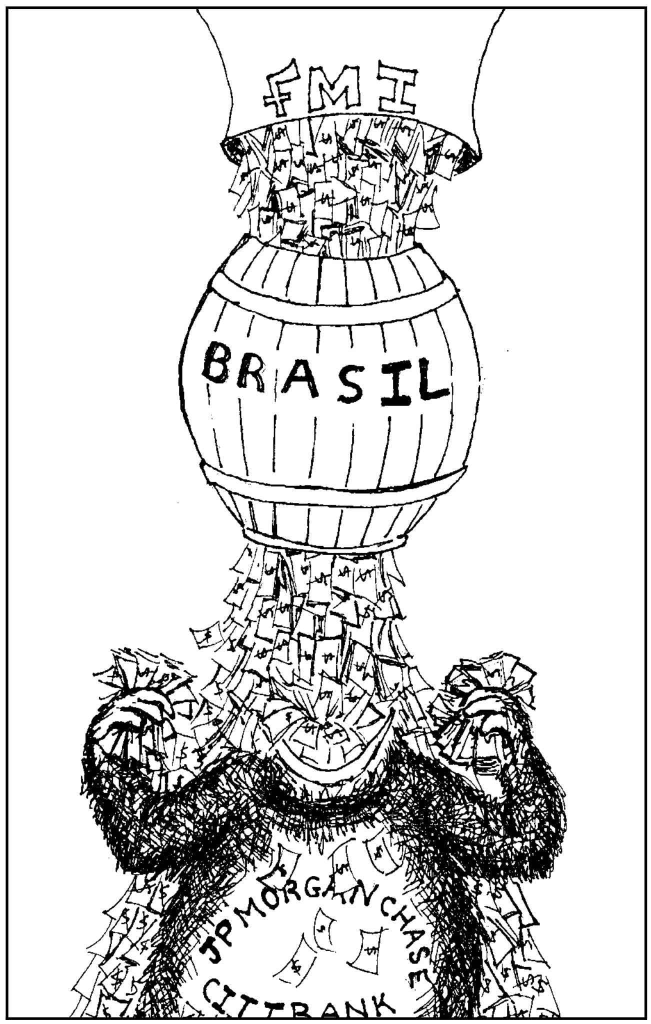
EIR Economics

Creditors Are Bleeding Brazil Even Drier Than Argentina

by Gretchen Small

Brazil has enormous natural and human resources, which, if mobilized for an aggressive national reconstruction project, could transform that nation into one of the most productive nations on Earth. But it is heading straight towards general default and the collapse of its banking system and national economy, repeating what happened to its neighbor, Argentina—despite the Aug. 7 announcement by the International Monetary Fund of an unprecedented $30 billion bailout of Brazil's creditors. The government of President Fernando Henrique Cardoso hysterically refuses to face up to the fact that the international financial system to which it has tied Brazil's fate, is far more bankrupt than Brazil itself.

Growing desperate, the Brazilian President, a sociologist trained at France's infamous Sorbonne, called the crisis a psychological problem. Speaking to businessmen on Aug. 21 during a visit to Uruguay, Cardoso argued that persons afflicted by "cognitive dissonance . . . do not perceive what is happening. There is actually a disconnect between what is happening, and what is reported and is perceived as what is happening." But he would not see himself in his own mirror, charging that it is "the markets" which suffering "cognitive dissonance," because they perceive that Brazil is a country in an economic crisis! Sounding like U.S. President George W. Bush, Cardoso insisted the fundamentals of his nation's economy are sound, and those who say otherwise must change their perceptions.



Facing a Rigged Game

While the government limits itself to begging for better "perceptions," and refuses to impose the capital controls necessary to defend the country's continued existence, Brazil is being bled dry. Foreign financiers know that the debt cannot be paid, and the country will have no choice but to default. They are working on getting out as much capital as they can, constrained only by their concern that the pull-out not be so disorderly that the Brazilian financial pyramid collapses before they have gotten out. Were there any doubts of the financiers' intention, the so-called "country risk" rating (see box) reveals them. On Aug. 21, Brazil's country risk was hiked yet further, to hit 2,300 basis points. That rating, alone, assures default will occur.

EIR warned Brazilians this would happen. Addressing a seminar organized around U.S. Presidential candidate Lyndon LaRouche's June visit to São Paulo, Brazil, *EIR* Ibero-American editor Dennis Small warned of precisely this danger on June 14, when Brazil's country risk rating was hiked to 1,300.

"People don't want to recognize it, they don't want to see it, they don't want to admit it. There is a gigantic elephant in the kitchen," Small said. "The problem here is that no one wants to believe that Brazil, in three weeks, could be in Argentina's situation. . . . How? Very simply: In four days Brazil's country risk could rise, not to 1,300, but to 2,500. Moody's, Standard & Poors, and Fitch change the country risk of Brazil. How? Just because the international rating companies decide to do it. And what happens? In three seconds, the total budget of the Brazilian nation blows up, because it's all tied to interest rates, and the interest rates are tied to the country risk. What is country risk? Country risk is whatever the owners of the financial cancer wish to say it is. And in six weeks, there is no national budget left."

