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Collapse of Brazil's currency spells doom for IMF system

by William Engdahl

The collapse of the Brazilian currency's peg to the dollar on Jan. 13, and the subsequent near 40% fall of the *real* in two weeks, has not only been a devastating blow to the economies of Brazil and the rest of Ibero-America, but it sounds the death knell for the International Monetary Fund (IMF) system. Last November, the IMF announced a $41.5 billion "preemptive" stabilization package for Brazil, ostensibly to prevent the largest economy in South America from falling victim to the currency collapse contagion which has ravaged Asia and Russia over the past 18 months.

As of this writing, the real is in free-fall, dropping 3-6% in value per day, hovering just near the psychologically dangerous level of R$2.0 to the dollar. The real stood at R$1.22 to the dollar on Jan. 12, the day before the ill-fated devaluation rocked world financial markets. But as significant as the crack of the real, and as grim as the economic prospects for Brazil are under conditions of soaring dollar debt costs, is the blow of the Brazil collapse to the institution which helped bring it about: the IMF.

Showing the utter bankruptcy of IMF policy, on Jan. 26, a senior Fund official in Washington admitted that the $22.6 billion IMF stabilization package for Russia, which the Primakov government had expected to be resumed, was no longer in force. "That program is dead," the official told the German business daily *Handelsblatt*. He could have added, that the IMF is dead as well.

Since August 1997, when Thailand became the first Asian country to seek emergency stabilization assistance, the Fund has organized $180 billion to try to "stabilize" what rapidly spread from an East Asian crisis into a full-blown global financial and economic catastrophe of an intensity not seen since the Great Depression. Soon, the Philippines, Indonesia, and South Korea were added to the crisis list. Then, in August 1998, Russia and Ukraine had to line up for emergency IMF funds. The funds committed by the IMF over the last 18 months exceed anything since its founding in Bretton Woods, New Hampshire in 1944.

Wrong medicine

It is no accident that the IMF remedy, far from the stabilization hoped for in Washington and other capitals of the Group of Seven, led to disaster in Brazil, and has yet to improve the standard of living in any country it has in its talons. The IMF mandate is invariably the same: The country is told, in order to get the needed funds, it must agree to IMF "conditionalities." The conditions are invariably the same: The country has to impose prohibitively high interest rates in order to stop the currency collapse, and the country must impose draconian cuts in public deficit spending, allegedly because the measures are needed to "regain the confidence" of foreign investors. Brazil was told that adhering to a firm peg between the real and the dollar was the *sine qua non* for getting the IMF funds, when the IMF stepped in last November amid the global shock waves detonated by the Aug. 17 Russia debt default and ruble collapse and the September collapse of the Long Term Capital Management hedge fund.

In the case of Brazil, when foreign investors began to run for the exits and cash in their real bonds and stocks for dollars, the IMF urged President Fernando Henrique Cardoso to hold fast, and backed Brasilia's decision to raise domestic short-term interest rates to 50% to restore foreign investor confidence. At that point, neo-liberal economists argued that the Brazilian currency was at least 20-30% overvalued in the wake of the massive devaluations across Asia during previous 12 months, from economies directly competing with Brazil for world export share.

The IMF demand guaranteed that Brazil would sink into deep recession, or, more likely, economic depression. The

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budget austerity demanded by the IMF for its funds, further cut off hopes of government spending to offset the severe economic contraction, causing a sharp drop in government tax revenues needed just to service domestic and foreign debt. Brazilian government domestic debt today is around R$320 billion ($167 billion).

The IMF rate rise of October, which was kept in place until the real cracked on Jan. 13, rather than reducing the budget deficit from 4% of GDP to 2%, as the IMF claimed it would, instead doubled it to 8%, forcing more creation of deficit bonds or borrowing. In addition, with the real plunging and Brazil owing some $254 billion in dollar-denominated debt abroad, according to the official count, the relative cost to Brazilian public and private entities of servicing that old foreign debt now is at least $25 billion per year more, according to estimates by Goldman Sachs.

In fact, the $41.5 billion IMF package for Brazil did no more than guarantee ample dollar reserves to foreign speculators scrambling to get out. Since August 1998, Brazil has been hit with capital outflow of more than $40 billion. In January alone, $8 billion more has gone. The Brazilian Central Bank reports current dollar reserves of $33 billion—but that includes more than $9 billion loaned as part of the IMF package. Informed estimates are that the actual figure was "closer to $12 billion when Brazil devalued." The Central Bank was rapidly exhausting precious dollar reserves to pay capital flight.

