Brazil faces financial panic: time to exercise sovereignty!

by Lorenzo Carrasco

Finance Minister Maílson da Nóbrega's appeal for mercy to Brazil's creditor banks during his presentation to the Council on Foreign Relations in New York Sept. 22, confirms how out of touch with reality he is regarding the international economic situation, on the verge of the worst crash in recent history. The September deal to suspend interest payments that the country struck with the private banks is a measure which, while necessary, is by itself inadequate to contain the imminent threat of a hyperinflationary explosion. What *is* necessary is that the Sarney government, even with only six months left to govern, take immediate and sovereign measures to halt the continued bloodletting of the nation's wealth, to the benefit of international usury which has no national allegiance and respects no borders.

Under the current monetarist presumptions which guide public finances in Brazil, the economic team headed by Minister da Nóbrega has nothing left to offer in trying to halt the explosive internal situation. To insist on the current policy of high interest rates as an anti-inflation strategy is like trying to put out a fire with high-octane gasoline. Consumed by the flames of unrestrained hyperinflation, the country would lose what remnants of political stability it is presently clinging to, and its presidential elections of Nov. 15 would be seriously endangered. Perhaps this is the intended blackmail of the bankers and speculators, to force the country to reinitiate interest payments on the foreign debt.

A Schachtian illusion

Until now, Minister da Nóbrega—encouraged by former ministers Delfim Netto, Ernane Galveas, and Mario Henrique Simonsen—has believed that a policy of high interest rates, like that imposed by German Economics Minister Hjalmar Schacht during the early years of Adolf Hitler, could be the solution for keeping monthly inflation rates under control. Based on this premise, the government launched the so-called "Summer Plan" in early 1989 with an interest rate shock. As can be seen in **Figure 1**—showing the real interest rates above inflation that the government offered its bond holders—the Central Bank suddenly raised the real interest rate to 13.51% in March, precisely when it was believed that all economic prices were frozen or stable.

The arguments of the monetarist horde rest upon the claim that if interest rates well above inflation are paid—at significant cost to the National Treasury, of course—consumption would be constrained, dollar speculation on the black market would cease, and consequently, inflationary pressures would lessen. But reality ignored such monetarist prescriptions, and precisely the opposite occurred. Even in the very first month of the Summer Plan, inflation reached 6%, triggering a new inflationary wave, this time more accelerated than previously. Three months later, in June, inflation reached 24%.

At that point, Minister da Nóbrega still clung to his illusions, ordering a new interest rate hike again intended to "contain inflation," at least long enough to reach the Nov. 15 elections. But these calculations too flopped: Inflation in August was 32%, in September 35%, and predictions for October are hitting 40%.

The explanation for this failure is both obvious and elementary. Interest rates primarily influence the internal debt—in particular, the debt in federal, state, and municipal bonds. The bulk of the internal debt, which is largely short-term, turns over daily on the speculative overnight markets.

Given this fact, the worst of all possible scenarios occurred: High interest rates diverted resources from the productive sectors of the economy while inflation rates shrunk wages. This process ended up enriching that 2% of the Brazilians who invest in the overnight market and, with the fabulous profits that market has yielded in recent months, unleashed an unprecedented wave of consumerism.

During June, July, and August, the National Treasury paid out in interest on its bonds the equivalent of $5 billion, representing 1% of the GNP. In August alone, with a real interest rate of 4.5%, $2.6 billion was paid out. It is conservatively estimated that by the end of 1989, the Treasury will have disbursed $16 billion in interest on government paper alone. This means that to turn over $50 billion in bonds—equivalent to 12.5% of the GNP—the government will be paying 4.5% of the GNP!

To give some idea of the speed with which these Treasury obligations are growing, one need only look at the first six months of the year during which these payments increased 39.1% over the same period of 1988. Already by August, the real increase was 89.8% with regard to the government's accumulated costs of the first seven months of 1988.

The way the Treasury has managed to meet payment on

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these interest charges is through another insane maneuver—the issuance of more notes and bonds—which is obviously having repercussions in the form of an increased volume of internal indebtedness.

