Click here for Full Issue of EIR Volume 29, Number 39, October 11, 2002

Brazil *Is* Going to Default, No Matter Who Wins the Elections

by Gretchen Small

Admittedly, competition for "Greatest Threat to the System" was fierce at the annual International Monetary Fund/World Bank meetings Sept. 27-29, what with the state of the Japanese banking system, the United States' current account deficit, and the great mortgage debt bubble. Still, the looming default on Brazil's $500 billion worth of foreign obligations was among the hottest of the topics dominating the nervous discussions among the bankers, speculators, government officials, and hangers-on who gathered in Washington, D.C. for that event.

Just this past Aug. 7, the IMF had announced its largest single bail-out package for any country, ever: a $30 billion loan agreement for Brazil, $24 billion of which would be disbursed in 2003. The package, at least $10 billion larger than expectations, was designed to "calm the markets," and keep Brazil's debt solvent through the transition to the new administration which takes office on Jan. 1, 2003. Public pledges of support for the conditionalities attached to the IMF bailout were then extracted from the leading Presidential candidates, including from Luiz Inácio "Lula" da Silva, whose possible victory has been widely trumpeted as the cause of Brazil's financial troubles. (Lula and his Workers' Party [PT], a leading force in Teddy Goldsmith's "anti-globalization" World Social Forum, have spent most of this campaign promising to play ball with "the markets," and cutting deals with foreign and domestic bankers.)

Seven weeks later, Brazil is blowing out again, and the feared "D" word—*default*—again dominates discussions of Brazil. Financiers are demanding that more money be pumped in—lots more—so that they can in turn suck it out of Brazil in the form of repayments and/or capital flight.

$63 Billion Bailout Enough?

Thirty billion dollars doesn't give Brazil much of a cushion, Britain's Fitch rating agency analyst Roger Scher told one of the conferences which followed the IMF/World Bank meetings. For Brazil to avoid default, the IMF may have to come up with as much as *$63 billion* in 2003, he calculated. Governments can't say no, either, Inter-American Dialogue President Peter Hakim threatened. "Brazil is one of those countries that could knock everyone's cart off balance. The IMF can't just sit back and say, 'We've done the best we can do.' "

Not even $63 billion, however, will keep Brazil from defaulting—and the financiers know it. Brazil's debt is unpayable, no matter who is elected as the next President this October. Whoever it is, will face a crisis the likes of which none of the candidates has given any indication they are prepared for. The way things are shaping up globally, Brazil could be forced to default—even before the new President takes office in January—when, as happened to Argentina in 2001, they simply do not have the reserves left to service the debt.

The message delivered by the financiers during the IMF meetings was straightforward: We're getting out of Brazil, and we want public monies, either governments or international financial institutions, to cover our exit.

The only question remaining is a political one. Will Brazilians allow the creditors and speculators to strip the country until it begins to break down, as happened to Argentina, before a default is proclaimed? Or, will Brazil impose exchange controls, declare a debt moratorium, and call for other nations to join it in forming a New Bretton Woods—while they still have something left upon which to rebuild? Either way, the debt will not be paid.

U.S. Presidential candidate Lyndon LaRouche warned during his June 9-15 visit to Brazil, that the entire world financial system could blow out during the two to three months to come, if governments did not put it through bankruptcy reorganization. What is happening in Argentina was "a *warning,*" of what faced every nation, including Brazil, he told Brazilians.

The crisis in Brazil was then just beginning to hit. By the end of July, as LaRouche had warned, Brazil stood at the brink of an Argentine-style meltdown. Capital flight drove Brazil's currency, the real, down by 18% in July, to a record low of 3.46 to the dollar; and its country-risk soared to nearly 24% over the U.S. Treasury bond rate. Top captains of American companies operating in Brazil met with Treasury Secretary Paul O'Neill when he visited Brazil on Aug. 5, and told him that an economic collapse of Brazil would "hammer U.S. banks, U.S. corporate profits, and U.S. stocks." Two days later, O'Neill, who only days earlier had derided IMF bailouts for filling corrupt officials' Swiss bank accounts, was singing the praises of the IMF's $30 billion bailout.

