar export earnings diminish somewhat, dollar availabilities should not be impaired, and might even improve, if Brazil is increasingly able to resort to European import sources (paragraph 14).

4. The long-run future balance of payments will depend largely upon the effective execution of domestic policies. Past Brazilian history in this field does not permit over-sanguine expectations. Much may now depend upon the scale and direction of United States advice and financial and technical assistance to Brazil, for which the ground work may have been provided by the joint Brazilian-United States (Abbink) Commission Report. If positive United States assistance emerges, IBRD loans might become complementary to United States-Brazilian cooperation for development.

5. IBRD may wish to press for satisfactory steps to decrease the backlog of deferred payments for imports, thus cooperating with IMF to remove a cause singled out by the Abbink Commission as damaging Brazilian external credit in the eyes of the private investor. To this end, adoption of foreign exchange budgeting may be necessary. (Paragraph 19.)

SUMMARY OF PRESENT POSITION

Balance of Payments

6. Brazil's balance of payments prospects depend upon:

(a) Export values of coffee, raw cotton and cacao (together 62% of total exports in 1948), and her ability to develop other exports now individually minor.

(b) Increase of domestic production of some imported essentials, notably wheat and fuels.

(c) Capital inflows, private and portfolio.

(d) Adaptation to changing European circumstances touching (1) inconvertibility, (2) European export abilities, (3) longer-run development of African supplies of competitive exports, some as European dollar earners and some as non-dollar sources for Europe.

(e) Execution of domestic development programs (currently the Salte Plan) predicated upon high equipment imports, and likely also to raise consumer money incomes ahead of increased domestic consumer good output.

Exports

7. Total exports in 1948 were US$ 1,173 million, a value only 2.4% greater than 1947, compared with a 16.2% increase between 1947 and 1946. Coffee exports were 41.5% of total 1948 exports by value, raw cotton 15.6% and cocoa beans 5%. In 1939 coffee exports were 40% of the total value of exports, and raw cotton 20%. Between 1939 and 1948 some other exports, still individually minor, increased markedly in volume, notably rice, sugar, pine wood and cotton piece goods. Foreign exchange receipts from present export leaders are likely to decline rather than

increase in the near future.

8. (a) Coffee exports were US$ 499 million in 1948, compared with an annual average of US$ 138 million for 1935-39. In 1948 the United States took 67% of coffee exports by volume (1935-39 annual average 55%) and 72% by value, while Europe took 23% by volume and 20% by value. Coffee exports to the United States constituted 65% of all Brazilian exports to the United States in 1948.

(b) Maintenance or increase of production depends upon change of present growing methods, as suitable new land permitting continuance of migratory cultivation is increasingly scarce. In the shorter run, the Sao Paulo growing district is in difficulties with insect pests, drought, and shortage of workers; the fourth official estimate is for a district crop in the 1948-49 season 20% below the 1947-48 outturn.

(c) Prospects for volume of exports are for a fall-back from the near all-time peak achieved in 1948 (17.49 million bags; only higher year, 1931, 17.85 million bags). Annual average volume of exports was 15.10 million bags in 1935-39; 1946 exports were 15.51 million bags and 1947 exports, 14.83 million bags.

(d) There were no Government systems of guaranteed or minimum prices, export subsidies, or marketing quotas in effect in 1948.

(e) Prospects for Brazilian coffee prices depend, for the better grades, upon United States consumer incomes. In 1948 Brazil supplied about 55% of all coffee imported into the United States,

compared with 53% in 1947 and the annual average, 1935-39, of 60%.

(f) New York duty paid prices for Santos green coffee fell 4.9% between November 1948 and March 1949, and recovered a little in April. The 12-month change ending April 1949 was a fall of 1.5%. It is expected that a decrease of United States consumer demand would carry a somewhat smaller price fall for Brazilian coffee than for higher grade milds.

(g) Upon average export volumes 1946-48, one cent a pound variation of price carries US$ 21 million annually, of which about $15 million is in United States dollars.

9. (a) Raw cotton exports were US$ 183 million in 1948, and US$ 166 million in 1947. Europe took 88% of raw cotton exports by volume and 87% by value in 1948. The three leading purchasers (Britain, Spain and Italy) took 50% of all raw cotton exports in 1948. In 1947 the same three took 41%, and in 1946 55%, Europe as a whole taking 80% in 1947 and 79% in 1946.

(b) Prospects for volume of exports are for a heavy decrease this year to about half last year's level, which drew heavily upon stocks. Longer-run prospects depend upon production increasing more than domestic consumption, which appears very possible.

