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Banco Central Scandal Overshadows Improvement in Brazilian Economy

by LADB Staff

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Despite a slight easing of the economic problems that have gripped Brazil since last October, President Fernando Henrique Cardoso has new fires to put out with the widening Banco Central scandal. After a three-week investigation, Banco Central president Arminio Fraga and supervision director Luiz Carlos Alvarez told a Senate panel (Comissao Parlamentar de Inquerito, CPI) that a January bailout of two small investment banks prevented a collapse of other banks. They also denied that some financial institutions were given advance tips about exchange-rate policy changes. Fraga confirmed reports that the Banco Central had sold dollars at below-market levels to Banco Marka and Fonte Cindam to help them cover losses in financial-derivatives markets (see NotiSur, 1999-04-16).

Unofficial estimates put the loss to the Banco Central at US\$940 million. Although such help is legal, questions arose because some bank executives reportedly protected their own investments while clients lost money. Questions increased when Brazilian news magazine *Veja* recently reported that the Banco Central had written a letter, ostensibly from the futures market (Bolsa de Futuros), calling for financial aid to the two banks.

The letter, prepared by present and past officers of the Banco Central, warned of a "systemic crisis" in the financial markets if the institutions were allowed to go under. The letter was used to justify the bailout of Banco Marka and Fonte Cindam. So far, Fraga has escaped the scandal, largely because he was in Washington working for financier George Soros when the real was devalued. But if the Banco Central wrote the letter submitted by the Bolsa de Futuros, Fraga could be indicted for perjury. In his testimony before the CPI, he justified the bailout saying it was based on a request from the Bolsa de Futuros.

Former bank president arrested

Fraga's predecessor Francisco Lopes was arrested April 27 and released six hours later on US \$175 bail. Police took him in handcuffs from the Senate chambers after he refused to give sworn testimony before the CPI investigating the charges of insider information prior to the devaluation of the real. When Lopes refused to answer questions under oath, the CPI froze his assets and authorized an investigation of his bank accounts, tax returns, and telephone and mail records. He is also prohibited from leaving the country or from selling any property.

In late April, police searched Lopes' Rio de Janeiro home and seized documents allegedly showing US\$1.6 million in overseas bank accounts. "Politically and morally, Chico Lopes is ruined," said Sen. Jader Barbalho, a key member of the CPI. Lopes took over as head of the Banco Central on Jan. 13, but his tenure lasted only 17 days. He was at the helm when the bank let the real float, setting off a 50% devaluation (see NotiSur, 1999-04-16).

Lopes' refusal to testify could trigger a wider investigation, possibly touching Finance Minister Pedro Malan, since the president of the central bank is responsible to the finance minister. Positive economic signs balanced against spreading scandal. Meanwhile, on April 28, the Banco Central made another interest-rate cut because of growing confidence in the economy. And Brazilian banks successfully sold bonds abroad to foreign investors for the first time since the mid-1998 Russian economic crisis cooled interest in emerging-market debt securities.

The Brazilian press, however, sees political storms including a possible rupture of the governing coalition that could have economic repercussions. Sen. Antonio Carlos Magalhaes, the influential president of Congress and leader of the Partido da Frente Liberal (PFL), appears committed to continuing the investigation into Banco Central activities, which touches many close friends of Cardoso.

An April 30 report in the Argentine daily Clarin said Daniel and Marcello Mendonca de Barros, sons of former telecommunications minister Luiz Carlos Mendonca de Barros, made a killing on the devaluation. The two, both under 30 years of age, are owners of Link, which operates on the Bolsa de Futuros de Sao Paulo. Mendonca de Barros, a friend of Cardoso, was forced to resign last year in a scandal involving the privatization of TELEBRAS, the telecommunication monopoly (see NotiSur, 1998-12-18).

Legislation may also be victim of scandal

Congress, which finally passed the fiscal austerity measures required by the IMF for the second disbursement of the financial bailout, has become sidetracked with the banking scandal and may not pass additional reforms requested by Cardoso until the second half of the year, analysts say. Lawmakers are indicating they are in no hurry to debate reforms to overhaul the unwieldy tax system, simplify political parties, and streamline the judiciary. Tax reform, in the works since Cardoso took office in 1995, will require support from state governors and city mayors, who are likely to resist any measures that will cut their funds.

Also, reforms to reduce the number of political parties in Congress will meet strong opposition from lawmakers because their influence would be reduced. "The feeling there now is that we are no longer in an emergency," said Carlos Lopes, political analyst at Santa Fe Ideias in Brasilia. "That means things have returned to their usual rhythm in Congress." Raise is not likely to appease workers. Financial analysts are looking at Cardoso's declining popularity and weighing whether he will remain committed to the unpopular austerity measures.

Brazil's increasingly frustrated workers took to the streets on May Day to denounce government economic policies they blame for record job losses and social suffering. Organizers said high unemployment and the recession gave an extra edge to the annual May Day demonstrations. Cardoso attempted to appease the frustrated workers by raising the minimum wage by six reais a month to US\$82 and announcing a program aimed at creating two million new jobs. In the past, such tokens have siphoned off discontent. But this year, the opposition Partido dos Trabalhadores (PT) says it will organize ongoing protests if more substantial increases are not forthcoming. "Cardoso has lost control," said student representative Lucas Camargo in Rio. "He's selling all our assets, our state patrimony, and now, even the real has been devalued. We detest his policies." "This country is

in ruins. There are no jobs, food is more expensive, people are suffering," said Rio domestic worker Denilza Monteiro. "The Plan Real was fantastic. Everyone I know could afford meat and furniture for the first time. Now, with these interest rates, unemployment, it's scary." [Sources: Associated Press, 04/16/99; CNN, 04/27/99; El Nuevo Herald (Miami), 04/20/99, 04/28/99, 04/29/99; The New York Times, 04/30/99; Clarin (Argentina), 05/02/99; Inter Press Service, 04/22/99, 05/03/99; Reuters, 04/26/99, 04/27/99, 04/30/99, 05/03/99, 05/04/99]

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