1. The Government of Brazil has consulted with the Fund under Article XIV, Section 4, of the Fund Agreement concerning the further retention of its transitional arrangements.

2. Inflation accelerated in 1961, when money supply increased much more rapidly than in any recent year due principally to a seriously deteriorating fiscal situation. Deficits in government-owned or subsidized enterprises increased sharply. There was a substantial increase in wage payments to government employees. Bank credit to the private sector continued to increase substantially at rates comparable with the expansion in 1960. The impact of this internal monetary expansion on the foreign sector was limited by a substantial depreciation of exchange rates, especially in the first part of 1961. Increases in exports, PL 480 assistance, and reduced payments for invisibles and amortization permitted the monetary authorities to maintain net foreign assets virtually unchanged in 1961. The budget for 1962 as approved by the legislature foreshadows a further deterioration of the fiscal situation. Also, due to a new attempt to hold the exchange rate, the foreign exchange position of Brazil has deteriorated at the beginning of 1962.

3. The Fund urges the Brazilian authorities to take early and determined action to arrest the inflation. Such action should include measures designed to eliminate the fiscal deficit within a short period. For this purpose firm action to reduce the deficits of the government-owned or subsidized enterprises will be essential, together with strict economy on all nonproductive investment. Elimination of the deficit will also require increasing revenues. Measures to limit the increase of bank credit to the private sector to amounts consistent with price stability will also be needed, together with effective wage restraint.

4. The Fund notes that Brazil's exchange system was further simplified since the measures of March 1961, particularly through the elimination of the preferential exchange rate. Moreover, dependence on bilateral payments arrangements has been reduced. The Fund notes that Brazil's balance of payments in 1961 benefited substantially from these and earlier improvements. However, certain imports remain severely restricted and informal payments restrictions have arisen recently from limitations on the freedom of the exchange market. The Fund considers it essential that freedom in the exchange market be restored promptly and that the exchange rate therein be permitted to respond to market forces. The Fund urges Brazil to implement its plan to terminate bilateral payments arrangements with other Fund members and to reduce the restrictiveness of import practices as soon as possible. The Fund will keep under close review
Brazil's exchange-rate policies and, in the meantime, does not object to the maintenance of Brazil's exchange practices on a temporary basis, but urges Brazil to eliminate the discriminatory aspects as soon as possible.

5. In concluding the 1961 consultations, the Fund has no other comments to make on the transitional arrangements maintained by Brazil.