

Brazil's 'Real Plan' masks hyperinflation

by Lorenzo Carrasco

The decision by the Brazilian government to inject enormous amounts of liquidity into the economy, especially starting last November with the crash of the "Asian Tigers," was a desperate effort to forestall a chain reaction of bank bankruptcies. But it could easily lead to a hyperinflationary explosion in the very near future, an explosion which would lay bare the perverse nature of that monetary stabilization plan known as the "Real Plan," named after the Brazilian currency, the *real*. The only way such a scenario could be averted would be if a major earthquake in the world financial markets were to overturn the Brazilian economy, and, with it, President Fernando Henrique Cardoso's re-election aspirations for this coming October. As U.S. economist Lyndon LaRouche has indicated, Brazil is a probable candidate, after Russia, to be hit by the next round of the world financial crisis.

Putting out the fire with gasoline

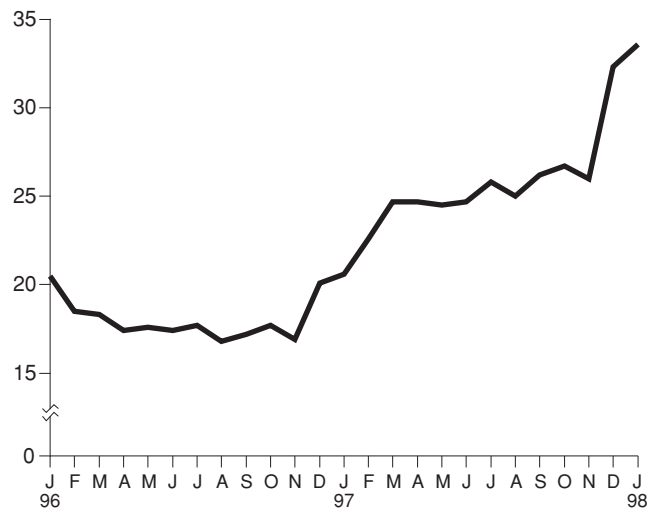
Following the panic of last October and November, when more than \$10 billion in foreign exchange reserves fled the

country and Brazil was staring bankruptcy in the face, the Cardoso government succeeded in restoring "confidence" to speculative capital by offering interest rates of more than 40% a year, imposing dramatic cutbacks in the government budget, and promising to deliver over the nation's communications and energy assets, including the state oil company Petrobras, through privatization. By these means, Brazil had raised reserve levels to \$60 billion by February, back to where they were before the Asian economic meltdown in October 1997.

This process of super-high interest rates and budget slashing did not trigger another wave of bank bankruptcies, only because the government used the Central Bank to inject massive amounts of liquidity into the banking system. As can be seen in **Figure 1**, the growth of the monetary base—which measures all financial paper issued as well as banking reserves—was 63% between January 1997 and January 1998, going from 20.6 billion to 33.5 billion *reals*, equivalent to a little less than \$30 billion (the exchange rate today is approximately 1.1 *reals* to the dollar). The greatest injection of liquidity occurred at the start of the Asian crisis last November, when the monetary base grew nearly 30%. This tidal wave of liquidity was used especially to increase bank reserves, which increased by 200% in the course of the year.

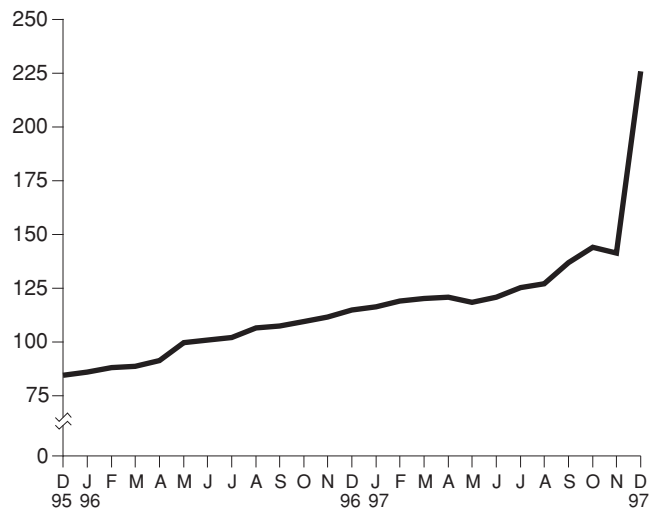
The mechanism employed by the monetary authorities to get funds to back this injection of liquidity, was to issue national treasury bonds. One result of this insanity can be seen in **Figure 2**. In January 1997, the total emission of treasury bonds reached 116.3 billion *reals*. During 1997, this emission grew 94%, reaching a record 225.7 billion *reals* by December (equivalent to \$190 billion). Obviously, the most dramatic

FIGURE 1
Brazil: growth of monetary base
(billions of reals)



Source: Central Bank.

