7.17

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Prime Minister (2)
This is the report the Chancellor mentioned
AT 13/2

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

13 February 1985

Andrew Turnbull Esq
10 Downing Street
LONDON SW1

Dear Andrew,

LATIN AMERICAN DEBT: BRAZIL

In my letter of 7 February, I reported that Brazil has breached its montary base target, and that this could delay both the next purchase under the IMF facility, and the rescheduling agreement due at the end of March.

It now seems that the situation is more serious than we thought, and the deadlines rather nearer. Under the draft rescheduling agreement, reached between the banks' Advisory Committee and the Brazilian Government, about $10 billion of trade facilities and $15 billion of money market facilities are due to be rolled-over on 19 February, probably for a period of 2 years. Final signature of the rescheduling agreement has of course been delayed by Brazil's failure to meet its IMF targets, and the difficulty of settling the terms of the next Letter of Intent until the new government takes office on 15 March. The banks were expected to roll-over these facilities for a short period to bridge this gap. This now seems less likely. The chief British negotiator has now told the Bank of England that some of the banks concerned wouldlike to terminate or reduce their facilities. The dnager is that once a number of them drop out, a larger number will be tempted to follow. The whole operation could then be at risk.

Senhor Galveas, the outgoing Brazilian Finance Minister, was due to meet de Larosiere on Monday. It seems likely that he will ask de Larosiere to make an interim statement to the banks. This would presumably say that the Fund Management were satisfied with the progress being made towards resolving the difficulty. On the strength of these assurances, the Advisory Group could then send a telex to all participating banks before the weekend, recommending

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them to renew the facilities which fall due next Tuesday 19 February. We have not yet heard whether de Larosiere agreed, but the Deputy Managing Director confirms our impression that there is a serious problem.

We are also in touch with the US Treasury, in an attempt to find out what they will do if the Managing Director cannot give such assurances, or the banks decide they are not sufficient.

The Bank of England believe that the British banks will be prepared to leave the facilities in place for a further period. There is thus no further action to be taken in London. But the situation elsewhere could deteriorate sharply during the week. If necessary, the G5 Deputies (who are meeting on Friday in the margins of the Summit preparatory "Sherpa" group), can concert any further necessary action.

I am sending copies of this letter to Len Appleyard (FCO), Callum McCarthy (DTI) and John Bartlett (Bank of England).

Yours ever
Rachel

MRS R LOMAX
Principal Private Secretary

Indebtedness : Econ. Pol. 145.

13 FEB 1985

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ς NO

Prime Minister (2)

AT 8/2

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

7 February 1985

Andrew Turnbull Esq
10 Downing Street
LONDON SW1

Dear Andrew,

LATIN AMERICAN DEBT: UPDATE ON BRAZIL

Although the regular assessment of the international financial scene is not due for 2 or 3 weeks, there have been some developments on Brazil on which I should bring you up to date. The information is based on informal contact in Washington with Fund staff. No formal Fund statements have been made yet but these may follow.

Brazil has breached its monetary base target for end-December by an even larger margin than the Fund's revised estimates allowed. The December increase was 36 per cent, bringing the figure for 1984 as a whole to 244 per cent (compared with an original target of 50 per cent, revised to 95 per cent). The problem seems to stem from a reluctance to raise interest rates.

The immediate effect is to prevent Brazil's next purchase under its Fund facility on 28 February. A Fund team is due in Brazil later this month to discuss a programme for 1985 but the results of this are unlikely to come before the Board before April/May at the earliest. This breach of Fund targets stalls both the commercial bank rescheduling agreement only just agreed (and reported in the Times on 5 February) and the forthcoming Paris Club rescheduling of their official debt, both of which require a Fund programme to be in place before they can proceed.

It now seems increasingly unlikely that there will be an official MYRA (Multi-Year Rescheduling Agreement) in place before the spring meeting. Brazil was the only promising candidate. This will make the presentation of the creditor Governments' case in Washington more difficult, although it may prove possible for the Paris Club to hold preliminary discussions with Brazil against the time when a Fund programme can be put in place.

I am copying this letter to Len Appleyard (FCO), Callum McCarthy (DTI) and John Bartlett (Bank of England).

Yours ever
Rachel

MRS R LOMAX
Principal Private Secretary