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10 DOWNING STREET

From the Private Secretary

17 October, 1983

Argentina's Debt Problems

The Prime Minister was grateful for the report on current developments on Argentina's debt problems. She agreed with the line which the Chancellor is proposing to take.

I am copying this letter to Brian Fall (Foreign and Commonwealth Office) and John Bartlett (Bank of England).

ANDREW TURNBULL

John Kerr, Esq.,
H.M. Treasury

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KW

Financial Times Monday October 17 1983

Companies and Markets

CREDITS

Argentina given date for first drawing on rescue package

AFTER MORE than two weeks of anxious nail-biting, Argentina's leading creditor banks have finally set a new date of October 28 for the country to draw the first \$500m instalment of the \$1.5bn loan it is to receive as part of its debt rescue package.

A recommendation to this effect has been telexed over the weekend to all 300 creditor banks by their advisory committee in New York. The drawing, previously scheduled for today, was thrown into doubt by the arrest two weeks ago of Sr Julio Gonzalez del Solar, the country's central bank president, and a freeze on debt rescheduling imposed by a provincial judge in the Patagonian city of Rio Gallegos. The freeze has now been lifted by an appeals court in Buenos Aires.

Mr William Rhodes, chairman of the Advisory Committee, confirmed, over the weekend that Argentina has agreed to bring all arrears of public sector debt interest outstanding as of September 30 up to date as a precondition for drawing on the loan. A statement over the weekend also said that the International Monetary Fund has assured creditor banks that its standby credit for Argentina, in jeopardy because of the arrears, remains in effect. The Government in Buenos Aires has meanwhile confirmed that it will proceed with the rescheduling of some \$6bn in public sector debt falling due this year, Mr Rhodes said.

The statement follows a marked change in the mood prevailing a week ago when the debt rescue effort was still bogged down in nationalistic fervour ahead of Argentina's elections in October 30.

Since then creditor banks have forcibly reminded Argentine officials that the country will need the \$1.5bn credit whoever wins on October 30. This argument has obviously had considerable impact which suggests that commercial banks are not as entirely at the mercy of political developments in Latin America as some observers had previously thought.

Indeed Brazil, which is in the process of swallowing unpopular austerity measures, provides another example of a country being prepared to pay

a heavy political price for commercial bank credit. At the moment, however, the main preoccupation of the lending banks is with arranging the credit itself. Tomorrow Sr Alfonso Celso Pastore will address banks in London on the last leg of a world tour designed to drum up support for the country's proposed \$6.5bn credit.

Mr Guy Huntrods, an executive director of Lloyds Bank International who has been accompanying Sr Pastore, said over the weekend that response to the tour so far had been generally positive. During the latest stop-over in Bahrain, he said, there had been a "constructive discussion" with about 30 creditor banks. Middle Eastern banks were among the least responsive to Brazil's previous rescue effort but were now showing "a mood of realistic appreciation of Brazil's needs," according to Mr Huntrods.

Brazil, as already reported, has asked for the initial disbursement of the credit to total "up to \$3bn." It is understood that this drawing should become available before the end of the year, allowing the country to eliminate debt service arrears now being held just below the critical level of 90 days. If the drawing can be made this quickly Brazil will be able to avoid the need for further bridging finance.

Meanwhile Portugal has scored a notable success with its current loan. On Friday the 16 lead managers offered to increase the amount to \$350m from the \$300m previously sought. The country's credit rating has been enhanced by its recent agreement with the International Monetary Fund and the loan's success will clearly be used to help public opinion accept the austerity which the IMF programme implies.

The Trans-Tunisian Pipeline Company has mandated a group of banks led by Bank of America International and Credit Lyonnais to raise an ECU 150m eight-year credit with a margin of $\frac{1}{2}$ per cent over London interbank offered rate (Libor) for the first 3 $\frac{1}{2}$ years rising to $\frac{3}{4}$ per cent thereafter.

Peter Montagnon

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Prime Minister (2)
To note and agree X.
AT
10/10

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

10 October 1983

Andrew Turnbull Esq
10 Downing Street
LONDON SW1

Agreed
ms.

Dear Andrew,

ARGENTINA'S DEBT PROBLEMS

The Chancellor has suggested that the Prime Minister might like to have a brief report on the latest developments in Argentina.

Generally, the prospect of a complete Argentine default is closer now that the authorities have had to suspend foreign currency payments to protect dwindling reserves. The suspension has been announced as a temporary one, pending the establishment of a system of foreign currency priorities. So far as we are aware these new restrictions have been imposed on a non-discriminatory basis. Our limited experience before the latest clamp down suggested that Argentina was honouring the assurances given in August to the IMF to lift discriminatory restrictions against UK companies. The DTI are continuing to monitor the position. Any resumption of discriminatory practices will of course lead to suspension of the IMF programme, preventing further drawings and in turn disbursement of the new commercial bank loan.

A key factor in the current situation is the breakdown in the commercial banks' refinancing of Argentine public sector debts. It hinges on a rescheduling agreement, negotiated with the state airline Aerolineas Argentinas, which is intended to serve as a model agreement across the board. Progress has been halted by an Argentine judicial ruling that the agreement infringes the constitution because it would be subject to US, rather than Argentine, law. The ruling also led to the arrest of del Solar, the Governor of the Central Bank, because of his part in negotiating the agreement. His subsequent release and an appeal court ruling in favour of the Government on the rescheduling agreement suggests that the immediate crisis may have passed.

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Handwritten red ink mark resembling the number '96' or a similar symbol.

A small red ink mark resembling a checkmark or the number '7'.

Small handwritten red ink marks on the right side of the page, including a small 'x' and some illegible characters.

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But the events have caused self-inflicted damage to any confidence that the rescheduling negotiations will be concluded before the elections on 30 October, as was originally intended.

The rescheduling is one of the conditions of the commercial banks' \$1.5 billion loan agreed in August. The first drawing of \$500 million has thus been postponed until 17 October. Without the drawing, or resumption of IMF drawings, the Argentines will be unable to make a \$350 million repayment under the \$1.1 billion bridging loan from the banks which has already been postponed once.

The third drawing under the IMF standby is also postponed pending the elimination of payments arrears. Continued delay in gaining access to commercial bank loans could lead to pressure on the IMF to waive the arrears condition for disbursement of the next tranche. So far the IMF management has shown no disposition to alter the terms of the loan. This is clearly right. Disbursement also depends on Argentina continuing to meet the IMF performance criteria. Although the programme was on course in the middle of this year there are signs that it may be under strain because of increasing pressure on the Government to ease wage restraint, accelerating inflation and an increase in the public sector deficit. The longer the delay, the less likely it seems that drawings will be resumed.

Although the situation seems to have been held for the present, further deterioration in Argentina's financial position cannot be ruled out in the period before the election and there can be no certainty about developments thereafter. The present exposure of British banks in Argentina is \$2.3 billion.

x { The Chancellor feels that the right public line to take on Argentina's debt problems is that her recent difficulties are entirely of her own making. It is therefore for her, as for other debtor countries, to put her own house in order by making the necessary adjustments in line with the IMF programme, and removing obstacles to agreement with the commercial banks.

Copies of this letter go to Brian Fall (FCO) and John Bartlett (Bank of England).

*Yours ever,
John Kerr.*

J O KERR
Principal Private Secretary