(c) Brazilian raw cotton prices are likely to follow closely price movements of United States raw cotton, with which Brazil competes in European markets.

(d) United States raw cotton prices fell 17% from a high in May, 1948 to a low in October 1948, then recovered 5.8% to April, 1949. The 12-month change, April, 1948 to April, 1949, was a fall of 11.3%. United States cotton markets are at present in a confused position with no apparent emergent trend.

10. Recent price falls for cacao have been severe; the New York spot price fell 55% from 44.6 cents per pound in July, 1948 to 20.0 cents per pound in April, 1949. The 12-month change, ending April, 1949, was a fall of 30%, but the April, 1949 price is still 74% above the average 1946 price of 11.5 cents, which in turn was well above the average 1939 price of 4.8 cents. Price falls since July, 1948 have been influenced by a sizeable reduction of United States consumer demand for chocolate confections at a time when West African cacao supplies were unusually large. It is not yet clear whether United States consumption will continue to decline, but with the probability of smaller supplies of cacao coming forward, prices are expected to stabilize around current levels.

11. No presently known resource can reasonably be expected to lead quickly to substantial new exports. There is disagreement among experts regarding possible mineral exports, notably iron and manganese ores, but there is substantial opinion that such heavy investment would be required for their exploitation that export would probably be non-competitive.

Imports

12. Total value of imports in 1948 was US$ 1,134 million, US$ 84 million less than 1947. In 1948 raw materials and fuels were 23.3% of

all imports, foodstuffs 18.6%, and manufactures 57.9%. Some individual items, as percentages of total imports, were fuels and lubricants 11.5%, wheat and wheat flour 11.9%, machinery 27.7%, and passenger automobiles 4.9%.

13. Import pressures are likely to be continuous, even if some present imports are replaced by domestic production. Consequently, any substantial increase of foreign exchange reserves could result only from official controls upon imports.

Direction of Trade

14. Before and since World War II the United States has taken 35% to 43% of Brazil's exports. Before the War the United States supplied about 25% of Brazil's imports, compared with 61% in 1947 and 52% in 1948. Before the War, Brazil customarily showed a small active trade balance with the United States; in 1947 there was a passive balance of US$ 311 million, which in 1948 was reduced to US$ 79.5 million. With the reopening of European import sources, Brazil should be able to regain her pre-war trading position, and in that event should not be seriously hampered by persistence of European inconvertible currencies. On the other hand, maintenance of volume and prices of exports other than coffee to the United States may in a very long run become increasingly difficult under competition from new African sources.

Terms of Trade

15. Prices of main Brazilian exports are likely to fall further, but prices of imports are also likely to fall. Raw material and foodstuffs imports were 41.9% of all Brazilian imports in 1948, wheat alone being 11.9% of imports. Prices in these import groups are likely to fall at least as much as average Brazilian export prices, since no great fall of coffee prices (affecting 40% of Brazilian exports) is expected. Price reductions upon imported manufactures (57.9% of 1948 imports) will probably be less than in the raw material and foodstuffs groups. On balance, therefore, the prospect is for some deterioration of present Brazilian terms of international trade, ending the unusually favorable terms enjoyed in the war period.

Devaluation

16. Devaluation of the cruzeiro is likely to follow any quick fall of Brazilian export prices, and might also occur if serious domestic inflation reappears. By itself, however, devaluation would not impair external credit-worthiness, and might under appropriate circumstances improve it by facilitating adjustment of domestic to external economic conditions.

Exchange Reserves and Commitments

17. At December 31, 1948, gold and exchange holdings were

equivalent to US$ 655 million. Gold holdings were US$ 317 million, and convertible currencies US$ 68.3 million, a total of US$ 385.3 million. Holdings of European compensation currencies were the equivalent of US$ 85.4 million, and of Argentinean, US$ 27.4 million (equivalent). Blocked sterling amounted to US$ 157.3 million (equivalant).

18. Gross gold and convertible currencies holdings (US$ 385 million) include the de facto note issue reserve (about US$ 275 million) and gold pledged to the United States Federal Reserve Board (US$ 60 million at the end of 1948). Thus the free margin was about US$ 50 million. If, upon establishment of a Central Bank, a gold reserve of 25% against issued currency is prescribed (as is said to be intended) hard reserves are at a minimum level.

