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Andrés Gaudân

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Brazil's Economic Worries Tied to Huge Amount of U.S. Debt

by Andrés Gaudín

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The world crisis, and above all the possibility that, in August, the US could enter into default on its debts, complicates the Brazilian economic outlook. President Dilma Rousseff’s administration admits it is worried. The US Federal Reserve says that, in the last year, Brazil was the second-largest purchaser of its now threatened Treasuries, topped only by China. Moreover, the South American giant is the fifth-largest holder of these bonds. The European Union (EU) has announced that it will no longer classify Brazil as a poor country, meaning that it will automatically lose inclusion in the EU’s Generalized System of Preferences (GSP), ending all tariff exemptions for Brazilian products entering the EU.

Business leaders fear losing the European markets and say that for that and other reasons—above all the overvaluation of Brazil’s currency, the real—a process of deindustrialization has already begun. They complain that the situation is aggravated by the influx of products from China, which come into the country through a triangulation mechanism, believed to involve Argentina, Uruguay, and Paraguay, Brazil’s three partners in the Southern Cone Common Market (MERCOSUR). They also say that, beyond the effects that the loss of European preferences and the import boom derived from the new exchange rate will have on the labor market, the unfair practice will exacerbate social inequalities and could cause the loss of 2.5 million jobs.

Historically, Global South countries have always worked looking northward. The crisis that rocks European nations and the US concerns them, and Brazil has the greatest exposure to what could happen in those centers of world power.

Latin American societies are particularly attentive at the moment to the warning from ratings agencies Moody’s and Standard and Poor’s, which announced in mid-July that they would keep short- and long-term US Treasury bonds "under review" for a possible downgrade. Those financial instruments, considered the safest in the world, are precisely the securities accumulated by the Brazilian government, which worries the Rousseff administration and proves a popular Latin America axiom, "When the North sneezes, the South catches cold."

Government downplays concern about fallout if US defaults

In response to a query from the daily, Institutional Relations Secretary Ideli Salvatti said that the nation's economy "is solid and is well-protected from external turbulence," but she finally admitted that "we are not invulnerable." She added that "the economic team is on permanent alert; we are very worried because the crisis in the US and the EU countries could be more serious than what we are seeing."

On July 25, Economy Minister Guido Mantega acknowledged the uncertainty but tried to minimize the repercussions of a possible US default. "Brazil is in a position to withstand the consequences of a US default, but today my concern is focused on containing the fall of the dollar [which has
depreciated 45.7% since 2006]. Brazil is the best prepared country in the region to confront possible fallout from this crisis," said Mantega in a message aimed more at speculative investors than the Brazilian public.

The US Federal Reserve said Brazil was the second-largest purchaser of its securities in the last year. Its total investment jumped almost 31%, exceeded only by China, which increased its exposure 34% in the same period. US Treasury bonds are one of the principal havens for the foreign-currency reserves of the Banco Central do Brasil (BCB), Brazil's central bank. The choice stems from Brazil's need to combat the fall in the value of the dollar and the consequent overvaluation of the real, which is fueling an import boom and shutting its industrial complex out of many important markets.

In May-June, the BCB bought more than US$4.5 billion in US bonds, but neither that nor other measures prevented the real from ending July at about 1.54 per US$, the lowest rate since 1999. The dollar's downward trend has continued: thus far this year, the real has appreciated by 6.5%. Various analysts estimate that, with the increase in interest rates (from 12.25% to 12.50%) announced in late July, the flow of dollars into the country will increase, further cheapening the US currency.

For the BCB's former director of institutional affairs Paulo Viera da Cunha and economist Ricardo Amorim, that decision has exacerbated Brazil's exposure. It has become a member of the select club of five countries, or economic areas, that own 32% of US public debt and that are, therefore, almost dependent on everything that can happen to the world economy if the US really defaults, a prospect that brings memories of the defaults that neoliberal policies caused in several Latin American countries in the 1990s.

