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Treasury Chambers, Parliament Street, SWIP 3AG
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Prime Minister
To note.
The paper on Argentina options is promised by the end of the week.
MCS 10/5

6 May 1983

Michael Scholar Esq
10 Downing Street
LONDON SW1

Dear Michael,

INTERNATIONAL FINANCIAL SCENE

The Chancellor has asked me to send you a further assessment by the Bank of England of the international financial scene, which the Treasury have discussed with the Bank and with other departments. Attached to this is an updated table showing British banks' and ECGD exposure to the major countries in Latin America, Eastern Europe and the Far East.

Since the last report fears of a further sharp fall in the oil price and of a rise in US interest rates have, at least for the moment, abated. The report was in fact prepared just before last week's meetings in Washington, on which the Chancellor has reported to the Prime Minister separately, but the message from Washington of increasing confidence over recovery, tempered with caution and emphasis on the need for continuous monitoring of problem countries on a case by case basis, reinforces the slightly more optimistic tone of this latest assessment.

The Chancellor has asked me to draw attention to the following particular points which arise from our consideration of the assessment.

(a) Barclays Bank last week received a triple AAA rating for a substantial bond issue in the New York market. This reflects the widespread confidence in British banks. Few US banks receive this top rating for credit-worthiness today.

(b) Mexico appears to be keeping to its IMF programme and Brazil believes the $6 billion trade surplus programmed for this year is attainable, although a cash flow gap of around $1.5 billion may emerge by July/August. Although there are still formidable risks ahead, if Mexico and Brazil continue successfully to adjust the chances are that, with suitable application, other Latin American countries will follow.

(c) Mexico may not, however, be able to meet the $1.5 billion of principal repayments of officially guaranteed private sector credits due in 1983 and is apparently seeking some form of rescheduling of these debts. This would afford Mexico relief but at the same time cost ECGD around £80-90 million in claims payments. ECGD are pressing for any rescheduling proposals to be discussed on a multilateral basis and are proposing that the additional $150 million export credit cover offered earlier in the year should now be limited to public sector risks.

(d) International banks, led by Lloyds Bank International, are insisting that Argentina end its discriminatory regulations before finally agreeing a $1.5 billion loan. The banks are also seeking assurances that Argentina will comply with their IMF targets. Although these may just be met under the first review, on current trends the June targets may be breached. We shall continue to monitor the position particularly closely, and a paper on policy options is in preparation.

(e) Pressure is mounting to resume negotiations on the re-scheduling of Poland's officially guaranteed debts. The Paris Club is to discuss this month the possibility of initiating exploratory discussions with the Poles with a view to subsequent official rescheduling negotiation. The entrenched United States position is, of course, the main obstacle.

(f) We think it prudent to keep a watch on the main debtors in the Far East, Indonesia, Philippines and South Korea. There are no signs of difficulty at present, and they continue to be able to raise new money on reasonable terms, but the amounts involved if any serious problems should arise are potentially very substantial.

(g) In the United States the Senate Banking Committee is still seeking to attach provisions to restrict US banks' overseas lending activities to the legislation to give effect to the IMF quota increase. But it looks increasingly as if Congress will be satisfied with a package of minor and flexible measures that has been proposed by the three US Federal banking regulatory agencies (the FED, FDIC and the Comptroller of the Currency).

I am sending copies to Tim Allen (Bank of England), Brian Fall (FCO) and John Rhodes (DOT).

Yours ever,

John Kerr.

J O KERR

INTERNATIONAL FINANCIAL SCENE

1 Main recent developments

The last report was written shortly before the OPEC agreement on the oil price. Signs since then that the agreement will hold have given the international market some reassurance. In particular, the risk of a further sharp fall in income of producers like Mexico, Nigeria and Indonesia has abated and with it the risk of a knock-on impact on confidence which could also have threatened oil importers like Brazil and South Korea; these countries will, of course, get some benefit immediately from the oil price fall and indirectly (and more slowly) from the resulting general increase in world activity. Meanwhile, fears that the US Fed might tighten monetary policy, and so put upward pressure on interest rates, have abated; in fact US rates, after an end quarter rise, are now slightly below their level in mid-March, and recent figures both for money supply and for the CPI have been reassuring. Nevertheless, these favourable developments are unlikely to obviate the need for additional finance this year for big debtors like Brazil and Mexico. A guide to how well they fare may be whether laggards (mostly Continental European banks) are successfully persuaded to contribute their full share of certain parts of the Brazilian debt package following meetings in London of the Brazilian Liaison Group (see below).

