Brazilian Economy: Milked, But No Sugar

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— Mario Simonsen, Brazilian Finance Minister to the Superior War College, July 9, 1977.

The Finance and Planning Ministers of Brazil felt themselves obliged to parade before the country's Superior War College three times during July to warn the Brazilian military against ideas of expanding the internal economy and of defaulting on Brazil's $30 billion foreign debt. Their unusual deployment bespeaks an angry armed forces reaction to a package of severe restrictions on internal and external credit announced at the end of June and to increasing bankruptcies of local businesses.

On June 23, monetarist Finance Minister Mario Simonsen rammed a package of credit cuts against industry and agriculture through the National Monetary Council. Simonsen did this by using the mandate for a "crusade against inflation" given him by President Ernesto Geisel. Inflation has increased by 46 percent during the past year, despite efforts to stop it by increased wage-cutting, cutbacks in the government capital budget, and restraining private-sector credit. But these monetarist remedies have only made inflation worse by pushing up the price of scarce credit and encouraging speculative use of capital while lowering productivity by forcing many sectors of the economy to operate far below capacity. Desperate anti-inflation gimmicks may be able to drive down inflation statistics for a few months, but at the cost of finishing off Brazil's fragile real economy and amplifiying the ensuing bust.

Behind the picture Brazilian officials and most foreign "experts" are painting a robust Brazilian economy based on the best export performance on record and the first balance of trade surplus since the 1973 oil price hike, the nation's real economy is rotten.

The record exports of $6.2 billion in the first six months of 1977 were a one-shot achievement. Aside from the freak high prices of coffee and soybeans during this period, all other Brazilian export sectors were flat; traditional exports such as shoes, textiles and iron ore showed substantial declines from the same period last year. Barring some unforeseen series of disasters in other producing areas, the prices of coffee and soy will

Chart I
Brazilian Trade
(millions of U.S. Dollars)

	Jan. - June 1976	Jan. - June 1977	% Change Value	Year 77 Brazilian Estimate	Year 77 EIR Estimate
Total Exports	4.409	6.204	+ 41	11.500 - 12.500	10.000 - 11,000
coffee	825	2.149	+160	4.200	3,000 - 3,300
soybeans	745	892	+ 20	1.900	1,300 - 1,500
iron ore	491	397	- 19	950	700
sugar	124	200	+ 62		
transport material	176	187	+ 6	800	400
shoes (Jan-Apr)	72	50	- 29		
Total Imports	5.763	5.961	+ 3	12.000 - 12,600	12,000 - 12,600
petroleum	1.853	1.850	0	3,560	
wheat	303	230	- 24		
non-ferrous metals	156	181	+ 16	430	
Trade Balance	-1,354	243		-500 to +200	-1,500 to -2,000

Sources: First half figures from *Cacex*. Brazilian estimates for 77 from many official and unofficial sources as of July.

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probably stay at or below current levels, which are just slightly over half their March peaks and insufficient to permit growers to recapitalize after a series of crop problems. And barring a sharp turnaround in current world tendencies towards domestic austerity and protectionism, Brazil's other mineral and industrial products exports will face even tougher market problems than they have until now. (See Appendix on Exports and Chart 1).

Monthly export levels will begin to fall in July, from the $1.2 billion achieved in May and June on the strength of pre-sold coffee shipments. A government committed to maintain a positive balance of trade has no choice but to slash imports — at whatever price. Finance Minister Simonsen explained to the military July 8 that the only method which can fight inflation while cutting imports is to "cool off demand."

What Simonsen and his mentors at New York's Chase Manhattan — which plays a substantial behind-the-scenes role in Brazilian economic planning — intend is a radical reduction in domestic consumption and capital investment in order to trim $2 billion or so off of Brazil's annual import bill. Until now the policy of "slowing down the rate of growth" has been implemented by using indexing to enforce 5 percent per annum reductions in real wages, by slashing consumer credit to force a 13.4 percent decline in middle class retail purchases, and by cutting government investment budgets by 20 percent per annum. If the forces captained by Simonsen have their way, these measures will be replaced by much more drastic depressionary policies.