19. A backlog upon exchange commitments arose during 1947, and in March, 1949 was some US$ 117 million, or about 5 weeks' imports at the 1948 rate. Probably because many individual items have been outstanding for very long periods, this backlog has aroused more concern than its absolute importance appears to warrant. The Abbink Commission represents it as a major factor impairing the investors' assessment of Brazilian external credit, and suggests a possible foreign loan for funding purposes. The IMF, when granting Brazil a US$ 15 million drawing early in April (10% of quota) conditioned further drawings (to the annual limit of 25% of quota) upon satisfactory reduction of the exchange backlog. An IMF Mission visited Brazil in April to assist in improving the administration of exchange controls, to ensure a more orderly distribution of available exchange. Further steps, probably

involving exchange budgeting practices, are required if the problem is to be effectively dealt with.

20. US$ 20 million of a US$ 80 million Federal Reserve Bank stabilization loan (secured against gold) was paid off in 1948, and another US$ 20 million in March, 1949. The remaining US$ 40 million should be liquidated this year; repayment may, however, be delayed with the consent of the United States Treasury.

21. The Brazilian President is reported to have sent a message to his Congress stating that Brazilian war accounts with the United States had been settled, with Brazil paying US$ 5 million annually until 1954. This has not been included in estimating foreign debt service (paragraph 23).

Foreign Debt Service

22. The presently outstanding foreign debt is estimated at US$ 739.4 million (324.4 million US Dollars and 415.0 million equivalent almost wholly sterling), not including undisbursed Exim-Bank commitment of US$ 35.1 million and IBRD of US$ 75 million. The total is thus US$ 849.5 million.

23. The peak load of debt service on this US$ 849.5 million is estimated at US$ 58.4 million in 1951, falling progressively thereafter (US$ 51.9 million in 1954, and US$ 29.7 million in 1960).

24. This peak service represents about 4.7% of current account balance of payment receipts in 1947 (about 5% of 1947 and 1948 exports).

Peak debt service loads for some other countries, as per cent of their 1947 current account balance of payment receipts, are Chile 6.5%, Colombia 3.8% Uruguay 4.6% and Mexico 7.0%.

Internal Finance

25. Inflation and cost of living increase slackened in 1947 and during 1948. War-time balance of payments expansion and deficit Government finance both ceased, and the former is unlikely to recur. The outlook for inflation now depends upon budgetary and domestic banking policies, in particular those related to execution of the Salte Plan.

26. Deficit Government finance has in the past been customary, Federal deficits being covered largely by currency issues. An anti-inflation policy adopted in 1946 resulted in a Federal budget surplus in 1947 and 1948, but the 1949 budget is again deficitory, due mainly to salary increases to Government personnel. Personnel represents about 45% of Federal expenditure.

27. State finances in Brazil represent a considerable part of total official finance, State deficits usually becoming a Federal burden. Total official expenditures were about 20% of estimated national income in 1946; of this total, 57% was Federal, 35% State and 8% municipal.

28. The 1949 Federal budget (total expenditures, 19.4 billion cruzeiros; expected deficit, 1.13 billion cruzeiros) allocates 29.6%

of expenditures to the armed services, and 11.2% to education. Public debt charges amount to about 7% of 1949 Federal and State budgets (3% for external, 4% for internal debt).

The Salte Plan

29. Should the Salte Plan finally receive Congressional approval, it will be of interest to IBRD. Its domestic finance will greatly influence the outlook for renewed inflation and its results will affect the long-run future balance of payments. It would, therefore, probably be desirable for IBRD to take into account the relationship to that Plan of any projects submitted to the Bank.

30. The Salte Plan is a developmental program, envisaging both official expenditures and expansion in the private sector (mainly in power). Its four main headings cover health, agriculture, power and transport. Devised to meet post-war needs, it was elaborated by the Executive Branch after long inter-party discussions before presentation to Congress in May, 1948. In the House of Representatives it was minutely examined and somewhat modified, and is now delayed in the Senate. The Abbink Commission, while not critical of the Plan as a whole, states that further study of the agricultural section of the Plan seems highly advisable. If this is so, the Plan may not yet constitute an effective program.

31. The Salte Plan sets broad expenditure objectives within which projects are being classified in lengthy technical appendices. Brazil

expected to finance the bulk of official foreign exchange requirements from her own resources, but this may now be more difficult with emergent current account balance of payment difficulties. The Abbink Commission explores and strongly recommends the non-inflationary domestic finance of the Plan.

32. The Salte Plan envisages developmental expenditures over the period 1949-53 of 17.5 billion cruzeiros in domestic currency (13.6 billion official and 3.9 billion private) and 8.2 billion cruzeiros (US$ 443 million) in foreign exchange (US$ 286 official and US$ 157 million private). Planned Federal expenditures total 18.3 billion curzeiros for the period, the domestic component and any self-financed foreign exchange to be covered partly by revenues and partly by domestic loans. The 1949 Federal budget appropriated 1.3 billion cruzeiros for official Salte Plan expenditures.