FIGURE 2
Treasury bonds outstanding
(billions of reals)



Source: Central Bank.

change occurred in November, when it grew 59% in one stroke.

This, of course, is public debt, and it is growing like a cancer. A large portion of it comes due every 60 days, and the national economy cannot sustain it.

The un-real plan

As we have repeatedly explained, the Real Plan, launched in June 1994, is little more than a monetary ruse. It disguises the ongoing hyperinflationary process, by deferring the impact of the costs of the soaring financial and banking pyramid through constant increases in the rate of growth of public debt, and by increased looting of the physical base of the national economy. Stated another way, these monetary mechanisms have created a dam to contain a growing hyperinflationary potential, but whose future collapse will wipe out the national economy and public finances.

The idea of the Real Plan from its inception was to create a fiction of currency stability, a “subjective” stability, transferring the process of global indexation of costs to indexation of purely speculative financial costs. This was achieved through two ruses: first, through the overvaluation of the *real* relative to the dollar, which today stands at around 30%; and second, the precipitous rise in interest rates, which presupposes “sterilization” of the currency by taking it out of circula-

tion with attractive interest rates. As of 1995, Brazil had already won the distinction of having the highest interest rates in the world. For example, today, the government is paying 30% interest to place its bonds on the financial market; private companies pay 76% for working capital; and, private individuals pay 247% for personal loans or credit cards, while the annual inflation rate is around 7%.

Through these cruel means, monetary stability—the *real*-dollar exchange rate—is made to depend on the massive entrance of foreign capital into the country. In this sense, the Real Plan is comparable to “convertibility” in neighboring Argentina.

Under this policy of very high interest rates and a radical trade opening, the physical economy of the country has contracted dramatically, through a massive transfer of resources to the financial sector. For example, growers, who saw the price of their products arbitrarily frozen, suffered an increase in the cost of their inputs by 30-40% in the past two to three years, not to mention the increase in financial costs. It is estimated that this transfer of resources is on the order of \$40 billion, minimally, in the space of a little less than three years. This brought about the shutdown of hundreds of thousands of productive rural enterprises—*de facto*, a reduction of 31% of these establishments—and eliminated 400,000 jobs directly, and more than 1.5 million indirectly.

The industrial sector, especially that based in the state of São Paulo, also finds itself in a state of bankruptcy. More than 300 important private companies, in the most diverse areas, have passed into the hands of foreign capital, while more than 450,000 industrial jobs have disappeared in São Paulo alone, where unemployment as of the end of 1997 had reached an historic level of more than 8%. This does not even include the more than 20% of the economically active population who subsist in a state of underemployment. In the past two months, industrial decline reached 6.5%. At the same time, the number of São Paulo businesses undergoing bankruptcy reorganization grew by 170% from February of last year to February this year. There are more than 5 million instances of overdue loans to business customers.

As a reflection of the economic calamity, the Brazilian government in 1997 produced a fiscal deficit of more than 5% of Gross National Product, despite record-high tax collections, which will be difficult to replicate because of the wave of bankruptcies.

Consumption bubble

Despite the physical destruction of the economy, the government presents us with a picture of apparent growth, mainly induced through the injection of consumer credit. For example, from January 1996 through November 1997—that is, 20 months under the Real Plan—total credits from the financial sector to the private sector grew by 27%; credits to the industrial sector grew 30%; to the rural sector, 7%; to the trade sector, -2%; to housing construction, 12%; and to individuals,