Credit Policy: Tighter Money And Rescheduling of Foreign Debt

Simonsen intends to use continued reductions in real money supply as his major weapon for shrinking the domestic economy and thus cutting imports. Simonsen has a target of a 25 percent increase in the nominal money supply for the year. He is rigidly sticking to this target, despite the fact that inflation for the past year was almost double that rate. During the first six months of this year, the money supply exceeded Simonsen's 10.1 percent growth target by only 0.5 percent which means that real means of payment in the economy were cut by 12 percent.

At a bankers' conclave in Manaus on July 26, Simonsen told an audience including Robert McNamara and Johannes Witteveen that his constrictive policy was responsible for pushing June and July inflation levels down to 2 percent per month. At the same time, however, he announced that Brazil would "detour" from Keynesian theory in order to continue making credit scarcer still, despite the danger of causing a depression.

Simonsen launched his credit-cutting crusade on June 14 by ordering the Banco do Brasil to end loans through promissory notes and curtail the discounting of bills of exchange. Severe cuts of up to $1 billion in agricultural credits were announced, including the elimination of entire promotion plans.

Hard on the heels of this stifling of domestic credit, the government quietly implemented new regulations requiring a grace period of at least 30 months on the amortization of all new foreign loans, instead of the normal six months. The Brazilian press, including the semi-official *O Globo*, reported that the net effect of this measure would be to exclude medium-sized Brazilian borrowers from the international capital markets, while raising interest on large private and state sector companies.

The government lengthened the grace periods primarily in order to "improve Brazil's debt profile" by effectively postponing until 1980 payment of $3 billion in debts otherwise payable in 1978-79. Planning Minister Reis Velloso assured *Jornal do Brasil* that "there will not be an excessive accumulation in 1980. We are not placing any time bomb there. On the contrary,...those which should be due in 1980 will be put off until 81-82." (See chart number 2 for a projection of debt service requirements with and without the measure).

The "time bomb" may be much closer than 1980. A short-fall of perhaps $2 billion from expected export income, combined with this year's debt service of about $6.6 billion and more than another billion deficit on other service accounts would require a capital inflow of well over $9 billion in order to achieve a balanced balance of payments. During the first half of the year, however, Brazil pulled in only $2 billion in foreign loans and a negligible amount of net direct foreign investment. The Brazilian monetarists say they will seek another $4 or $5 billion in loans in the second half, which — if obtained — would still leave a shortfall of $2-3 billion. This could only be covered by running down reserves. A rapid drawdown of Brazil's foreign reserves, now somewhere between $5 and $6 billion, could, however, provoke a panic during the latter part of this year, with resulting flight of several billion dollars more of hot money and investments and the simultaneous closing of loan windows. That would put Wall Street's largest creditor into default. The confidence game is moving into end game, forcing the monetarists into last ditch gambles.

"Shock" Effects Are Felt

The late June credit cuts, especially those affecting agriculture, brought an immediate round of protests from farmers and predictions that the result would be a marked decline in 1978 production. Agriculture Minister Paulinelli, who *Veja* magazine reported had fought tooth and nail against even sharper cuts, toured the country trying to defeat what he labeled "the mood of pessimism" in agriculture. The protests and somber predictions increased after Simonsen's price setters increased the price support levels for various crops by 23.5 percent, only half of the inflation rate. There can be no doubt that the resulting reduction in agricultural credit and increase in farmer risk will lead to a marked decline in 1978 production, leading to inflationary shortages and the need to either increase food imports or starve the population.

Agriculture, once Brazil's pampered export sector, is already smarting under previous monetarist measures ending fertilizer and tractor subsidies, and putting them out of the reach of farmers. Farm costs have also been upped by increases of up to 1500 percent in the price of farmland caused by an orgy of middle class speculation.

