

## **NO CRISIS IN SIGHT**

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### **Our economy will grow, however we are not going back to sustained development**

When the global financial crisis broke out in October 2008, I predicted that its effects on the real economy would be smaller than those of the 1929 crash, because the governments monetary and fiscal reaction would be much stronger and more decisive than it was 80 years before. This actually happened, unemployment increased far less than in the 1930s and now middle-income countries such as China and Brazil have already overcome the crisis, whereas rich countries start to do it. However, nobody can say for sure what will happen with the recovery. Nothing indicates that it will be strong and steady it may be slow and hesitant, and it may be followed by a new crisis. I bet on the first alternative. Since rich countries were those whose enterprises and households went mostly into debt, they will need a relatively longer time to get out of it. In this situation, investment and private consumption will remain depressed. The huge fiscal effort achieved by the countries had the expected effect of remedying the shortage of aggregate demand, but it wasn't able to relaunch private spending, and therefore recovery shall be slow, taking the form of a wide U.

In rich countries, therefore, the probability of a new crisis breaking out is small. Commodities and stock markets are picking up as a consequence of the high increase in international liquidity, but this increase in the price of assets is not enough to create a new bubble: in the United States, the stock market is just 15% above its September 2008 level.

Yet in middle-income countries there is a stronger recovery. In Brazil, the action of both the Finance Ministry and the public banks was successful, trust was restored, and stock investors already recovered a good part of their losses. Yet, would there be room for a new financial

crisis? In the short run, I don't think so. Speculative bubbles are rare in middle-income countries, and they usually are not strong enough to give rise to banking crises, among other reasons because local banks are not willing to finance the necessary speculation for an asset bubble to result in their own crisis.

What we have to fear in Brazil are exchange rate crises or balance-of-payment crises, resulting from trying to grow with foreign savings: this is what happened in 1982 and in 1998. Since the funding of current account deficits is made in foreign currency, the country is always subject to the loss of trust of the foreign creditors and to a "sudden stop", followed by a violent depreciation of the local currency. We are heading that way, since the tendency to overvaluation of the exchange rate is once again present, and the country is already back to a current account deficit situation, but we shouldn't fear a crisis in the next two years because Brazilian reserves remain very high. Instead, we should expect that Brazilian economy picks up again and that, in 2010, we should have a relatively high growth rate, to compensate for the low 2009 growth. However, we are not going back to sustained development. Our average growth rates will remain modest - approximately half what they could be if we decided to follow the example of Asian countries and combine fiscal responsibility with an exchange policy that could guarantee a competitive exchange rate.