Fed figures show that China is the US’s largest creditor (US$1.16 trillion), followed by Japan (US $882.3 billion), the United Kingdom (US$272.1 billion), a group of oil-exporting countries (US$211.9 billion), and Brazil (US$187 billion).

No longer poor is not necessarily good
This climate of uncertainty was further complicated when the EU announced that it would exclude Brazil from the list of countries that receive its tariff benefits. EU trade commissioner Karel de Gucht said in an interview with the daily, "Our Generalized System of Preferences is set up to respond to the situation of poor nations, and Brazil is not a poor country; it is a country that still has poor people. Three years ago it was classified as a middle-income country, according to World Bank rules."

Business associations warn of future consequences, because the 12% of Brazilian exports that go to European markets benefit from the GSP tariff reductions and exemptions. Most at risk are industrial products (various kinds of machinery and equipment, automobiles and auto parts, and plastic, chemical, and textile products).

Gucht's statements are only part of the story. When the EU wants to make Brazil pay for its new economic-powerhouse status, it is really retaliating for some aspects of Brazil's program to protect its industrial activity. The European countries are annoyed with new policy norms for the industrial sector, which allow suppliers in the country—which generate jobs and pay taxes—to sell to the government at prices up to 25% higher than those for imported goods. Government purchases are of special interest to the EU since half of all European products that enter Brazil go to the government.
Triangulation facilitates flood of Chinese goods

In early July, at a forum in which the Federação das Indústrias do Estado de São Paulo (FIESP) and the Central Única dos Trabalhadores (CUT) participated, business leaders and workers complained that the country had begun a deindustrialization process. They do not deny that the overvalued real has generated an import boom that displaced national industry, but now they emphasize the penetration of Chinese products, many of which, they say, enter the country by triangulating with Argentina, Paraguay, or Uruguay. As these countries are MERCOSUR members, tariffs are not levied on imports from them.

This is most likely the case, but those in the government are accustomed to listening to the complaints of business leaders and know how much attention to pay. reports a proven and unexplained increase this year in the entry of certain "made in Argentina" products, which in general are low-priced goods and thus represent a minimal amount in total bilateral trade—barely 1.15%.

Ivo Rosset, a textile businessman whose company dominates the sector with 65% of total production, says, "The Chinese come in with prices that we cannot compete with, and this has already caused several factories to close. One must consider that, while industrial wages in Brazil are around US $1,000 a month, in China they are around US$100." The industrialist said this affects competitiveness and "could result in the loss of 2.5 million jobs and the migration of businesses to China."

Economist Luiz Rossi believes, however, that "the deindustrialization about which so much is said is not real. Industry is growing, they are increasing production, sales, and employment. What is happening is that there are other sectors, such as the service sector, that are growing more and are gaining in relative importance in the composition of GDP."

Foreign Trade Secretary Tatiana Prageres also refuted the statements of Rosset and the CUT. "The complaint of a presumed trade illegality in the entry of Chinese products does not have a solid foundation," she said. "It's not enough to denounce something; it must be proved."

From outside the country came a different opinion, not contaminated by passions or interests, that for many academics helps explain the cause of Brazil's present economic situation, beyond the real blow that could result from the crisis in the core countries. Renowned Uruguayan economist José Manuel Quijano recalled how Rousseff was forced last February to impose a harsh budget adjustment that endangered her ability to fulfill her principal campaign pledge—the total eradication of extreme poverty through the application of social policies.

"Rousseff paid the price for the final months of the administration of [former President] Luiz Inácio Lula da Silva, who increased public spending to levels that the Brazilian economy could not support," said Quijano. He was particularly harsh with the former president, and many of his Brazilian colleagues share his view. "Brazil can no longer support the real, and there has been a painful deindustrialization in response to Lula's frenzied policy, which gave Brazilians the ability to buy cheap imported goods with an overvalued real. Thus, he left the people very happy, but he destroyed the economy. That is what Brazil is suffering today."

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