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Brazil Suspends Interest Payments on Debt Owed to Foreign Commercial Banks

by LADB Staff
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Feb. 20: In an 18-minute speech broadcast Friday night on a national radio and television network, Brazilian President Jose Sarney announced that his government had suspended interest payments on the foreign debt destined to commercial banks. The government, he said, was not adopting "an attitude of confrontation," but instead hoped that a "definite and lasting solution" to the debt problem would emerge during negotiations with creditor banks which are scheduled to begin in New York in March.

The Brazilian president stated that the decision was grounded in his commitment to avoid sacrificing national economic growth, and thus, Brazilians' standard of living to making debt service payments. "We want to negotiate a formula to meet our obligations without compromising our development, a formula that avoids the political instability that will inevitably follow a new recession, unemployment and social crisis."

Of the estimated $81 billion Brazil owes to commercial banks, some $24 billion in loans are held by US banks, led by Citicorp, Chase Manhattan and Bank of America. If the temporary moratorium on interest payments exceeds 90 days, US banks are required by law to put aside reserves to cover overdue payments. Such a development, of course, would make a substantial dent in the banks' profitmaking capacity.

Brazil has made no principal payments since 1982. In 1985 and 1986 the country appeared to have resumed high growth rates, while also turning in large trade surpluses. But the price freeze imposed last February via the government's economic adjustment program known as the Plano Cruzado increased purchasing power and stimulated an unprecedented boom in consumer spending. Exports dropped while imports rose.

Consequently, foreign reserves fell, bringing on a new crisis. In 12 months reserves dropped from $11 billion to less than $4 billion. Since October 1986, the trade surplus has continuously declined, from over $1 billion per month to only $129 million in January, the lowest since 1983. Brazilian interest payments on the debt total about $12 billion annually; thus, the country needs at least a $1.005 billion trade surplus to pay interest on the debt. Of the annual $12 billion, $8.3 billion are destined for payments to private banks.

Meanwhile, inflation has soared since late November, and is now running at an annual rate of more than 700%. It is known that Brazil wants new credits, and a reduction in its current payments, although the details of its negotiating position have not yet been publicized. Sarney said the country's political and military leaders were solidly behind the decision to suspend interest payments. "We need to negotiate with the authority of a sovereign country and a government supported by the people."
The president also announced that domestic austerity measures would go into effect to complement the interest payment suspension. These measures include a six-month prohibition on the printing of new money, strict controls on spending by public companies not to exceed revenues, and a congressional review of a whole range of public subsidies. The Brazilian news media reported that government officials had originally established a 90-day suspension period. However, the length of the suspension was left indeterminate in Sarney's speech, and in subsequent official reports.

On the same day, the Brazilian Central Bank announced the implementation of a special resolution which applies rigid controls on currency outflows to the exterior, including profit and dividend remittances, and other returns on capital. The measures will remain in effect until Feb. 27, in an effort to stave off a type of "panic reaction" to the government's decision. A government source told UPI that Brasilia forwarded a telex early on Friday to private banks informing them of the decision. The telex said the government had suspended "foreign currency payments," and that financial resources corresponding to the cruzado value of the scheduled payments would be deposited in a special account with the Central Bank.

The Sarney government is apparently committed to a strategy of economic growth, combined with public austerity measures. The president has pledged that Brazil would not fall into recession, while on the other hand, he has promised public deficit reductions to domestic financial and industrial leaders. Meanwhile, the country's majority party, the Brazilian Democratic Movement (PMDB), has warned that it would not endorse any cutbacks in social spending. Sarney's announcement was criticized by both the right and the left. Sen. Roberto Campos, former Planning Minister under the military regime said Brazil’s unilateral move was the result of "management incompetence and imprudence. There is no external factor to justify Brazil's insolvency."

Labor leader Luis Inacio Lula da Silva, whose Workers Party (PT) has frequently called for a total moratorium on Brazilian debt payments, was also skeptical. "A moratorium works when you announce it from a position of strength, when you have money and decide to invest it domestically instead of paying it abroad. But in this case, I think the moratorium is just bankruptcy. Brazil is simply recognizing that it has no way of paying." Da Silva said the moratorium did not demonstrate an "heroic act by the president," but only that Brazil is out of money to pay the debt. He called for a broad-based debate on the debt problem which would be grounded in the needs and desires of the majority of Brazilians rather than elites in Brasilia and the international community.