Industry presents an extremely uneven picture. (See chart 3). While high priority import substitution industries such as steel, petrochemicals, cement, and capital goods have increased production through bringing new plants into production, traditional consumer production

Chart 2
Brazilian Debt Profile

(billions of U.S. dollars)

	1975	1976	1977	1978	1979	1980
Foreign Debt (Dec 31)	21.1	28.5	32.0	36.0	40.0	44.0
Interest Due	1.8	2.1	2.8	3.3	3.8	4.5
Principal Due						
(before)*	2.1	2.9	3.8	5.5	6.8	7.7
(after)**			3.8	4.6	5.0	10.6
Total Debt Service						
(before)*	3.9	5.0	6.6	8.8	10.6	12.2
(after)**			6.6	7.9	8.8	15.2

* before grace period change
** after grace period change

Note: 1975 and 76 are official figures; other years are EIR projections based on existing amortization schedule and a continued strong inflow of new loans.

Observe 1980 debt service "time bomb" which would occur if 30-month grace period requirement is not perpetuated.

Chart 3
Brazilian Internal Economy

PRODUCTION GROWTH **	JAN - MAR	JAN-JUNE
Motor vehicles	- 2.7	- 7.0
Passenger cars	- 12.7	- 7.5
Tractors	- 28.5	- 20.0
Steel ingots	+ 32.5	+ 23.6
Cement	+ 8.2	+ 9.0
Machines and Tools (Jan-Apr)	+ 1.9	n.a.
Manufacturing in general *	+ 7.0	+ 3.0

INDUSTRIAL EMPLOYMENT Sao Paulo job offers (S.P. Eco. Secretariat)	JAN - APR	
general	-21.4	n.a.
production workers	-18.4	n.a.

CONSUMER SALES	JAN - MAY	JUNE
Rio retail index	-8.0	-13.4
Sao Paulo retail index	-4.0	-12.0
Passenger cars	-8.0	- 8.0

* approximate
* * % over same period of 1976

industries have suffered production cutback and bankruptcies.

Sao Paulo recorded a record number of bankruptcies in April and the real value of defaults during the first five months was running 50-80 percent over last year's levels. Even President Geisel and some bankers admit that high interest rates, averaging about 60 percent on business loans, were a major cause of the bankruptcies. The Getulio Vargas Foundation reports that debt-equity ratios are still increasing, which makes companies vulnerable to the reduction in production levels sought and achieved by the monetarists.

Consumer spending in Rio and Sao Paulo stores edged progressively downward during the first half, to 13.4 percent below last year's level in June. And merchants see no relief in sight. Government spending on development projects, as reported in previous issues of EIR, has been sharply cut again this year, and more cuts are on their way. The steel program is being funded at 26 percent below its scheduled requirements, leaving Siderbras directors to debate whether to slow down all expansion or triage some projects. Industry Minister Calmon de Sá reported that in 1980 Brazil would have only 14 million of the 22.3 million tons of steel capacity programmed in the Second National Development Plan, which will leave the nation as a major steel importer. The triaging of highly reproductive investments, even in priority areas such as steel and chemicals, shows the utter desperation of monetarist managers who are seeking savings now at the expense of gravely aggravated future accounts deficits.

With government budget cuts slowing down or eliminating major projects and industrial expansion reaching an end, the construction industry is undergoing demolition. Its problem is compounded by delays of up to a year in obtaining payments for work done for the government, a problem which brought protests from even James Hammond of the Council of the Americas.

Under the pressure of tremendous resistance from pro-

ducers and their friends in the military, the monetarists backtracked slightly on their June 23 program. They opened a few loopholes to soften the "shock" effect of their measures, and the entire cabinet was paraded around the country to offer reassurance. But then at the end of July, they renewed the offensive by slashing farm price support and government project levels. As the economic difficulties of Brazil continue to mount, all pretenses of tact and moderation will tend to vanish.

Persuading The Military

The fact that all currently strong factions of the Brazilian military are obsessed with "state security" and accept the brutal social and political implications of that doctrine need not be cause for complacency by Brazil's creditors. In the face of today's prospects of austerity undermining the economic machine which makes Brazil the leading economic and military power on the South American continent, even the most obtuse and apolitical military could well regard the debt problem as a threat to "national security."