The countries in deficit which have so far avoided serious debt difficulties by being able to increase borrowing in the international capital markets have mostly had to concede somewhat higher margins and shorter maturities. Borrowers like Nigeria (who have reluctantly approached the IMF) and the Philippines have had to work harder in the negotiations: there is nothing left of the "borrowers' market" conditions for the developing countries typical up to a year ago, except possibly for Malaysia and Taiwan.

The Latin American packages have held together and the negotiation of others (Peru and Uruguay) continues in a reasonably orderly way, although the daily financing needs of most of them are being managed only on a hand-to-mouth basis. The Yugoslav package looks as though it is about to be put in place.

Latin America

Despite signature of the projects for new money and rescheduling nearly two months ago, a meeting of the Liaison Group of banks for Brazil in London on 18-19 April was informed that there are still acute short-term liquidity problems, with little or no progress having been made on the full restoration of short-term trade credits and money market facilities, each of which is some $1.5 bn short of target. As an adverse cash flow is in any case expected in coming months - even assuming healthy monthly trade surpluses in line with the record performance achieved in March - renewed efforts are being made to make good the two shortfalls. However, the outcome is very much in the balance and, with Fund reserve targets at stake, further bridging finance may need to be sought from either the banks or official institutions sooner rather than later. In addition, a request for further new medium-term finance later in the year remains probable.

Discussions on the Mexican proposals to reschedule public sector debt to banks are still at an early stage and the moratorium which expired on 23 March has had to be extended to 15 August. A major development has been the announcement of a scheme to reschedule private sector financial and commercial debts, which has provoked a mixed reaction among creditors. For their part, export credit agencies are both concerned and confused over the treatment of official credits to the private sector. Clarification is being sought from the Mexicans by the Paris Club, although some form of rescheduling of such debt appears inevitable. Despite these difficulties governments are anxious to avoid jeopardising their contributions to the rescue package by coming off export cover. On a more positive note, the IMF is reportedly satisfied that the economic programme is on course despite the loss in export revenue following the recent cut in oil prices. Mexico, however, remains vulnerable and the international banking community appears resigned to the likelihood that the country will need additional new loans later in the year.

Argentina is still moving only slowly towards agreement on its medium-term loan and rescheduling needs. Remaining obstacles include the need to eliminate interest arrears and assurances that the Argentines will comply with their IMF targets. These may just be met under the first review but the Fund staff are concerned that, on current trends, the subsequent June targets may be breached. The IMF will try to get the programme back on course but the Argentines are expected to argue that the original criteria were unrealistic. A further problem lies in Argentina's continued failure to remove discriminatory financial measures against UK companies; the Fund requires their elimination by end-July.

Elsewhere in Latin America, talks with the advisory groups of banks and the IMF are generally progressing slowly, although there is growing recognition of the urgent need to finalise packages for smaller countries in advance of possible second-round approaches by Brazil and Mexico. The Chilean package is perhaps the most difficult, following suspension of the standby arrangement in March. A "shadow" programme is being worked out to allow the resumption of Fund drawings by September at the latest. Meanwhile bridging finance is being sought, with commercial banks seeking official contributions from the BIS and US authorities. As far as we are aware, deadlines set by the IMF Managing Director for the receipt of commitments to participate in the rescue packages for Peru and Uruguay have not been met; in the case of Peru this may reflect no more than technical difficulties, while for Uruguay sufficient support from banks was eventually provided to enable an IMF two-year standby facility to be approved on 22 April. The Venezuelans have shown belated signs of getting to grips with the country's debt problems. In late March a moratorium on public sector principal payments was announced to allow negotiations to take place on the rescheduling of the country's short-term debt - without the threat of further damaging default actions. There has as yet been no suggestion that new money will be required. The authorities have nevertheless confirmed that an approach for unconditional assistance from the IMF will be made, and the banks may well require the assurance of IMF involvement. Ultimately further loans combined with an IMF programme may well be needed.

