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Brazil's debt payments have come to a halt

by Mark Sonnenblick

The developing sector's largest single foreign debt careened out of control with the failure of a week of intensive negotiations in mid-May between Brazil, its creditors, the International Monetary Fund, and the U.S. Treasury. Brazil has slipped to a month behind in servicing its $90 billion debt, its central bank president announced in Washington, but no creditor has dared to declare Brazil in "default," nor are the banks willing to provide new loans to disguise the default.

The Brazilians are taking a much more relaxed view of the crisis than they did last fall when they maimed themselves to keep the banks happy. Brazilian officials simply are not paying what they cannot pay despite having cut their imports by 17 percent.

Arrears are now running over $2 billion, according to bankers involved in the crisis. The Brazilians know that a formal Brazilian default would throw more than the entire capital of most of the major American banks into the "bad loan" category. As far as Brazil is concerned, the virginity of its credit rating is lost forever, and there is little to be lost by letting its arrears proliferate to $4 or $5 billion by the end of the summer.

The four-part debt rescue package laboriously negotiated with its creditors under IMF auspices this past winter is a shambles. Morgan Guaranty encouraged Brazil not to declare a debt moratorium, but instead ask for a voluntary agreement that each bank would keep up its share of Brazil's $19 billion short-term debt. That provided an escape valve for a Swiss-led faction of continental European banks which have, in the view of the Brazilians and the IMF, "pulled the plug." European banks decreased their short-term lending by $1.5 billion. Smaller American banks have also refused to restore $200 million in loans.

Ottokard Finsterwald of Austria's Creditanstalt-Bankverein now complains, "We said to the IMF, 'This is absurd. We haven't agreed to this plan.' " At a May 17 New York meeting of Brazilian creditors, the European banks announced that they would definitely not increase their current exposures in Brazil. The Europeans said, "This is an American problem," and suggested that the highly exposed U.S. banks give $2 billion in new medium-term loans to cover Brazil's immediate arrears. The Americans refused to take in the Europeans "dirty laundry" and decided that they would not give the long-rumored "son of jumbo" loan.

The only thing the banks agreed upon during their days of meetings is that Washington, i.e., the U.S. taxpayer, should bail them out. Treasury Secretary Donald Regan hinted May 13 that he may be willing to give a new round of "bridge loans" with nothing but the prospect of drowning at the other end of the bridge. Such U.S. government largesse is questionable, however, since on top of opposition from President Reagan and American taxpayers, it would discredit the arguments used in Congress by advocates of the United States giving $8.4 billion more to the IMF that the IMF is the institution that should handle LDC debts.

Langoni makes some observations

Neither the IMF, nor the alleged U.S. recovery, nor Brazil's stringent austerity program helped Brazil keep itself out of de facto bankruptcy. After days of battles with the IMF, central bank chief Carlos Langoni announced May 18 that Brazil would have to ask for "a waiver" of its commitments to the IMF, if the IMF did not soon give it the seal of approval for its first-quarter performance.

Langoni did not try to hide the fact that Brazil failed the IMF's good housekeeping test, but he pointed out that if the IMF does not disburse the $400 million loan payment due May 31, the loser will be the Bank for International Settlements, which was to get those funds as partial repayment on a bridge loan given earlier this year. A rejection by the IMF also automatically voids the existing Brazilian loan package with its private banks, Langoni calmly noted, an eventuality which would only leave other Brazilian creditors stranded.

Langoni and his mentor, Planning Minister Delfim Netto, have promised the banks that they will implement IMF "shock" policies in Brazil during the second half of the year. But, as usual, they are lying, however much they may personally wish that were the case. Brazilian President João Figueiredo is now seeking to engineer a smooth presidential succession process which will keep Brazil on the path to democratization. The existing IMF program has already brought mass layoffs, riots, and other social dangers; Figueiredo is certainly not prepared to tolerate an intensification of those dangers. Brazilian officials warn that if the IMF does not loosen conditions and allow Brazil to grow, Brazil may just dump the IMF. As things stand, that would also mean dumping its deals with private creditors.

The reality is that existing institutions have failed to defuse the "debt bomb," and a new wave of debt shocks is fast approaching. "The chances of not getting into a second wave are just about nil," concludes National Security Council official Norman Bailey, one of the White House's chief debt strategists.

There is no sign yet that anyone in Washington knows how to respond.

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