Velloso and Simonsen made pilgrimages to the Superior War College on July 8 and 9 to try to ram some monetarist economic "theory" into military brains. Velloso responded to probable military demands that Brazil's past rapid economic growth be continued,by warning that classical import-substituting "desarrollismo" requires "the proletarianization of society" and "state ownership" of everything. Simonsen picked up from there by decrying calls for "the strengthening of the internal market" as "one of the many exotic theories which governments are obliged to refute in moments of crisis... The expansion of internal markets would simply bring Brazil to international insolvency (default-ed.)."

"The balance of payments must be balanced by hook or by crook, and an adjustment through insolvency would lead Brazil into a catastrophic crisis, not only of national credibility, but also of production and employment as a result of the inevitable rationing of essential imports," claimed Simonsen.

OPEC Connection A Way Out?

In his speech Simonsen went on to blame the OPEC countries for Brazil's balance of payments and debt problems. But it is precisely the OPEC countries which could provide a bridge between Brazil and a New World Economic Order.

The admonitions of Simonsen and Velloso against economic expansion and default show that some officers are seeking ways of halting economic triage and the debt which requires it, while guaranteeing non-Rockefeller sources of petroleum and other essential imports in order to avoid the retaliatory blockading of imports threatened by the banks and their local agents. Economic complementation deals such as the proto-barter accord signed with Iran June 21 could provide such an option to Brazilian nationalists.

The Brazil-Iran agreement provides for Brazil to purchase from Iran $1 billion worth of oil or 25 percent of Brazil's oil imports whichever is less in each of the next five years. Iran, in return, will purchase goods and services from Brazil or make investments in Brazil equal to at least 30 percent of each year's oil purchases. It is expected that Iran will purchase technology and manufactured foods in addition to large quantitites of soy, iron ore, and other raw materials.

Petroleum Intelligence Weekly (PIW) reports that Brazil is now negotiating similar proto-barter deals with other oil exporters, including the Soviet Union, Mexico, and Indonesia. In these cases the Brazilian exports could come from problem sectors of the economy such as shoes, iron ore, and machinery. The Mexican state oil company (Pemex) has just opened an office in Brazil to facilitate its relations with its Brazilian counterpart, Petrobras. PIW informs that the Soviets are also anxious to increase trade with Brazil.

Top Arab Development Fund and Saudi financial officials recently toured Brazil to study possible participation in a dozen major development projects, according to *Washington Forum Newsletter*, a Rothschild-linked operation. The same source says that the Saudis have already agreed to put $50 million into Brazil's state electricity company and that "this is only the beginning."

Rothschild interests are openly pleased by the prospects of large volumes of Arab money flowing into Brazil. These bankers *claim* they are the brains behind the Arab money and that they can use it to pay Brazil's debts and save the Eurodollar market, while buying out control of Brazil from Rockefeller's New York banks. They fear the potential of Arab independence. From a position of financial control, they would try to prevent Brazil from using complementation deals as back-up for dumping its debt.

The head of the N. M. Rothschild clan, Leopold, paid a long visit to Brazil recently and has just opened a bank there. Leopold reminded the press that his family has been financing Brazil since its independence in 1822 and that they are now lead bank on over $1 billion in Brazilian debt.

The new bank is an operation worthy of the Rothschild rag merchant tradition. Interconsult is a low-overhead job with a capital of only $7 million in joint venture with the Banco do Comercio e Industria de Sao Paulo, a local Rothschild agent. Its ostensible reason for being is to help foreign manufacturers get "Made in Brazil" labels for their sales to Brazilian markets, so as to meet import substitution regulations. But its real function will be to arrange "marriages of convenience" between local firms made desperate for liquidity by the credit crunch and international scavengers with some ready cash. This business could give the Rothschild group the inside track on taking over Brazilian industry at bargain prices and on influencing government policies, as well as making no-risk profits.