3 Eastern Europe

Progress towards a restructuring package for Yugoslavia continues, albeit slowly. HMG are making available £78 mn (some of which has already been disbursed) as their contribution to what the IMF, at least, see as the first of a series of annual financial packages. The commercial banks have reached agreement in principle on terms to refinance 1983 maturities and the provision of new money, and the BIS have offered a $500 mn short-term facility. The Poles held a preliminary meeting with the banks in March and sought a moratorium on debt repayments until at least 1990, whilst official creditors have agreed to discuss their next move at the Paris Club meeting in May. Romania achieved an unexpectedly large adjustment in its current account and the current round of rescheduling discussions should be the last, though there are more serious doubts about the medium term. Other Eastern European countries (GDR and Hungary) continue to struggle along, successfully adjusting their current account of the balance of payments by clamping down on imports. Nevertheless the improvement in their external position may not be sustainable, and in any case remains insufficient to meet all debt servicing obligations for 1983; as long as Western creditors are unwilling to increase commitments the situation remains precarious.

4 Far East

There are no immediate debt problems, but the difficulties in other areas have turned attention on the larger borrowers in a region which has hitherto been highly favoured by lenders. The Philippines, whose external position has been deteriorating for several years, and which has a sizeable short-term debt, looks the most vulnerable to an erosion of external confidence. Adjustment and economic management generally has been much stronger in South Korea but the very high level of short-term debt poses potential dangers here too. The reduction in the oil price has hit Indonesia severely and, if the oil price were to slide or world recovery were to fail, the current deficit could become unsustainable over the next year or two.

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INDEBTEDNESS AND BRITISH EXPOSURE (end December 1982)

$ billion

	Total external debt	British banks unguaranteed claims	ECGD amounts at risk*
Latin America			
Argentina	39	2.3	0.4
Brazil	81	4.4	2.5
Chile	18	1.1	0.05
Ecuador	6	0.5	0.1
Mexico	83	5.2	1.8
Peru	12	0.4	0.2
Uruguay	4	0.3	0.01
Venezuela	33	2.4	0.08
Eastern Europe (convertible currency)			
East Germany	15	0.8	0.2
Hungary	7	0.5	0.08
Poland	25	0.5	1.3
Romania	10	0.4	0.6
Yugoslavia	20	0.9	1.3
Far East			
Indonesia	20/	0.6	1.7
Philippines	19	1.2	0.4
South Korea	37	2.0	1.1

Because of differences in definition the ECGD exposure figures in the final column are not directly comparable with the figures in the other two columns.

/ At end March 1983; excludes short-term debt
* most recent estimates

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CF/PA [ANNEX

[to John Kerr's letter to me of 6 May on "International Financial Scene" not shown to PM.] MCS 10/5

This Annex contains country notes as follows:

LATIN AMERICA	Argentina, Brazil, Chile, Ecuador, Mexico, Peru, Uruguay and Venezuela
EASTERN EUROPE	East Germany (GDR), Hungary, Poland, Romania and Yugoslavia
FAR EAST	Indonesia, Philippines and South Korea

Notes (i) Each note begins with an estimate of the country's total external debt. The source for the estimates varies and might have come from the IMF, official sources within the country (Ministry of Finance, Central Bank etc) or reports from elsewhere (Embassies, press etc). In each case the figures quoted are the ones judged to be the most accurate and up-to-date.

(ii) Each note ends with a statement showing ECGD's position and the exposure of UK banks to the country concerned.

LATIN AMERICA

ARGENTINA

Total indebtedness at end-1982 was officially estimated at $39 bn including $2.7 bn in arrears.