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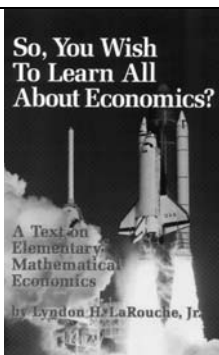
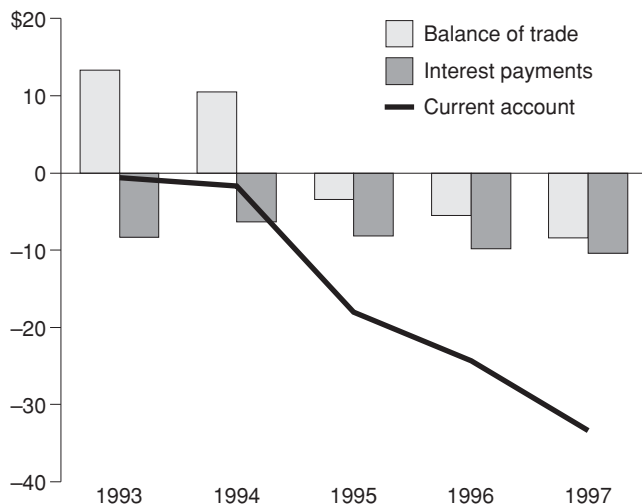
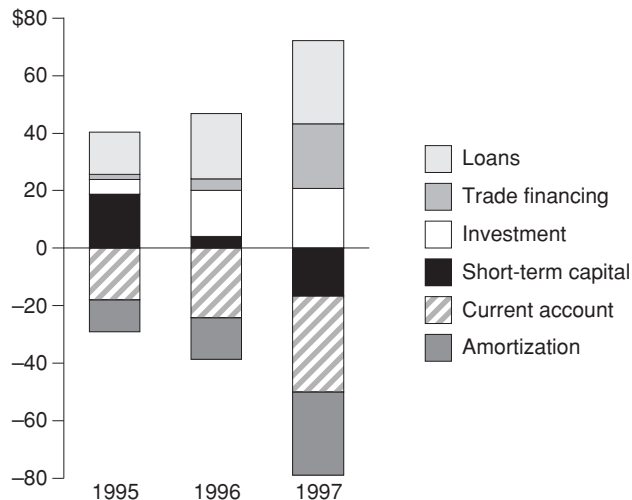


FIGURE 3
Brazil's current account deficit
 (billions \$)



Source: Central Bank.

FIGURE 4
Brazil's capital imports and exports
 (billions \$)



Source: Central Bank.

152%. That is, 15% of all loans to the private sector today are for direct consumption, while the flow to the industrial and housing sectors have fallen: each only captures 25% of all credits granted to the private sector today, down from earlier, higher levels.

This so-called “growth” of the economy is also linked to the growing trade and current account deficits, provoked by, among other things, the import of consumer goods for the bubble.

As can be seen in **Figure 3**, the trade balance went from a positive level of more than \$10 billion in 1993 and 1994, to a deficit of more than \$9 billion in 1997, while payment of interest on the foreign debt reached on the order of \$10 billion. Thus, the current account, which in 1993 and 1994 was nearly zero, fell successively, reaching a deficit of \$33.4 billion in 1997—just as *EIR* had forecast.

But, the problem of the current account is only one aspect of the hemorrhaging of the economy. In **Figure 4**, we compare the total import and export of foreign capital—which, by definition, balance out each year through fluctuations in the foreign reserve holdings of the country (putting aside contraband, capital flight, drug trafficking, and other illegal activities). Observe that, in 1997, capital flight was \$80 billion; in addition to the \$33.4 billion of the current account, \$28.7 billion left the country as amortization on the debt, and another \$16.7 billion in short-term capital. This last category is very significant. In 1995, some \$18.8 billion in short-term capital had entered the country, and in 1996, another \$3.9 billion. This flight shows in stark terms the fragility of the whole framework of the monetary scheme in place.

To try to compensate for this flight capital, the government employs the tool of high interest rates to attract capital, in addition to its policy of privatizations and the sell-off of private companies to foreign capital. For example, in 1997, the government managed to draw in \$72.2 billion—\$20.6 billion in investments, \$28.8 billion in loans, and \$18.2 billion in trade financing. Behind this scheme are several frauds. First, a large portion of the so-called investments are no such thing, but rather the seizure of private companies by foreign capital. Second, another portion is capital coming in through the privatization of public companies.

Trade financing, which was minimal in 1995 and 1996, has become a considerable component of capital inflows from abroad. This refers largely to credits for imports—that is, credit for consumption—which means de facto short-term foreign debt, which is necessarily high-risk given the generalized climate of default in the country. And this is called “economic growth”!

At this rate, and only if tranquility reigns on the international markets in 1998 (which is highly improbable), Brazil will need a minimum of \$90 billion to maintain the myth of “economic growth” and avoid national bankruptcy.

The speculative fest continues

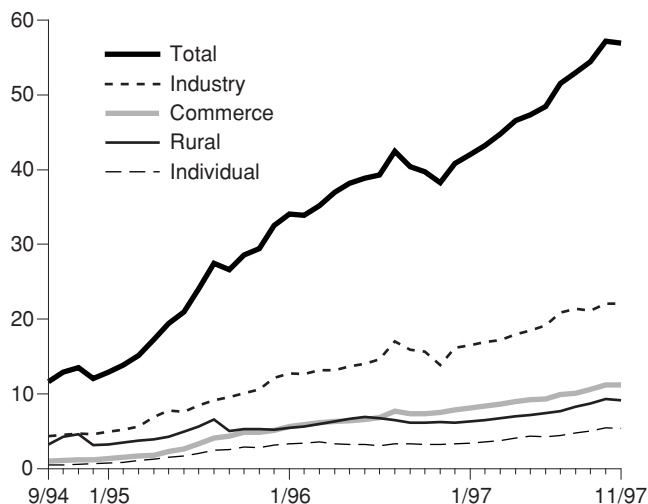
None of this has produced much boasting on the part of President Cardoso’s economic team, or by its presumed spokesman, Central Bank president Gustavo Franco.

