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Brazil Declines New IMF Agreement

by LADB Staff
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Brazil has chosen not to renew its agreement with the International Monetary Fund (IMF), though government officials say austere fiscal programs will continue even without IMF mandates. Though public statements from the fund and the Brazilian government did not show the enmity that exists in relations between the IMF and Argentina, the decision represents the first time since 1998 that Brazil has been without such an agreement. Steady upward economic trends preceded the decision.

Lula: Brazil gained "the right to walk on its own legs"

Finance Minister Antonio Palocci announced on March 28 that Brazil would not renew a standby loan with the IMF and would maintain the economic policy based on fiscal austerity that the government has followed so far, a policy that includes a 4.25% budget surplus. Palocci said, "The fundamentals of the economy are more favorable now" than they were in January 2003, when President Luiz Inacio Lula da Silva of the Partido dos Trabalhadores (PT) took office, which is what made this decision possible. He added that "this is better for Brazil and better for the IMF."

Brazil "has earned the right to walk on its own two feet" and does not need help in practicing fiscal austerity, said President Lula, who added that the IMF was informed of the decision with "calm."

The IMF's public face received the announcement calmly as well, with Managing Director Rodrigo Rato praising Brazil's "sound macroeconomic and institutional framework" and "the government's commitment to pursuing further reforms, and a balance of payments position much stronger than earlier anticipated." "The IMF staff and management fully support the authorities' decision," added Rato. "The decision by the authorities reflects the impressive results, generally ahead of expectations, of Brazil's macroeconomic stabilization and reform policies that have been supported by the current arrangement."

Interactions between Brazil's neighbor Argentina and the fund were less diplomatic in March, with President Nestor Kirchner saying that IMF advice was unwelcome. "We don't want this type of tutelage and Argentina has already suffered too much," said Kirchner after Rato said the IMF would ask Argentina to respect foreign and domestic investors' rights as a condition for a new loan agreement. Few expect a change in course The announcement that the standby credit arrangement would not be renewed after its March 31 expiration drew mixed reactions in Brazil.

Opposition forces on both the left and the right said that there would be no changes in economic policy. Luiz Marinho, president of the Central Unico dos Trabalhadores (CUT) trade union confederation which has close ties to Lula’s governing PT expressed the hope that there would be a shift to bring economic policy more in line with Lula's "historic commitments" to the country's social movements. Marinho said that, without the formal link with the IMF, an opportunity opens up for debate on how to sustain economic growth, promote more productive investment, generate
jobs, and increase wages, while leaving behind economic policies tied to combating inflation merely through increases in the interest rate.

But Palocci's explanations of why the six-and-a-half-year period during which Brazil resorted to IMF aid and oversight was coming to an end led to few conjectures that it signaled a change in direction. The government will continue its efforts to keep the primary budget surplus above 4.25% of GDP, which it did last year. What that means is that public spending and investment, excluding debt servicing payments, will remain at least US$25 billion lower than what is brought in through taxes. These savings are intended to sustain the government's capacity to meet its debt payments. If the surplus were maintained in the long term, it would reduce the debt in terms of proportion of GDP.

Last December, Brazil's foreign debt was equivalent to 51.8% of GDP, after several years in which that proportion reached nearly 60%. But that indicator, which is important when it comes to determining the country risk rating, is likely to grow this year, as a result of the Central Bank's increase in the basic interest rate from 16% in September to the current 19.25%, with a tendency toward a further rise because of the inflationary pressures generated by high international prices of oil, steel, and farm commodities. Inflation has become a concern for Brazil's expanding economy as it has in Argentina.

Many economists, who see the official target of 5.1% inflation for this year as impossible to meet, even project the possibility of a more stringent fiscal adjustment to curb inflation. The Central Bank's adherence to that goal makes a further increase in interest rates inevitable, which discourages productive investment, subsequently creating an obstacle to economic growth, say economic analysts.

**Brazilian economic strength breaks records**

Brazil sought assistance from the IMF in 1998, after the crisis sparked by Russia's financial meltdown led to capital flight from Brazil. The loan agreement signed in November of that year made US$41.5 billion available to Brazil, while setting targets for inflation and the primary budget surplus. With the January 1999 devaluation of Brazil's currency, the real, the strict fiscal austerity followed by the central, state, and municipal governments, and a major rise in interest rates, the country successfully weathered the storm. But turbulence reappeared in the months preceding the election of Lula in October 2002, caused by the financial markets' fears of a leftist PT government.

Lula's pledges as a candidate to honor Brazil's commitments and contracts and to maintain his predecessor's economic policy intact failed to prevent capital flight, devaluation of the real, and a rise in inflation. As a result, the new government renewed the accord with the IMF, raised interest rates and the primary budget surplus, which led to economic stagnation in 2003, when GDP only grew 0.5%. Last year's strong economic performance, however, made it possible for Brazil to withheld from drawing on the entire IMF loan available until now, and to decide not to renew it.

The decision not to renew followed the March release of economic statistics that showed record-breaking strength in many sectors of the Brazilian economy during 2004. Besides last year's 5.2% economic growth, the economy is less vulnerable to international turmoil today, said the minister,
with exports totaling more than US$100 billion in 2004 while the nation's current account once again posted a surplus. Brazil's trade surplus came to nearly US$33.7 billion last year while the foreign debt went down by nearly US$13.6 billion to US$201.4 billion in December, according to Central Bank figures. The trade surplus in Brazil for the first quarter of 2005 wound up solidly in the black at US$8 billion, representing a 40% growth compared with the same period a year ago, when there was surplus of US$5.7 billion.

In 2004 the trade surplus hit US$33.7 billion, a 36% increase compared with the US$24.8 billion of 2003. The number was the highest in the country's history and the second consecutive annual record. Financial markets expect a US$29 billion trade surplus for this year.

National foreign reserves have gone up significantly in the past few months, with the Central Bank purchasing foreign exchange, whose abundance in the market triggered an overvaluation of the real. By February the total international reserves had already expanded to more than US$59 billion, with net reserves (excluding IMF loans) standing at US$31.4 billion. With a public debt burden that in 2003 was 58.5% of GDP and an external debt that tops the US$200 billion mark, Brazil is still somewhat hamstrung by its debt, but the advances in its reduction have led to the optimistic statements from Lula's government and the fund.

Head of Central Bank investigated

There were some storm rumblings at the Central Bank in the first week of April, however, when Attorney General Claudio Fontelles sought the criminal investigation of Central Bank President Henrique Meirelles for crimes against the financial system, tax evasion, and electoral crimes. The central allegation against Meirelles is that, while he was general director at BankBoston, he hid his ownership of Silvania Empreendimentos, a business located abroad, from federal authorities. Similar accusations forced the Meirelles to step down as director of monetary policy and the Central Bank last summer.

The Lula government, however, expressed its confidence in Meirelles, and said he should stay in charge at the bank as the investigation progressed. The bank released a statement that Meirelles faced the corruption charges with "tranquility and serenity" and said his dealings had been "completely legal and honest." The Supremo Tribunal Federal (STF), Brazil's top court, is considering whether to go forward with Fontelles' investigation. The STF would have to approve it for any investigation against the bank president to go forward.

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