"What the Brazil devaluation has done," one senior European banker told *EIR,* "has put the spotlight on the other major currencies which remain fixed to the dollar. Argentina, with its dollar peg and its currency board, is obvious. But the real worry is if China and Hong Kong are forced to devalue the renminbi and HK dollar. That would put significant new down pressure on all Asia."

On Jan. 24, China's official *Business Weekly* wrote, "some analysts said the devaluation or floating of the renminbi would not definitely be a bad thing." As the report went out over world financial wires the next day, the Hong Kong stock market plunged 2.5% over fears of renewed pressure on the Hong Kong dollar peg. Within 24 hours, Chinese government officials and People's Bank of China Governor Dai Xianglong issued statements denying any intent to devalue. Financial markets remained nervous nonetheless. "The Brazilian crisis and the China debt situation have led to new worries about the Hong Kong dollar and possible devaluation of the renminbi," Percy au-Young of DBS Securities said.

Closing the barn door . . .

On Jan. 20, in its first-ever public mea culpa, the IMF released a self-criticism of its handling of the crises of the past 18 months. In a masterpiece of understatement, the IMF admitted that it had "greatly underestimated" the depth of the crisis sweeping Asia in 1997 when it stepped in with its orthodox policies. It added that the programs were "based on macroeconomic estimates that turned out to be incorrect," that were too optimistic about how financial markets would react.

At this juncture, with Asia in its deepest depression in decades, with economic growth rates plunging across western Europe, with Organization of Petroleum Exporting Countries teetering on the brink of fiscal catastrophe because of depressed world oil prices, there is no light at the end of the tunnel. And, as Brazil sends new shock waves through world financial markets and economies, the world's second-largest industrial economy, Japan, continues to sink deeper into depression and bank crises.

At a Jan. 28 press conference in Tokyo, Vincent Truglia, head of Moody's Investors Service Sovereign Risk unit, warned that further downgrade of Japan's sovereign debt rating was probable. Given the huge size of Japan's bad loan overhang from the bubble era in the late 1980s, and the massive funds committed to economic stimulus, Truglia predicted that Japanese public debt could top 140% of GDP by 2003, "far in excess of anything ever seen in an industrialized country." He said that the total cost of cleaning up Japan's estimated $2 trillion in bank bad loans could cost the government "between 15-20% of GDP."

Today, that level is more than 100% of Japanese GDP. Government data recently revealed that Japan's economy contracted 6.9% last year, the worst recession since the 1970s. With a sinking economy, prospects for Japan to absorb Asian exports and thereby help stabilize the depression across Asia are also sinking. In time, Japanese banks will be forced to liquidate significant portions of their $204 billion in U.S. Treasury holdings. Were that to accelerate into the March 31 Japan fiscal end-year deadline, it would trigger a collapse of the U.S. government bond market, the world's largest, push interest rates there sharply higher, in turn triggering a collapse of the bloated $12 trillion U.S. stock market, and a severe recession in the world's largest economy, pulling Europe and the entire world into a nightmare.

With Brazil's currency in free-fall, China and Hong Kong under enormous pressure, and Japan on a pre-set disaster course, clearly the IMF as the central agency for emergency action has become totally discredited. Indicative of the emerging mood toward drastic changes of the international rules of the game, on Jan. 24 Brazil's prominent business daily *Folha de São Paulo* ran a front-page editorial titled "Courage to Change." The paper, citing the positive experiences of Malaysia after its controversial September imposition of exchange controls, insisted, "It is time to change paths, to abandon the belief in the market's ability to organize the economy, which should not be reduced to submission to the empire of speculation. The alternative is centralization [i.e., exchange controls]."

While exchange controls have been advocated by *EIR* founder Lyndon LaRouche as an emergency stopgap, ultimately, the only alternative to the madness of the IMF system is a new Bretton Woods conference establishing a new concert of nations agreed in regulating exchange stability, outlawing speculative hedge funds and hot money, and creating the ur-

gent basis for launching Great Projects in infrastructure such as the Eurasian Land-Bridge. Better to end the IMF cure, before it ends us.

