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Currency Rates

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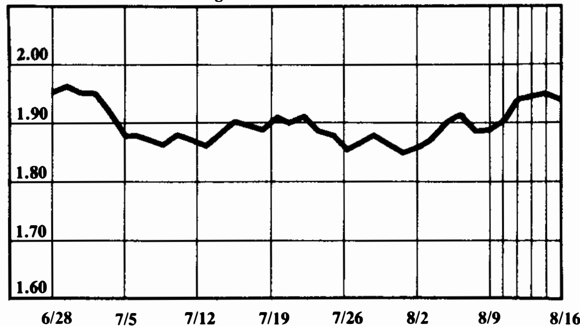

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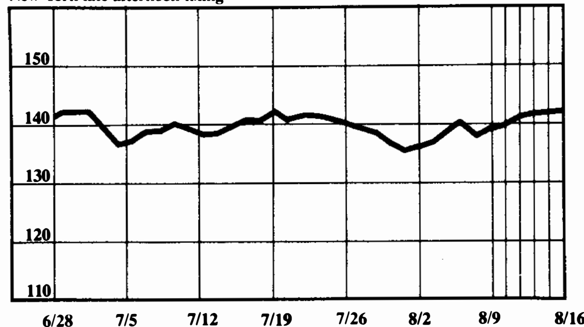

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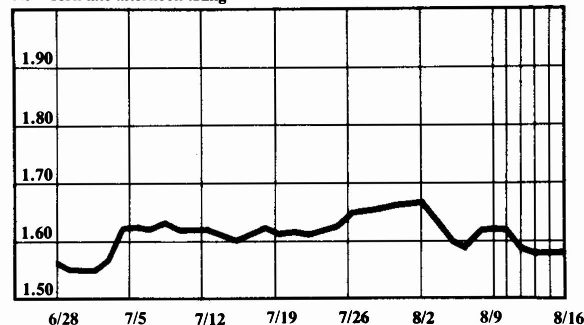

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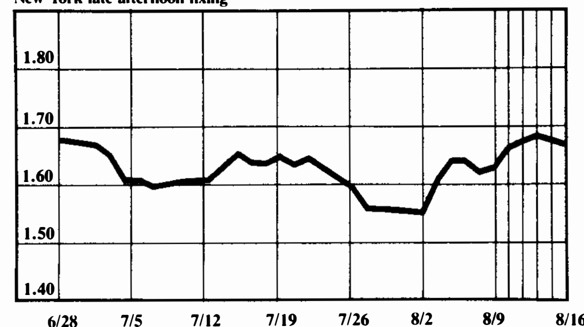

Brazil's 'day after' will be a lollapalooza

by Lorenzo Carrasco

Brazilian President José Sarney's administration decided on June 30 to suspend interest payments on the foreign debt to commercial bank creditors. The idea was to ensure that his successor would take office on March 15, 1990, with about $8 billion in foreign reserves, enough to let him renegotiate the debt from a position of strength. The government's strategy also envisions increasing imports, especially those of capital goods, even though this would reduce the hefty trade surplus.

Although the measures are correct, they alone will not solve the country's economic and financial problems. Finance Minister Maílson da Nóbrega is deluding himself if he thinks he can hold inflation to around 30% monthly for the administration's remaining seven months. Current monetary policies, based on high interest rates, will turn into a hyperinflationary explosion like July's in Argentina. In Brazil, however, the extreme social inequalities and the discredited state of all the country's institutions will make the consequences much worse.

Inflation

In recent years, Brazil's chronic inflation has been fed by two sources. First, the National Treasury has issued growing volumes of government debt in cruzados so that the central bank could buy over $10 billion a year in dollars earned by the trade surplus. It sends those dollars abroad to service the foreign debt and make other transfers.

Second, refinancing this critical mass of internal debt has formed a speculative bubble which is inflating of its own accord. This monetary bubble is not in any way backed by the production of real goods and services. This cancer is the source of the Brazilian banks' absurd profit levels and the real driving force of Brazilian inflation.

By these means, the Treasury has totally lost control over the generation of credit and currency. The money it obtains by selling the notes and bills it issues is not channeled into the real productive process. Its only use is as collateral for the overnight money market. The same happens with the issuance of currency, which rises and falls only in order to

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give liquidity to government notes when their bearers want to cash them.

Thus, the sovereign function of regulation of credit and currency was, de facto, given away to the country's biggest private financial institutions, the "market forces" behind the speculative merry-go-round.

The problem has gotten bigger, because the government has been keeping interest rates super-high all year, under the monetarist axiom that that would help lower inflation. But, as could be expected, it was a colossal failure. From January through July, the National Treasury paid 15 billion new cruzados (more than $8 billion) on interest on the internal debt. That is 66.31% of all tax collections for the same period. The recessive effects of the high interest rates helped undermine the tax base.

Merely for refinancing federal debt in bonds and bills during the first seven months, the National Treasury sold 75 billion new cruzados (NCz) worth of new debt. Of this, NCz 65 billion ($9 billion) was to roll over principal and NCz 9 billion (more than $5 billion) was to pay interest and NCz 1 billion was to cover state-guaranteed foreign debt.

During the same seven months, the Treasury deficit was NCz 10.1 billion, virtually identical to what it had paid in interest on the government's internal debt. This means the infamous government deficit, the eternal source of bally-hoo in the Brazilian and foreign press, is merely financial.

The situation worsened in July, because the real monthly interest rate pegged by the Central Bank was 3.41% over inflation. This rate—compared with the 1.97% spread over inflation in June—means that, by this means alone, the real cost of paying interest on the internal public debt was jacked up by 46.6% in a single month. This exponential process could only end up with a horrible hyperinflation.

The biggest bank robbery

This defective financial and monetary administration produced fat profits for the Brazilian private banks, which are, as we already said, the ones that dominate the entire national monetary process. According to auditors from the Arthur C. Andersen Company, the ten largest Brazilian banks piled up 2.7 billion new cruzados in profits in the first half of this year from their government debt portfolios. To have a correct idea of how big that it, 2.7 billion new cruzados is practically what the government paid in interest on that debt in July.

Just those same ten banking institutions hold in their portfolios half the total value of the federal debt in bonds and bills, which is currently calculated at 110 billion new cruzados. The government sells all these instruments to the banks, and pays high interest on them. The banks use 32 billion new cruzados of this paper as collateral for overnight deposits made by the general public on which the banks pay interest at low rates, generally less than the inflation rate.

Arthur C. Andersen's auditors concluded, "The numbers show that financing the debt is a very lucrative business for the banking system and the risks are negligible."

The government's current tactic of delaying payments on the foreign debt will undoubtedly help "cool down" this vicious cycle of speculation. But it will not stop it from growing unless other urgent measures are taken to straighten out the national financial system.

Although it is difficult for President Sarney's government to attempt a systematic financial reform only seven months from the end of his administration, certain steps are imperative to make sure his successor will find the country in governable condition. They include:

- Immediately reduce the interest rate to below the inflation rate.
- Place high taxes on windfall bank profits caused by the way the public debt has been handled.
- Oblige the financial institutions which hold almost the entire internal debt to freeze the due dates on it so as to enable the new government to renegotiate the foreign and internal debts on an equitable basis.

If this is not carried out immediately, on the "day after," as some are calling the period right after the new President's inauguration, the situation he will face will be so bad that he would envy the flames of the inferno.

The old monetary system is dead. Put it in the closet, and open the closet to horrify children on Halloween. The question is, how do we build the new monetary system?

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