Signature of the $1.5 bn medium-term loan (UK share of $159 mn) originally targetted for 31 March has been postponed and is now unlikely before some time in May. The advisory group of banks have approved the revised version of the draft loan agreement but have not yet passed it on to the Argentine Government. Before signing the loan, the banks are seeking a clarification of the (apparently xenophobic) Argentine bankruptcy law and a confirmation that the Argentines are complying with their IMF targets. The banks are also pressing for the remaining financial restrictions embodied in Law 22591 to be discontinued.

The Argentines are seeking an advance payment of their third and final drawing of $300 mn under the bridge loan but the banks are unlikely to consider this without getting certification from the IMF that Argentina is on target with its Fund programme. A further issue standing in the way of an early drawing is the fact that repayment of interest arrears is still not up to date although this problem is being tackled by the Argentine government who plan to bring all interest payments to date by June 1983. Repayment of public sector interest arrears corresponding to February ($280 mn) is two thirds complete and the Argentines are expected to start paying off March arrears in the last week of April.

Talks on the rescheduling of $5.5 bn of public sector debt maturities overdue on 1.12.82 and falling due from that date to 31.12.83 are aimed for agreement by end-June. The terms are likely to involve a six-year repayment schedule with a three-year period of grace. The refinancing of the short-term private sector debt covered by Central Bank exchange guarantees and $1.4 bn in foreign currency swaps is still under negotiation.

An IMF mission arrived in Argentina on 18 April to review Argentina's performance under the fifteen month standby arrangement worth SDR 1.5 bn which was approved on 24 January. According to our banking sources it seems probable that the Argentines will just fulfill the performance criteria for March but the Fund staff are understood to be unhappy about present trends which make the June targets look very vulnerable. The IMF will try to get the programme back on course but the Argentines are expected to argue that the original criteria were unrealistic. As well as fulfilling normal performance criteria, drawings under the programme after end-July are subject to the removal of continuing discriminatory financial restrictions against UK interests embodied in Law 22591. In the current political climate the Junta feel unable to tackle this problem without receiving impossible UK concessions (eliminating the exclusion zone around the Falkland Islands was mentioned to the Governor). Finance Minister Wehbe has offered to make payments of remittances to the British banks in the US but while this demonstrates the good intentions of the financial authorities it is not regarded as satisfactory or sufficient as it does nothing to eliminate the application of discriminatory measures against British companies.

A four month $500 mn BIS facility was agreed in January but despite the Argentines' apparent need for foreign exchange this is unlikely to be drawn before it expires in May because of gold negative pledge clauses in earlier loans which have not been waived.

Despite the uncertain political climate on account of the forthcoming elections in October, the likelihood of a trade surplus of some $3 1/2 bn in 1983 leaves room for some optimism.

At end-1982 ECGD had an estimated £116.5 mn at risk under Section 1 and £143.5 mn under Section 2. Argentina remains off cover.

At end-December 1982, UK-registered banks' consolidated external claims on Argentina totalled $3.3 bn of which $3.1 bn was unguaranteed; claims by British-owned banks totalled $2.6 bn of which $2.3 bn was unguaranteed.

BRAZIL

Total indebtedness at end-1982 was estimated by the IMF at $81.3 bn. Nearly two months have elapsed since major components of the rescue package were finalised - the signing of Projects (i) [new money loan of $4.4 bn] and (ii) [the rescheduling of 1983 banking maturities] together with IMF drawings totalling SDR 0.84 bn including the first tranche under the three-year SDR 4.24 bn EFF - but major difficulties persist. Most notably, Brazil is still faced with acute short-term liquidity problems which have led to arrears of some $600 mn building up, despite a record trade surplus of $514 mn in March and the expectation of a further surplus of $650 mn in April (though even so the targeted $6 bn trade surplus for the year will still be difficult to achieve). Furthermore, banks agreed to a deferment of half the repayment ($1.1 bn) of the bridging loan from 10 March to between June and December. However, despite the goodwill shown by banks towards the Brazilian package as a whole, continuing difficulties over Projects (iii) [short-term trade credits] and (iv) [money market facilities] are threatening the Brazilian financing strategy with the real danger that a further call on banks for medium-term finance this year may now be necessary.