LaRouche dismissed the $30 billion as a bluff by a Washington which had no idea what to do. The last thing to do,

© 2002 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

Lyndon LaRouche warned Brazil, during a visit there in June 2002, that the crisis in Argentina was a warning of what Brazil itself woulf face within two to three months.

he said, is to throw another "wall of money" at a gigantic speculative bubble, thus worsening the hyperinflationary explosion to come. The only way to stop the national, and perhaps even greater international chaos that would follow a blow-out of a debt the size of Brazil's, is to "freeze everything, . . . freeze the unpayable debt," he said. "Then you have to go to a fixed exchange rate, which you defend with exchange controls and capital controls. . . . With that in place, you then activate domestic credit mechanisms to keep the nation's vital real economy alive."

The Longer It Goes. . .

LaRouche was right. The IMF package barely got Brazil through August. September was a re-run of the July crisis, only worse. Brazil now heads into October in a much worse situation than July: its debt is larger, of shorter maturity, and more of it is tied to the dollar; it has fewer foreign exchange reserves, a further looted domestic economy, and a far-weaker currency (around 3.7 reals to the dollar on Oct. 3, after wild plunges, fluctuations, and government support operations).

Every measure taken by the Central Bank to maintain the pretense that the debt is still "performing," has worsened the problem. Brazil's bonds were selling for less than 50¢ on the dollar by late September, with usurious yields in the 25% range. The Central Bank's "solution" has been pitiable: to sell short-term paper, of only months' duration, in exchange for bonds coming due between 2004 and 2006, because the bondholders are otherwise simply dumping them on the cut-rate market for dollars.

To entice capital to keep buying Brazilian domestic debt, the Central Bank has been selling bonds indexed to the dollar (in which the government absorbs the effect of any devaluation), or bonds with floating interest rates (which guarantees the maximum rate of usury available for the bondholder). Eighty percent of Brazil's domestic public debt is now either tied to the dollar, or carries floating interest rates. With the country's benchmark interest rate set at 18% for months, the cost of servicing the debt is phenomenal.

The dollar-indexed debt, however, is even more insane. This is the precisely the same "Tesobono" mechanism which blew out the Mexican peso in late 1994; (and a similar indexing finished off the Argentine peso by last year). Mexico's Tesobonos totalled some $30 billion, when they blew out. The Brazilian domestic debt is now at over 1.1 trillion reals, equal to about $300 billion at today's exchange rate, and the going estimate is that 45% of it is now held in dollar-indexed bonds—up from 40% just last July. Brazil's public dollar-linked *domestic* debt, thus, is at some $135 billion—four and a half times larger than Mexico's Tesobono bubble. These are de facto foreign obligations, although official figures don't report them as such.

It is this mechanism which has built in a hyperinflationary rate of growth of Brazil's debt, and made it arithmetically unpayable. As the real devalues—it has lost almost 40% of its value in 2002—the value of the *dollar*-indexed debt increases proportionally, automatically, without Brazil doing a thing, or receiving a penny! The total public debt grew, for example, in July by 9.8%, because of this. According to Bloomberg wire service's calculations, for every 1 centavo drop in the real, Brazil's debt increases by 3.5 billion reals—nearly $1 billion at today's exchange rate.

The Ever-Present Argentine Mirror

The financiers are already banking on a Brazilian default. George Soros and Citigroup Vice Chairman Stanley Fischer were among the heavyweights who said so publicly, during the round of IMF-associated meetings. The issue really being discussed, was—as Templeton Asset Management's Mark Mobius put it in a Sept. 24 interview with Bloomberg wire service—"There is going to be a default. The only question now is: Can it be done in a controlled manner?"

The answer is: only LaRouche's way. Capital is fleeing generally out of "emerging markets" (as the nations of the developing and former Comecon nations are now called). A World Bank economist reported during the IMF confab, that the bank projects international private capital flows to Ibero-America will be 64% less in 2002 than the year before—i.e., only $25 billion or so will enter Ibero-America. The bank

calculates that private foreign capital going into the "emerging markets" overall, is running 22% less than last year.