LaRouche in 1997: 'Brazil will be next'

During 1997, when the "Asian financial crisis" was exploding, Lyndon H. LaRouche, Jr. repeatedly forecast that Brazil would be the next target of the global financial oligarchy. The following are excerpts from radio interviews he gave to "EIR Talks":

July 15, 1997: 'the hottest situation'

The situation in Brazil, is, in terms of potential impact, the hottest strategic situation presently in the Western Hemisphere. What is it? Brazil is being targetted for a takeover of its raw materials assets by British interests, the same British interests which have raped Africa, that is, the raw materials cartel, the London strategic minerals cartel, and so forth, and the petroleum cartel, and it is targetted, as has been Colombia, which is virtually under the control of the British government now—the drug trafficking in Colombia, under the control of the British government, which is being run through mercenaries—the same British mercenary operation run under the London Privy Council of the Commonwealth, which is running the genocide in Africa. So, Brazil is *targetted for this kind of takeover,* the kind of takeover which occurred in Central Africa, in Burundi—first Rwanda, then Burundi, then Zaire, and now going on to other places. Brazil will come to a blow.

Ricky Cardoso, the President, is a darling of the British, and has been fostering this takeover and *rape* of his own country, by these British interests that have looted and are looting Africa. It's coming to a head. The United States actually should at this point, intervene, to get the British *kicked out* of the Western Hemisphere, because if Brazil comes to a point of crisis, either Brazil will disintegrate, which will represent for the President of the United States, Clinton, a quagmire at the Rio Grande border of the United States, because it won't stop in Brazil. It will come sweeping up through Central America to the Mexican border, and so forth, and so on, which we cannot tolerate—a quagmire beyond belief! Very much like the quagmire that the British and the French are trying to build up against Clinton in the atrocity which the British are conducting in Africa.

So, this is a *hot situation,* and the United States must put its weight behind the sovereignty of Brazil and its institutions against the efforts of the British to use an eminently corruptible President, Cardoso, as a vehicle for facilitating—being done in Ibero-America, starting with Brazil—what it's done in Africa. This is a *very hot* situation.

Nov. 18, 1997: 'no bottom to the crisis'

People who've been following *Executive Intelligence Review* during the past couple of months, are aware of the fact, that the financial crises in Mexico, and in South America, like those which are occurring in the Far East—in Southeast Asia and in Japan—are actually organized out of the British Commonwealth, centered in London. That is, if you look at the financial institutions and agencies, such as George Soros, which are running these operations, which are resulting in triggering this depression, you will find that 80 to 90% of all of the forces involved, are British. So, this is a British operation.

Brazil is exemplary of that. There is virtually nothing in Brazil of any significance, behind the Brazilian crisis, which is not British—and that includes George Soros.

The Brazil crisis, on the surface, has no bottom. Brazil is a large nation; it's the largest nation outside the United States, in the Western Hemisphere, as an economy. Unless you have a military coup d'état, which establishes some degree of sovereignty over the country, there is no bottom to the Brazil crisis.

Now, the Brazil crisis will hit while the crises in Southeast Asia, Taiwan, Japan, Korea, are hitting with utmost force. While we're looking at the conference now going on in the Philippines, in Manila, which is trying to pick up the pieces from the crisis so far, which will not work. Nothing good will come out of Manila. . . .

In the meantime, all of eastern Europe is blowing up, including the former Soviet Union. There's a crisis in Russia, which is *major*. And which can hit the European markets hard and fast. The bonds which are issued by these cities within Russia, these city bonds, these can go into a chain-reaction effect. And under present conditions, with the other things going on, Europe can be hit.

In other words, we can, before Christmas, we can find a big hole, and nothing much more, in the Christmas stocking—that's the way it's going. And the developments in Brazil are one of the big bombs, the big detonators, which can blow out the U.S. financial market.

Dec. 23, 1997: 'Brazil is the target'

When these European interests, which are involved in hedge-fund attacks against the currencies and economies of East and Southeast Asia—when these packs of hyenas, begin to move beyond Southeast Asia, their next target, right now, is Brazil. So, get ready for the explosion of the biggest economy south of our borders. And Brazil can go bankrupt, faster than you can say, "South Korea."

Remember, it wasn't so long ago, that South Korea was the A-number-1 economy of the region: the great tiger. And look at it today.

Brazil is in a much *poorer* condition than South Korea. So, you can imagine what that means. And you can imagine what the cascading effects of a Brazil blow-out will mean to the interests of the United States. . . .