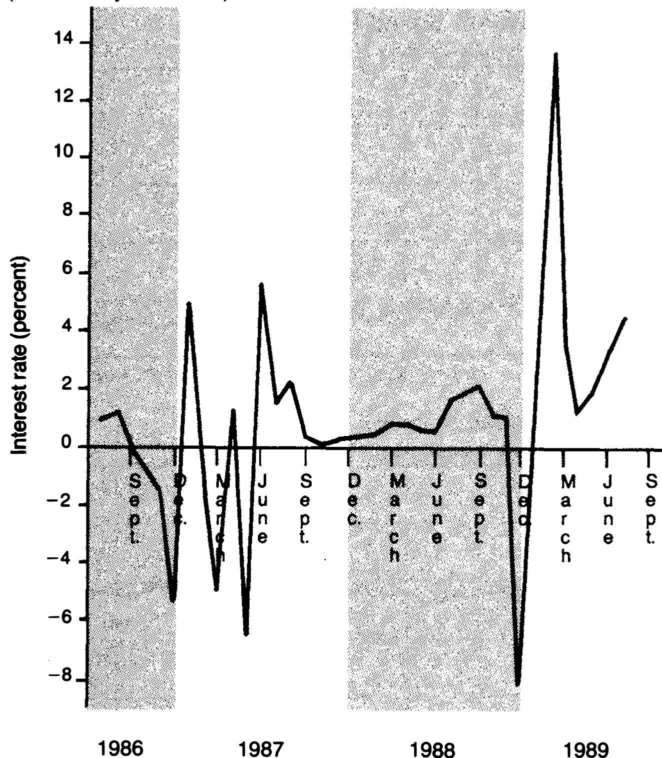
This process can be seen in **Figure 2.** The public sector's liquid debt—which is the sum of the foreign and internal debts—is increasing due to the growth of the internal debt. In the first trimester of 1989 alone, this rose 35.6% with respect to final results of last year. In this we can observe a phase change. For the first time, the internal debt—at $92.1 billion—surpasses the volume of the public sector's foreign debt, a tendency which can only worsen. Until now, the internal debt had been growing in proportion to interest payments on the foreign debt, since to honor its foreign debt obligations, the government has bought dollars from exporters by issuing treasury notes and bonds. However, the cumulative volume of internal debt has become a cancer that has begun to metastasize.

One limit to this process is the government's increasing difficulty in finding buyers for its notes, despite the granting of ever greater discounts in the auctions of its Financial Treasury Bonds (LFTs). One test of fire will be the LFT auctions coming up in the next few weeks, with inflation threatening to reach 40%, and the nominal overnight interest rates surpassing 50% a month.

The most serious aspect of this infernal process is that in just a few short months, it has managed to produce a massive transfer of resources from the productive sectors to the speculative financial sectors. The aggregate of wages this year will fall from 38% of the GNP to 32%; a 6% loss with respect to last year, according to the labor minister himself.

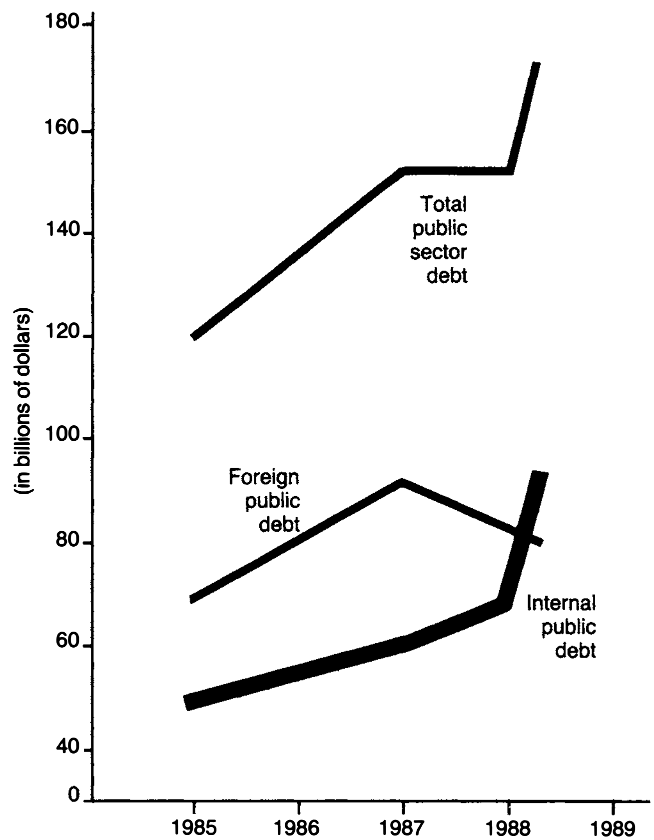
This demonstrates why a mere suspension of interest payments on the foreign debt, and the accumulation of foreign exchange reserves to avoid an exchange crisis such as that which toppled Argentina's Raúl Alfonsín, is insufficient to avoid a hyperinflationary explosion. If the government insists on raising the real interest rate with the argument that this will "cool out" the consumerist wave that it itself triggered by offering outrageous profits on the overnight market, it will only be creating conditions of political instabilty and social injustice that could lead to outbreaks worse than those recently witnessed in Argentina and Venezuela.