U.S. multinationals have recently made heavy investments in Brazil and are bracing themselves to weather the economic collapse. While tractor producers can be heard muttering about pulling out, other industrial combines are banking on being able to monopolize shrinking markets by driving their local competition out of business. The Planning Manager of an American multi with textile operations in Brazil told EIR: "Some of those weak companies will have to sell out or just fold. But it's good for those that remain."

Will the Brazilian military swallow this?

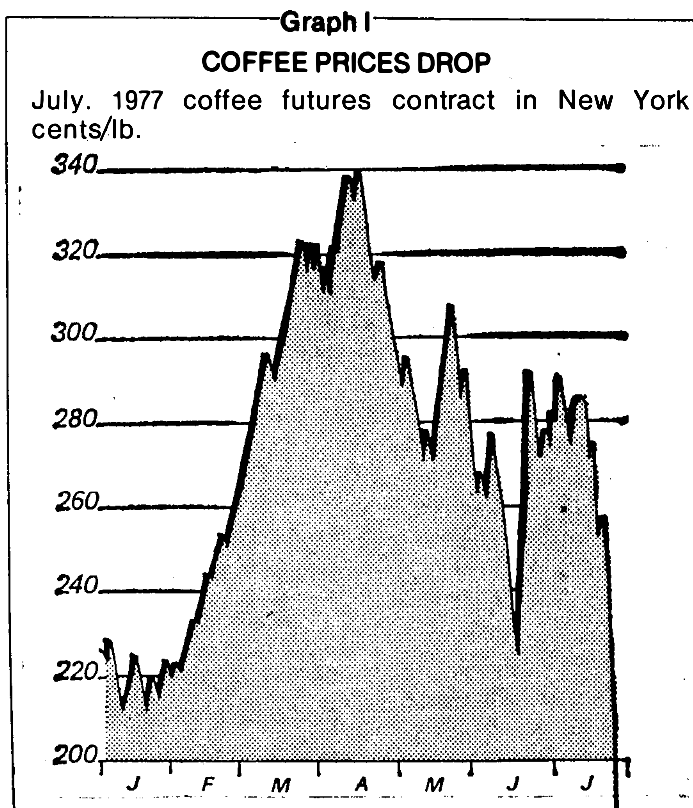
APPENDIX:

Brazilian Export Situation

COFFEE: During the first six months of 1977, Brazil exported 8.5 million sacks of coffee. Coffee earnings of $2.149 billion were 160 percent more than those of the same period last year. This record windfall was responsible for over 70 percent of the nation's overall export improvement between the two periods.

Brazil has not sold a single bean since April when the world market price dropped far below the minimum price at which exports are permitted by the government. The July contract closed at $1.67 per pound, well under half of its price in March.