Daily newspaper O ESTADO DE SAO PAULO reported that Liberal Front party leaders said Brazilian foreign currency reserves had fallen far below the figure cited by official sources. Thus, instead of the official $4 billion figure, reserves had in reality dropped to $500 million. Liberal Front politicians told O ESTADO that the government had shore up its international reserves via "discreet negotiations" in Switzerland where a portion of the government's gold reserves was sold. A major question to be answered in coming weeks is whether Brasilia will alter its strategy and work with the International Monetary Fund (IMF). For the last two years, banks have been willing to restructure the Brazilian debt outside IMF agreements because of the country's enormous productive capacity. It is now argued, however, that without an IMF agreement, Brazil will find it difficult to get either long term credit or favorable interest rates from the banks.
Leader of the majority party PMDB (Brazilian Democratic Movement Party), Sen. Fernando Henrique Cardoso, said the decision to suspend interest payments was adopted above all as a "strategy" for debt rescheduling negotiations. He told reporters that the current national economic situation is not as serious as in 1982, when Brazil was on the verge of bankruptcy. An editorial in the FOLHA DE SAO PAULO remarked that "Brazil does not have the means to meet its obligations...there are only two options: the IMF or moratorium."

Feb. 21: Finance Minister Dilson Funaro said that only a multi-year rescheduling agreement with creditor banks grounded in adequate economic growth prospects will result in a normalization of interest payments on the debt. The minister's statements were delivered during a meeting with foreign correspondents at his home. In reference to the disruptions in the domestic economy which occur every year when Brasilia renegotiates debt payments, Funaro said, "Brazil needs to have a long-term negotiation to avoid the vicious circle of renegotiations."

Next, he emphasized that his country cannot meet debt payment obligations now or in the future while saddled with economic recession. The minister reiterated Brasilia's position on "interference" by foreign organizations, i.e., the International Monetary Fund will not be invited to return to Brazil in an effort to secure cooperation by private banks. In response to questions on the length of the interest payment moratorium, Funaro replied that the Brazilian team communicated to the committee in New York representing the country's over 900 bank creditors that payments could not be resumed until debt restructuring negotiations were completed.

Funaro reported that foreign currency reserves are currently at $3.962 billion. This state of affairs, he said, resulted from a boom in consumer spending, declining export revenues and rising imports. Soybean and orange juice exports were used as examples of declining terms of trade. He said in 1986 Brazil exported volumes of the two products equivalent to those of 1985, but earned millions of dollars less. The minister emphasized that in order to remain competitive, and establish the bases of sustained economic growth, Brazil must recover lost ground in terms of technological development and modernization of the national industrial park. Large investments are necessary for such an undertaking. There is no way, he said, such a program can proceed when Brazil is burdened with world market price declines for its exports coupled with large capital outflows to pay interest on the foreign debt.

In the last four years, he added, capital investments have been reduced to a bare minimum. Next, the finance chief argued that as long as Brazil devotes the equivalent of 5% of gross domestic product (GDP) to foreign debt payments, economic growth cannot be sustained. He mentioned that reduced payments of between 2.5% and 2.8% of GDP are considered compatible with economic growth. Referring to "other Latin American nations" he refused to name, Funaro said some pay up to 7.8% of respective GDPs, and are thus condemned to economic recession. The minister said before the decision to suspend interest payments was made, the government consulted with other debtor nations, and in particular, Argentina.

Funaro stated that while each debtor nation's problems are somewhat unique, all require methods to deal with the crisis so as to achieve economic recovery. When reporters asked about possible solutions to the debt problem, he mentioned the US debt initiative, known as the Baker Plan.
This plan, he said, is problematic for many debtor nations since it requires fulfillment of certain conditions which are politically unpalatable. Finally, Funaro asserted "there is no basis for creditors to demand an agreement" with the IMF before negotiations with Brazil can proceed. (UPI, 02/21/87)

Feb. 22: According to NEW YORK TIMES correspondent Alan Riding (TIMES, 02/23/87), in an effort to avoid reprisals the Brazilian government moved to reassure creditors it was ready to work out new agreements.

Officials fear a sudden withdrawal of dollar deposits, and has also initiated stockpiling essential imports such as wheat and oil in case existing trade credits are reduced or terminated. Government officials told reporters Brasilia would not request cancellation of existing debts nor "concessionary" interest rates below market levels and that implementation of any new agreement would not mean losses for creditor banks. Instead, Brazil is seeking an agreement similar to that obtained last year by Mexico, including new credits, postponement of principal payments coming due over the next six years, and a reduction of the "spread" or premium paid to banks above prevailing interest rates.

Finance Minister Funaro told reporters that Brazil still hoped for a $9 billion trade surplus this year and would therefore require about $4.5 billion in "new money," of which around $2 billion could come from the World Bank and the balance from existing commercial creditors. He added he considered the spread rate obtained by Mexico of 0.8125% to be "high." Feb. 23: Funaro denied reports that the government has decided to seek an agreement with the IMF to obtain $1.5 billion in stand-by credits. He said Brasilia is currently developing a plan to reschedule payments on debts contracted by the military regime in 1983. Government sources reported that this and other plans do not mean that new adjustment programs are to be negotiated with the IMF. (Basic data from several reports by Associated Press, UPI, Agence France Presse, NEW YORK TIMES, PRENSA LATINA)