Econ Pol

10 DOWNING STREET

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Prime Minister

You ~~with~~ should be aware of the very precarious position of the big Brazilian banks, noted at X attached. I had already heard about this from a City source: in effect the Brazilian banks have an unscheduled and unauthorized overdraft every night, mainly with US banks in New York. This could collapse anytime.

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FROM: J.G.LITTLER
DATE: 17 February, 1983

CHANCELLOR

cc Chief Secretary
Financial Secretary
Economic Secretary
Sir Douglas Wass
Mr. Burns
Mr. Middleton
Mr. Unwin
Mr. Carey (o/r)
Mr. Lavelle
Mr. Hall

INTERNATIONAL DEBT PROBLEMS, PARTICULARLY BRAZIL

I think you were aware of difficulties over Brazil which came up while we were in Washington last week, and which took the Governor of the Bank of England away from our meetings for most of Thursday afternoon and Friday morning.

2. Along with the IMF programme and credit, the rescue operation for Brazil comprised four elements:

- $4.4 billion of new commercial bank money;
- agreed rescheduling of 1983 maturities;
- agreed extensions of official trade credit;
- arrangements to restore exposure of commercial banks in the inter-bank market, in favour of Brazil, to the higher of the levels of June and December last year (subsequently amended to restoring just over 80% of the June 1982 level).

x

3. Under the first three headings, there is no problem. Indeed the trade credit element has actually been over-subscribed. But there has been difficulty from the outset over the fourth element. The latest position seems to be that something approaching $½ billion as a minimum is still "missing". This is because various banks in different parts of the world have not met their part of the rebuilding of credit implied. Apparently the British banks have done all that was required of them. The situation is being held - literally from day to day with overnight money, by a group of United States banks which have set up a safety net operation for this purpose. The trouble is that their patience is wearing a little thin. There was considerable risk last night of the arrangement collapsing, but one or two extra contributions flowed in from Japanese and French

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sources, which may have encouraged an extension.

4. Unfortunately, we are in the position in which, at any time, the safety net banks in the United States may decide they have had enough, in which case payments will not be met. This will reopen what we thought to have been a settled package. The effect is bound to disconcert the markets, and probably to spill over on to the finely-balanced positions of two other countries:

- Venezuela: this has all the appearance of a mismanaged liquidity problem, rather than a deeper debt burden, but the short-term liabilities of Venezuela are very high indeed, and the willingness of commercial banks to keep on renewing them is not helped by the apparent insouciance of Dr. Sosa, the Finance Minister, who foolishly gave in London last night a public threat of future exchange controls!

- Chile: where the amounts involved are altogether smaller, but sentiment has been adversely affected by the change of Finance Minister in the middle of difficult negotiations.

5. I will keep in touch as well as possible, and pass on further news. Meanwhile, Mr. Kerr might like to let Mr. Scholar at No.10 know that these difficulties are around, rather than have No.10 taken by surprise by some unhappy headline news.

– in the FT today (Saturday)

(J. G. LITTLER)