The concern of the officials meeting in Washington was not Brazil, or Turkey, or any of the other debtors, but how to ensure top financiers get their money out, before the entire asset class of "sovereign emerging market debt" disappears. This will happen if Brazil defaults, Merrill Lynch analyst Tulio Vera reminded a Washington seminar. Thus, the various competing proposals—each more psychotic than the next—placed on the table at the IMF meetings by the U.S. Treasury and the IMF, for how to streamline bankruptcy procedures to maximize centralized control over the collapse. None of these proposals will work, but they do serve as an admission that bankruptcies are the order of the day.

In Brazil's case, the game had been, until July, to keep rolling the debt over, as it comes due. But, as the government and corporations found in September, "the market" is no longer willing to buy Brazilian paper. That means, they either pay them off, or default. Several large Brazilian corporations did default on payments due in September, "rescheduling" them with their creditors. The government had to pay off 57% of the dollar-indexed loans which came due, and could not get investors even to renew $8 billion in currency-hedge contracts which came due, because "investors" preferred to hold dollars.

Shutting Down Economic Activity

As more comes due, where will the money come from to pay the debt off? Reserves are finite . . . and diminishing. The Central Bank spent some $700 million in three days at the end of the month, to keep the real from dropping to 4 to the dollar. The government, like Argentina before it, has already gutted expenditures, in order to free up tax revenues for debt payments—simply not disbursing at least $10 billion worth of planned government programs in 2002. Brazil's participation in the International Space Station was cancelled, as were key river-dredging projects, a plan to create a national network of health clinics, needed national highway repairs, and on and on. Even basic yearly service for Army draftees was cancelled.

As uneasy Brazilians watching Argentina are constantly reminded, gutting the physical economy of the nation to pay an unpayable, usurious debt, is not a viable path to solvency, but rather leads to a Dark Age, to starvation, and death. Brazil, while still maintaining high-technology economic capabilities, has far greater portions of its population already living in abject poverty than Argentina had, before the spectacular *physical* implosion of the latter's economy over 2000-2002.

Today, thousands of desperate Argentine workers are seizing bankrupt companies to try to keep them operating—even if that means working for only 7¢ an hour, a hot meal, and a place to sleep—because their only other choice is to steal, to join the 40,000 people scavenging off garbage dumps, or to starve to death.

U.S. Credit Market Debt Grows by Record Amount

by Richard Freeman

American indebtedness exploded in the second quarter of 2002, taking the U.S. debt bubble to unprecedented, and unsustainable, heights. The leading sectors increasing their debt load were the Federal government, households, and financial businesses. Throughout the economy, this debt is papering over existing debt, feeding the housing bubble, and letting households and productive non-financial businesses survive. Lyndon LaRouche has warned that this process—led by Federal Reserve Board chairman Sir Alan Greenspan—is creating the basis for a powerful Weimar-style hyperinflationary explosion to shatter the world financial system.

U.S. total indebtedness combines three sectors: 1) business debt (the combined debt of non-financial and financial businesses); 2) household debt (combined household mortgage, credit card, and installment debt); and 3) Federal, state, and local government debt.

The Federal Reserve Board of Governors, which does most of the reporting of U.S. indebtedness, only reports debt on a "credit market basis," which represents nine-tenths of all debt. "Credit market debt" is that debt which can be purchased and sold freely on the credit markets. However, there is also "non-credit market debt." The U.S. government issues both credit market and non-credit market debt; the latter consists of special U.S. Treasury securities, which cannot be bought on the open market, and which are bought by U.S. government trust funds, principally the Social Security Trust Fund.

Table 1 zeroes in on U.S. credit market debt, and its major components. The table shows that total U.S. credit market debt increased from $29.234 trillion to $29.846 trillion from the first to the second quarter, a rise of $612 billion. But the Federal Reserve Board of Governors annualizes the quarterly data; that is, were the second quarter trajectory to continue for a full year, that second quarter increase rate would swell total U.S. credit market indebtedness by $2.448 trillion. *This would constitute the largest annual increase in U.S. credit market debt in history.*

There are three major components which drove overall credit market indebtedness higher. During the second quarter, U.S. Federal government borrowing increased by more than $112 billion—when annualized, it comes to a gigantic $451 billion increase. **Table 2** shows that the Federal government borrowed 11 times more during the second quarter 2002, than