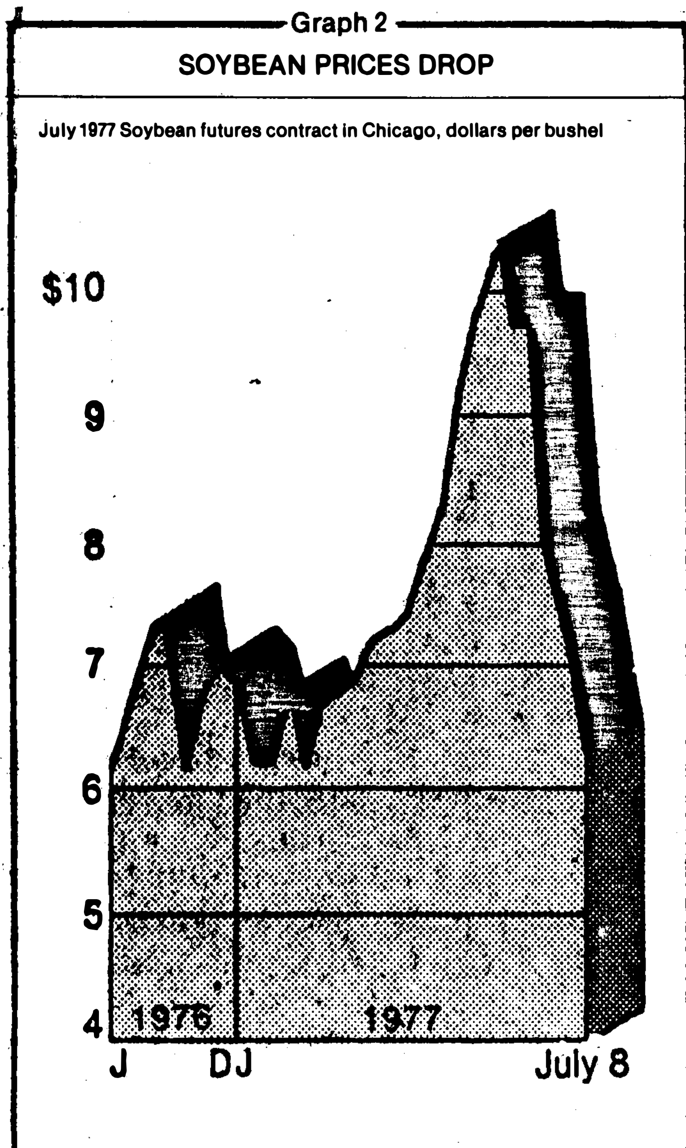
There are doubts whether Brazil even has enough coffee for internal consumption until the new harvest comes in in September. Even then, *Money Manager* estimates that Brazil will only have about 3.8 million bags available for export during the remainder of the year. This would bring in at most $800 million, which would leave Brazil's coffee exports for the year about $1.2 billion short of the $4.2 billion target still projected by Simonsen.



Graph I

COFFEE PRICES DROP

July. 1977 coffee futures contract in New York cents/lb.



Graph 2

SOYBEAN PRICES DROP

July 1977 Soybean futures contract in Chicago, dollars per bushel

SOYBEANS: In contrast to the empty coffee warehouses there is plenty of soy piled up on the farms, but only a third of the crop was sold before the bottom dropped out of the market in April. The story of how Brazil lost out on the end of the soy boom is a classic. When the prices began dropping close to the $300 per ton level in late April, Brazilian farmers stopped selling, since they had been promised that the 12 percent export tax would be reduced when the price fell below that level. The tax was finally reduced to 7 percent and then 4 percent in July, but by then Rio Grande do Sul farmers alone had lost $250 million in export value. The U.S. harvest is coming in September and each shower in the Midwest knocks a few dollars off the present $230 per ton price. Things look bleak on this front.

ORANGE JUICE AND CACAU: Brazil always seems to come up with a new miracle export whenever its previous boom collapses, but neither of these two will pay the debt. Despite the Florida frost, orange juice brought in only $36 million in the first five months of 1977. Cacau prices are now skyrocketing, but a big part of the reason is that 25 percent of Brazil's crop has been destroyed by pod rot, says *Financial Times.* Brazil has been equalling last year's export value on half the volume.

IRON ORE: Brazilian exports are far under last year's in value and even more in volume. Continued cutbacks in Japanese and Italian steel production will push Brazilian ore exports down still further. The huge Carajas project, which would double Brazil's ore export capacity, has now been abandoned. The only bright spot are the proto-barter deals involving iron ore for oil, one signed with Iran and another being negotiated with Mexico.

MANUFACTURED GOODS: The official statements that exports of industrialized products are running 20 percent above last year's value sounds very nice — until one finds that the entire increase is attributable to higher prices for instant coffee and soy meal. There are important increases of 43 and 21 percent in some machinery categories, but transport equipment is stagnant, and light manufactures are being badly hit by worldwide real wages cuts and protectionism. The shoe industry suffered a drop of 40 percent in export volume and 30 percent in income during the first five months, and most textile categories were down 13-39 percent. The semi-official daily *O Globo* shares our pessimism about future prospects.

When you put this picture together, it is hard to see how exports could provide the $12-$12.5 billion needed to equal the government's projected import level. On the contrary, exports will probably fall in the $10-11 billion range, barring unforseen developments.

—Mark Sonnenblick