Chronicle of a Death Foretold

It is remarkable that months later, the Brazilians continue to let the game go on. Bloomberg wire service reported that "bankers said the IMF's announcement of a $30 billion loan package to help Brazil avert a debt default isn't sufficient to persuade them to loosen their purse strings," and they would not renew loans to Brazilian borrowers. BCP Securities's much-quoted Walter Molano told Argentine daily, *Clarín*, that the IMF package won't work, and he recommends that investors "should sell everything now." Morgan Stanley issued a similar report, titled "Bearish on Brazil." The New York Council on Foreign Relations's Latin American man, Robert Maxwell, told *Folha de São Paulo* that the IMF's $30 billion aid package, at best, could put off the collapse of the Brazilian economy a few months, and it ensures that the bankruptcy will be that much worse for both Brazil and the IMF.

Brazil now finds itself unable to roll over much of its debt. The Central Bank was only able to roll over 65% of the $2.5 billion of public debt which came due in the week of Aug. 12-16, even though it offered a record rate of 30.17% a year on 47-day bonds! *Jornal do Brasil* noted on Aug. 15, that

LaRouche Hits 'Country Risk Ratings' as Corrupt

This press release was issued by the LaRouche in 2004 Presidential campaign committee on Aug. 17, 2002.

Lyndon LaRouche today condemned the fact that the U.S. and other governments regularly intervene to enforce private agreements and conditionalities, as part of the process of debt negotiations with developing sector nations. LaRouche, the renowned economist and 2004 Democratic Presidential pre-candidate, singled out country risk ratings as a transparent example of such corruption.

"For example: take country risk ratings, which are a key factor in debt negotiations, and which are a purely private-interest evaluation of the supposed credit-worthiness of a nation," LaRouche stated. "But governments are using that, through the International Monetary Fund, and they are imposing it as if it were law. So here you have governments being used to defend purely private interests—this is a clear case of corruption. The use of government, or of IMF conditionalities—which is essentially the same thing—to impose private conditionalities on countries such as Brazil, is a case of corruption of government, and corruption by the IMF."

The country risk rating is an index which purportedly measures the percentage points above the going interest rate for U.S. Treasury bills, which foreign lenders demand of a given country as a premium for the "risk" involved in extending that country a loan. The country risk rating is calculated exclusively by J.P. Morgan Chase—the major U.S. bank, that is itself skating at the edge of default, according to reliable financial sources!

For example, Brazil's country risk currently stands at 2,200, meaning that the Brazilian government is forced to pay usurious interest rates 22% greater than the rate on U.S. Treasuries, for any bonds that it issues. The *Financial Times* of London earlier this week reported that, if Brazil's country risk remains at 2,200, there is no conceivable way that it can avoid defaulting on its enormous debt bubble. The *Financial Times* suggested that the only way to lower the country risk, was by reestablishing "investor confidence," which in turn required that all of Brazil's major Presidential candidates for the October elections sign on to the terms of the IMF's recent $30 billion bailout package granted to Brazil's creditor banks.

This is a typical case of the kind of corruption LaRouche denounced.

that is more than double the interest which the Argentine government offered on similar paper a year ago, only months before its default.

Brazilian private corporations are in the same boat, and they hold a foreign debt estimated at $120 billion, more than the $95 billion in official foreign debt which Argentina defaulted on in December 2001. All eyes are on Eletropaulo—the main electricity distributor for the city of São Paulo, the third largest in the world—today owned by U.S.-headquartered AES Corporation. Eletropaulo met a $120 million bond payment Aug. 21 only because the state-owned National Economic and Development Bank (BNDES) provided the cash. Where Eletropaulo will get $225 million for a loan coming due on Aug. 26, is unknown.

In their stampede out, the foreign banks are cutting off even trade credits for Brazil's companies. Central Bank President Arminio Fraga claims that trade credits have been cut by 20%, but most private sources report the cuts have been by far more than 50%. Exporters say that trade credits have dropped from $16 billion to $5 billion, Brazil's *O Globo* reported Aug. 20. Those being offered have much shorter maturities and prohibitive interest rates. According to Roberto Segatto, President of the Foreign Trade Association, interest rates have risen from their pre-crisis levels of 3-4%, to an average of 12%.

Desperate to extend the game a bit longer, Fraga and Treasury Minister Pedro Malán succeeded in scheduling—with some difficulty—a personal meeting with top representatives of 10-12 U.S., European and Asian banks on Aug. 26, in the offices of the New York Federal Reserve. The IMF will likely send a representative. Their stated goal is to convince the banks to restore credit lines, and give a "signal of confidence" in Brazil. Should their request be refused, the result could be an uncontrolled stampede by foreign money from Brazil.