Chain reaction crisis feared in Latin America

Financial markets plunge as Brazil devalues currency

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Stock markets plunged in Europe and the Americas Wednesday in the wake of the Brazilian government's decision to allow the country's currency, the *real,* to be devalued by 7.5 percent. The action was followed by the resignation of the president of Brazil's Central Bank, Gustavo Franco, a leading advocate of the harsh austerity policies which Brazil has pursued over the past four years.

The devaluation was triggered by a political crisis within Brazil, arising from domestic opposition to the austerity measures demanded by the International Monetary Fund as the price of the $42 billion loan package agreed on two months ago to provide a financial cushion for the Brazilian currency and financial markets.

President Fernando Henrique Cardoso, who won reelection October 4 campaigning as the candidate of fiscal prudence and stability--he declared he had been "elected to defend the *real* "--failed to win a majority of congressional seats for his party in legislative elections later in the month. Opposition politicians also won the governorships in several key states.

In early December the national legislature defeated a bill to cut state pensions by $2.2 billion, part of the $25 billion program of budget cuts that Cardoso had agreed to in return for the IMF loan.

In Minas Gerais, the third largest state, which includes the city of Belo Horizonte, former President Itamar Franco won the governorship as an avowed opponent of the austerity policies of Cardoso, who had served as finance minister in Franco's cabinet. Only days after Franco took office on January 1 he announced that Minas Gerais would default on debt payments owed to the national government, with the first payment on $15 billion in debts to be missed on January 20.

This announcement triggered a plunge in the Brazilian stock exchange, which has fallen 5 percent or more in each day's trading over the past week. Speculative capital began to flee the country at the rate of $200 million a day, amid fears that other states would follow the lead of Minas Gerais.

Cardoso attacked the default by the state government as illegal, declaring, "Breaking the law won't be tolerated. Everyone must obey, no matter the cost. That's democracy." But on Tuesday, January 12, Rio Grande do Sul, the southernmost state bordering on Uruguay, announced that it would also be unable to make payments on its nearly $1 billion in debts to the national government.

With a second state government defaulting, the outflow of capital turned into a flood, with $1 billion leaving the country in a single day. The devaluation became unavoidable, as Brazil's foreign currency reserves have now declined by more than half since the summer, to less than $34 billion, only a fraction of the country's foreign debts.

Brazil's decision set off shock waves internationally. In Europe all major markets fell sharply, with the Madrid stock exchange down 6 percent, the Paris Bourse down 4.1 percent and the German exchange in Frankfurt down 4.3 percent. Two of the biggest German banks, with huge outstanding loans to Brazil, saw their stock values plummet--Deutsche Bank fell 6.5 percent and Dresdner Bank 4.43 percent.

The New York Stock Exchange plunged more than 260 points in the first few hours of trading, followed by a partial recovery and then a second drop which left

Wall Street down 125 for the day. Bank stocks were particularly affected, since Brazil is the largest single foreign borrower from US banks, owing $30 billion.

Adding to the turmoil, especially in the financial sector, was the impact of a major bank collapse in China. The Beijing government announced earlier this week that it would not bail out the Guangdong International Trading and Investment Company (GITIC), the biggest private banking firm in southern China, which now stands to default on $4.2 billion in debts.

President Clinton told reporters at the White House that the US government was closely following the events in Brazil. "We are monitoring the developments closely, especially what is going on in Brazil," he said. "We have been in contact with key Brazilian government officials, the G7 and other important countries. We've been in contact with the IMF."

The Brazilian devaluation marks the collapse of the latest effort by the International Monetary Fund to contain the deepening world crisis of capitalism. Less than two months ago, under strong pressure from the United States, the IMF announced a $42 billion loan package for Brazil. The deal was unprecedented, since Brazil's currency was not then under stress, following the reelection of President Fernando Henrique Cardoso on October 4, and his pledge to continue the cuts in public spending and other anti-inflationary measures which had stabilized the *real*.

US officials praised the decision as a big step forward in IMF policy-making because it provided for international intervention before a crisis, thus supposedly avoiding the pitfalls of recent IMF interventions in Asia, when bailouts of Thailand, Indonesia and South Korea resulted in an exacerbation of the spreading financial contagion, followed by the collapse of governments.

The effect now, however, is that the crisis has come anyway, while the IMF has already shot its bolt and can do little further to restabilize the markets. The immediate fear was of a plunge in currency and stock values throughout Latin America--Brazil is by far the largest economy in the region, and investors fearing a spreading collapse were expected to pull out of Argentina, Chile, Mexico and other Latin American markets. The panic could also spill over into the few remaining "emerging markets"--South Africa and Turkey, for example--which have not yet been overwhelmed by the financial convulsions that have swept through Asia and Russia.

The biggest impact, however, is likely to be on corporate America, which has more capital invested in Brazil than in either Japan or France. With $36 billion in direct US investment, and operations by more than 400 of the Fortune 500, Brazil dwarfs any other "emerging market" in its importance to American capitalism.

Even before the events of Tuesday and Wednesday, the financial press has singled out Brazil as a possible trigger for wider global convulsions. A yearend commentary in the British daily *Financial Times*, for instance, warned, "Just as Asia appears to be bottoming out, Latin America faces a severe regional recession."

The newspaper warned: "Emerging markets face another difficult year, and investors' appetite for risk remains particularly fragile. A sharp acceleration in the pressures on Brazil is just one of a number of factors that could ignite the tinderbox."