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LETTERS TO THE EDITOR
Dangers of debt restructuring

From Mr Alexander Kazan.

Sir, Morris Goldstein is right to point out that the worsening of Brazil's net public debt-to-gross domestic product ratio since 1994 is perhaps the most important reason for its current troubles ("Brazil's unwatched borrowing", August 27). However, his conclusion that future International Monetary Fund disbursements to Brazil should be conditional on debt restructuring is misguided.

Such advice, if taken, would undoubtedly reduce the access that emerging markets have to international capital markets. IMF loans are intended to bridge short-term crises when capital markets temporarily close to countries. The idea is to instill confidence so that countries can, in a reasonable time, resume access to those markets. They were never meant - and should not be used - to encourage a country to take steps that would essentially shut the door to international capital markets.

An IMF-endorsed restructuring could keep private capital out of a country for years. Moreover, such a policy would suggest that, every time the IMF starts talking with a country, private investors would bolt for fear that a restructuring was in store.

The IMF would be wise to counsel countries against rising debt vulnerabilities, as Mr Goldstein rightly suggests. However, this advice is only useful if offered well before a crisis develops. To make debt restructuring a condition of IMF assistance would not only damage the Brazilian economy, but would risk making it more difficult for all emerging markets to access capital markets.

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While a renewed slide into recession was unlikely, "I wouldn't rule it out," he said. Still, the most likely scenario in his view is that the economy will pick up steam in the second half of the year, growing at an annual rate of 3.5 per cent in the second half and at 4.5 per cent next year.

Mr. Meyer said futures markets, which have reflected a relentless erosion since March in market expectations for any Fed rate increases this year, were appropriately "reacting to the economic data".

The stock market was working against a recovery, he said.

"Instead of the stock market leading and becoming a factor supporting it, the recovery is dragging it along," Mr. Meyer said.

While he does not expect the market's travails to derail the resumption of solid growth, "there aren't too many post-recession precedents for this. It's a very unusual situation," he said. "We have this enormous set of corrections taking place, and the question is whether or not there's an ongoing post-bubble hangover that could put the expansion on hold for a while."

The unambiguously good news, he said, was that inflation would probably continue falling this year, as "we've seen an unusually large cyclical rebound in productivity" that reduced the upward pressure of wages on profits and prices.

But he is worried that by next year "we'll see an inflection point and inflation begin to rise somewhat", forcing an inevitable, pre-emptive move by the Fed to tighten the noose on money and credit, after cutting short-term interest rates to 40-year lows last year.

When will the investment slump end? Mr. Meyer's favourite "real" leading indicators of investment are the government's monthly report on orders for non-defence capital goods (commercial heavy equipment), also a favourite of Alan Greenspan, Fed chairman, and a recently devised G7 investment index, as well as surveys conducted by the National Federation of Independent Business and the National Association of Purchasing Management. All suggest that, if not sinking, investment may have stabilised.

Mr. Meyer said a critical turning point from the current mix of sluggishness and uncertainty for employment and the economy in general would be when "firms turn their attention from maintaining current profitability to looking for opportunities to enhance future profitability".