FIGURE 1
Real interest rates for Brazilian treasury bonds (LFTs)
(inflation-adjusted rates)



Source: Central Bank of Brazil.

FIGURE 2
Public sector liquid debt in Brazil



Source: Central Bank of Brazil.

The solution: a shock of sovereignty

The dynamic of the crisis itself shows, albeit negatively, what solution must be sought. As we can see, the country is channeling some $16 billion into speculative investments this year. The solution is simple: to direct the flow of these resources instead into productive investments in real economic infrastructure, as was described by economist Lyndon LaRouche in *EIR* of Sept. 8, and extensively detailed in his *Operation Juárez* proposal.

The government should drastically reform the national financial and banking system, with the primary purpose of isolating government paper, which must then be protected from the speculative oscillations of the markets and exchange rates of foreign currencies. Immediately, the government should propose an arrangement with its treasury bond holders, to set a date after which the accumulation of interest is suspended. With the backing of the national Congress, the government has the prerogative of buying back these bonds with new debt instruments, setting fixed interest rates and longer repayment deadlines.

This task would be simpler than it appears, since 80% of the market for government paper is concentrated in the hands of private banks, non-financial companies, and financial brokers, who should understand that this is the only possible—not to mention patriotic—way out of the current crisis.

These new government debt instruments could be viewed by the companies as discountable assets. This is especially important for those private companies which, because of the current characteristics of the financial markets, protect their operating capital from the ravages of inflation by keeping them on the overnight markets. Thus, for example, Mercedes Benz which currently turns over several million dollars a day on the overnight market, would be able to discount the new bonds once it is demonstrated that the money would be invested in the company's own expansion.

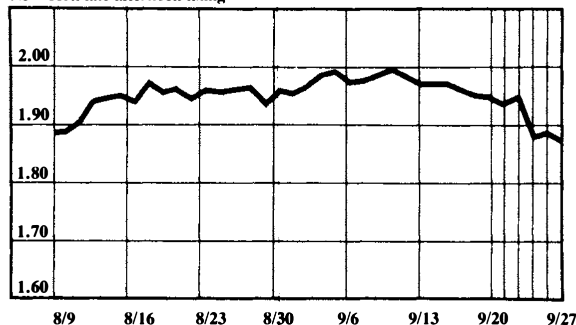
For this new system to function, it is clear that the Central Bank, which until now has functioned as an agent of private creditor interests—both domestic and foreign—and not as an agent of the National Treasury, must be re-nationalized. As part of this reorganization, the country must reestablish a system of issuing credit based on gold reserves, which would restore confidence in, and independence to, credit destined for productive use. This measure would also increase the value of gold production; most gold stocks today are fleeing the country as contraband under the auspices of powerful international groups.

If these measures were to be backed up by a Supreme Court review of the constitutionality of the country's foreign debt contracts with the international banks, as was recently proposed by members of the national congress's Mixed Commission to Audit the Debt, this would constitute the necessary "shock of sovereignty" to enable the country to keep its distance from the rapidly approaching international financial crash.

Currency Rates

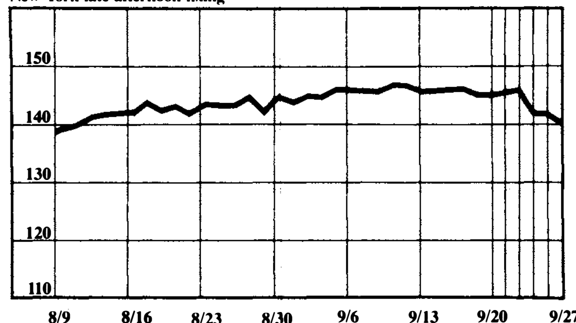
The dollar in deutschemarks

New York late afternoon fixing



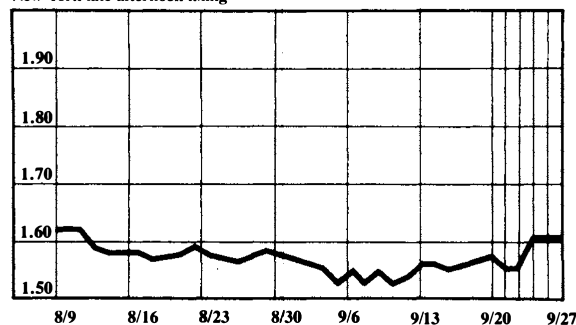
The dollar in yen

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing