Brazil crisis is 'solved'—save for being 'struck by lightning'

by Lorenzo Carrasco

The reestablishment of international credit lines to Brazil, and the timid reentrance of capital encouraged by the raising of annual interest rates to 45% and a reduction of barriers to speculative capital, had the immediate effect of triggering euphoria on the part of Central Bank president Arminio Fraga, who is a key chesspiece of the international bankers and speculators in their control over Brazil. Fraga, together with Brazilian Finance Minister Pedro Malan and President Fernando Henrique Cardoso, are wishfully imagining that everything will return to "normal," that is, at least to what existed before Russia declared its debt moratorium last Aug. 17. However, this is a fantasy, since the physical state of the economy is one enormous calamity.

The reality is that the so-called "normality" of capital flows has been artificial since at least October 1998, when Federal Reserve Chairman Alan Greenspan, as a representative of the London-Wall Street banking interests, decided to keep the speculative bubble afloat by injecting more liquidity, thereby increasing the hyperinflationary potential of the world economy. And it was the enormous explosive potential in Brazil—the central topic of discussion at the annual meeting of the International Monetary Fund (IMF) and Group of Seven—which accelerated that decision.

Fraga, despite all the power he can wield inside Brazil, is only the instrument of this hyperinflationary strategy, baptized by his godfather, George Soros, at the annual Davos meeting, as a "Wall of Money." It was Fraga's commitment to this policy which was ratified during the March tour he conducted, along with the rest of the Brazilian economic cabinet, to Frankfurt, Bonn, London, New York, Tokyo, and Paris, promising the immediate implementation of a program to cut public expenses and hike taxes. It was Fraga who met personally with the heads of the Federal Reserve and with the main New York banking houses, as well as with Bank of England president Eddie George.

The main purpose of this excursion by Fraga, Malan, and company, was to establish an agreement with the banks, whereby they would "voluntarily" maintain open lines of commercial credit to Brazil, at least for the next six months, which added up to $42 billion by late February—$22 billion in commercial credit and $20 billion in interbank lines. This agreement was unveiled by Citibank vice-president William Rhodes, and by the Institute of International Finance, which represents the 300 largest banks in the world. Rhodes, who in mid-March became the coordinator of the international banks with the Brazilian government, declared that "the level of confidence is growing, both internally and externally, because it is already believed that the government will de facto implement the measures it announced, and I would say that the country's perspectives are the best of the last 18 months."

Banking pestilence

But this interest in Brazil by the banks is not Platonic love, or anything of the sort. During the so-called "exchange fluctuation," the banks pulled in enormous profits, much greater in one month than in the entire previous year. For example, Morgan Guaranty Trust made 275.9 billion reals (Brazil's currency) in one month, eight times its 1998 profits. According to the Central Bank's information system (known as Sisbacen), J.P. Morgan bank, which is part of the Morgan Guarantry Trust group, made R$193.5 billion in profit in January, bringing the group total up to R$469.5 billion in just one month.

Also in just one month, other banks brought in three to four times more profit than they had in the previous year. Chase Manhattan, R$310.1 billion; Citibank, R$258.2 billion, not including its commercial bank, Citibank NA, which suffered losses in 1998 and still brought in R$132.5 billion in profits in January of this year. Other banks got "only" double their profits of the previous year, such as BBA Creditanstalt, with R$248.8 billion. The level of usurious pestilence is so absurd, that in the case of Morgan Guaranty and Morgan Trust, January earnings were 295% higher than those of December.

According to Roberto Setubal, president of the Brazilian Banking Federation, the banks' exceptional profits in January, derived from the devaluation of the real, came from three fronts: the Treasury bonds issued by the government, dollar purchases on the futures market, and subsidiaries abroad. He also states, with a good dose of cynicism, that the government was, to some degree, the other side of the coin. "All those holding dollar debts lost, and the government was one of these," he said. Which reveals what the game was all along: a transfer of public money to the banks.

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The devaluation of the real caused an increase of debt linked to the exchange rate by R$33 billion. In December, it was R$67 billion, and by the end of January, it had risen to R$110 billion. This means a near doubling of the income obtained from the privatization of Telebras, or R$22 billion.