The reason is simple. Despite the fact that Cardoso has given substantial guarantees that he is prepared to continue auctioning the country off to foreign capital, and despite the

FIGURE 5

Financial system loans, in arrears and non-performing

(billions of reais)



Source: Central Bank.

agreement with megaspeculator George Soros, with whom he met during the World Economic Forum in Davos, Switzerland earlier this year, to try to avoid a speculative attack on the *real*, the country's economy has entered a phase of accelerated deterioration. This is primarily due to the exhaustion of the consumer bubble, reflected in the growing levels of bank arrears.

As can be seen in **Figure 5**, the growth of non-performing financial loans and arrears has been one of the characteristics of the Real Plan since it was launched in June 1994. This tendency worsened last year, when the level of loan defaults rose 31% from January to November, going from 42 billion to 57 billion *reals* (slightly less than \$50 billion). Industrial defaults rose 33%, trade sector defaults 38%, rural loan defaults 44%, and private individual defaults 59%. This means that the consumer bubble is about to pop, and the number of defaults will grow.

The only growth is in debt

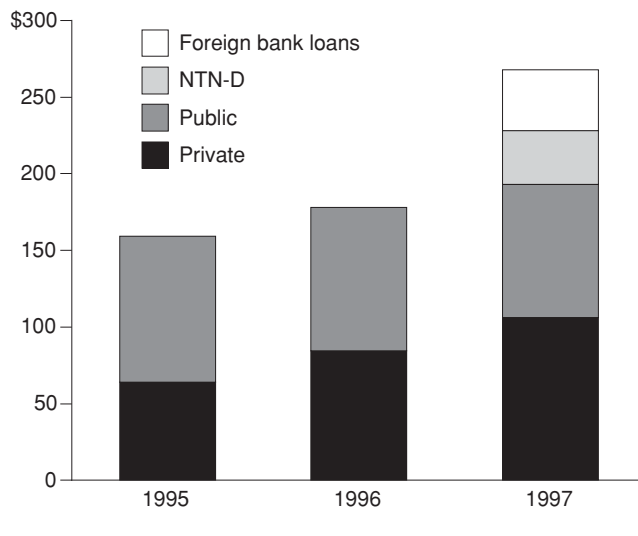
In addition to the exponential growth of the internal public debt, another consequence of the Real Plan is that the foreign debt, too, continues to rise. **Figure 6** gives official figures on the growth of public and private foreign debt. From 1995 to 1997, total debt went from \$159 billion to \$193 billion, of which \$35.4 billion is short term. Growth is primarily due to the private foreign debt, which went from \$64 billion to \$106 billion, while the public foreign debt fell modestly, from \$95 billion to \$86 billion.

But the problem doesn't end there. At least \$35 billion of

FIGURE 6

Brazil's real foreign debt

(billions \$)



Sources: Central Bank, EIR.

the government debt, which is officially considered internal debt, is in dollar-denominated treasury bonds, so-called National Treasury Notes, Series D (or NTN-D). These are, in reality, foreign obligations. Further, according to the Bank of International Settlements in Basel, Switzerland, foreign banks with branches in Brazil are directly lending on the internal market, which constitutes another \$40 billion of de facto foreign obligations. This means that the country's actual foreign debt is on the order of \$268 billion—and could be even larger, given the myriad subterfuges the government has created to clean up the official figures.

It is this debt pyramid which lies at the base of Brazil's supposed monetary stability, which clearly makes the country extremely vulnerable to a sudden speculative attack. The government is well aware of this possibility, and so offers additional guarantees to international speculators, through the futures exchange market. The Central Bank itself admits that it sold \$10-15 billion worth of futures contracts in January, to try to stabilize the exchange rate, which only exposes the potential for speculation against the *real*. In November 1997, this figure was \$20 billion, which represented half of all futures sales. This was precisely the path taken by the Thai Central Bank in mid-1997, in its doomed attempt to defend its currency, the baht. This did not avoid devaluation, but merely forced the government to swallow the additional losses.

Given the Brazilian government's current policies, the only possible forecast is that, either a new world financial crisis will overthrow Brazil, or an explosion in Brazil will help to collapse the world financial system.