The total debt in government paper rose in January to R$364 billion, more than a 12% increase in one month, and 489% higher than that of 1994, the year the Real Plan was launched. More serious still is that the Central Bank lost R$7.6 billion in January and February 1999, with the sale of dollars on the São Paulo Futures Market. And so, the big loser in this financial casino was the federal government. The head of the Central Bank's economic department, Altamir Lopes, explained that operations on the futures market serve as a kind of security for dollar-indebted companies, what is technically known as a "hedge." The operations were conducted through the Bank of Brazil, which operated in the name of the Central Bank, as per the instructions of the then-president of that institution, Gustavo Franco.

As a result of this speculative orgy, the nominal public deficit, which includes expenditures plus interest payments, surpassed 8% of Gross Domestic Product, according to official statistics. In absolute values, this equals R$72.7 billion, since nearly the entirety of these expenses were from payment of interest on government debt.

IMF agreement: bailing out insolvency

In the face of this disastrous picture of Brazil's public finances, the only plausible reason for the international financial system to continue a flow of capital into the country, is the understanding that there still exists some margin for further looting, before the government collapses under social explosion. And this is the basis for the recent pact with the IMF. The government hopes to finish 1999 with a primary surplus (i.e., excluding debt service payments) of 3.25% of GNP, which will mean dramatic budget cuts and tax increases totalling some R$4.5 billion. For example, expenses for education were reduced from R$4.6 billion to R$4 billion, which is a crime if we compare these figures with the R$70 billion spent in 1998 on interest payments on the public debt.

These comparisons are so scandalous that, for the first time in history, the IMF has agreed to accept as a criteria for fiscal performance the primary, and not the nominal, budget performance—the difference being that the nominal criteria includes debt service payments, which today are sacrosanct. Thus, according to the agreement with the IMF, the primary result of the public sector will be 3.1% of GNP this year, going to 3.25% in the year 2000, and 3.35% in 2001.

This agreement is pure illusion. For example, the inflation rate set for 1999 is 16.8%, 6.5% in the year 2000, and 2% for 2001. The exchange rate, according to the deal with the IMF, should be at 1.70 by the end of 1999, 1.77 in December of 2000, and 1.84 at the end of 2001. The average interest rate goal for this year is set at 28.8%, 16.6% in 2000, and 13.7% in 2001. And here is where the problems begin, because even with a rate of 29%, which is what they hope for, it would mean interest rate payments on an internal debt of more than R$400 billion, of approximately R$116 billion, representing 13-15% of GDP, which, according to the IMF agreement, will contract 4% during the course of this year. The R$116 billion equals more than 80% of all tax revenues garnered in 1998.

More serious is that the interest rates have stayed above 40% so far this year, meaning that things may reach the absurd point that interest on the debt could surpass the entirety of the nation's tax revenues. And there are only two solutions to this picture: either there is a tremendous Weimar-style hyperinflationary explosion, or the explosion is contained through even higher interest rates and more budget cuts, triggering a depressive implosion that would have the same devastating effect.

In exchange for "running the risk" of financing a bankrupt nation, the international banks are demanding that the remaining public companies, such as Petrobras, Banco do Brasil, and Caixa Economica Federal, be privatized, after which the Brazilian economy will be left a mere husk, ready for the garbage heap. The government has committed itself to handing over some R$27.8 billion through the privatization program.

But leaving aside numerology, in which it becomes apparent that even if Brazil wants to, in the short term it will be in no condition to pay its debts, we must now analyze some of the data of the real economy. As mentioned earlier, the government is expecting a contraction of the economy on the order of 4%. In reality, the contraction could reach 8% or more.

For example, during January, the industry of São Paulo declined nearly 11% in relation to January 1998 production levels. According to the Brazilian Institute of Geography and Statistics (IBGE), it was the sixth consecutive decline, and the largest. This collapse of the greatest industrial state of Brazil was the consequence of a 24.8% decline in production by the transport sector, 17.5% by the metal machine industry, and so on. The situation is equally serious in the other Brazilian states.

At the same time, the São Paulo Federation of State Industries reported that more than 28,000 industrial jobs were terminated in the first two months of this year, and that since the beginning of the Real Plan in 1994, there has been a loss of 535,000 jobs, representing nearly 25% of what had been the labor force of São Paulo state.

In sum, the country is facing a picture of social desolation. Perhaps most shocking is the IBGE report that, over the past two years, life expectancy of Brazilians has declined by three years.

So, if this all adds up to the Brazilian crisis being "solved," then the old adage also holds: "The only thing missing is to be struck by a bolt of lightning."