Recent meetings between the commercial banks and the Brazilians have, however, focused instead on renewed efforts to firm up the $1.5 bn or so on each of the two projects which is said to be needed by Central Bank President Langoni. Project (iii) is thought to be a problem at the Brazilian end in matching exporters with pre-financing credits together with the declining level of imports whilst on Project (iv), continued reluctance from Spanish, Swiss, German and Arab banks to restore interbank lines is evident. If renewed commitments are not obtained, other alternatives such as a speeding up of Project (i) disbursements or further recourse to official organisations will need to be considered. [The $1.2 bn BIS facility (of which UK share $110 mn) is due to be repaid by end-August.] Continuing shortfalls on these two projects may also jeopardise Brazil's ability to meet Fund targets on international reserves - a performance criterion which will need to be met before a further tranche of EFF resources is made available after 1 June.

At end-1982, ECGD had an estimated £348.1 mn at risk under Section 1 and £858.6 mn under Section 2. Brazil remains on cover.

At end-1982, UK-registered banks' consolidated external claims on Brazil totalled $7.9 bn, of which $7.0 bn was unguaranteed; claims by British banks at that date amounted to $5.2 bn, of which $4.4 bn was unguaranteed.

CHILE

Total indebtedness at end-1982 was $18 bn (two-thirds private sector). Less than three weeks after IMF approval of an SDR 500 mn two-year standby, a precipitous decline in international reserves, resulting from speculation against the peso and the withdrawal of short-term credit lines by foreign banks, forced the Chileans to seek a renegotiation of commercial bank debt on 28 January. The following proposals were put to an Advisory Group (including Midland) of creditor banks:

(i) 90-day standstill with effect from 31 January, on all medium and long-term public and private (financial) sector capital repayments. Interest to remain current;

(ii) rolling over of short-term debt to maintain end-1982 levels ($4.2 bn);

(iii) rescheduling, over 8 years including 5 years' grace of 1983/84 maturities on medium and long-term public and private (financial) sector debt ($3.5 bn);

(iv) $0.9 bn new money;

(v) refinancing of 1983/84 maturities on debt owed by two liquidated banks on more favourable terms than (iii) above.

Subsequently the Advisory Group persuaded the Chileans to include private corporate sector debt in the moratorium; such debt is being negotiated bilaterally with individual creditors, but progress has been hampered by the government's reluctance to provide liquidity support for private corporate debtors. At the beginning of March, however, eight industrial companies which were close to collapse were given a 45-day reprieve in their overdue payments by local and foreign creditor banks and, following pressure from foreign bankers, the state-owned Banco del Estado extended a bridging loan of a reported pesos 2.66 bn (some $35 mn) until 15 April to six of these companies. Only recently have the authorities shown a willingness to assume more formal responsibility for private sector debt, with the announcement on 13 April of a scheme to refinance, over 10 years,

some $7 bn in debts owed by the corporate sector to domestic commercial banks. The scheme forms part of a major economic package introduced on 22 March after consultations with the Fund who have temporarily suspended the standby arrangement in the knowledge that the original credit ceilings and reserve targets up to June would be breached. The package - which also includes the doubling of import duties, higher taxes on petrol, a more flexible exchange rate policy and the closing of the parallel market - is intended to lay the foundations for a resumption of Fund drawings, although it is not entirely clear when this will occur. The IMF are currently working with the Chileans on a "shadow" programme to enable them to get a "technical" waiver on the June targets. Continued IMF support is essential to the success of the financial support package.

So far only tentative agreement on the terms of the rescheduling has been reached. Meanwhile the authorities have revised their original request for new money in 1983 and are now seeking around $1.3 bn. At the same time, the prospective delay in disbursements of this money because of the time required to get the Fund programme back on course has prompted the Chileans to seek some $500 mn in bridging finance up to at least June in order to keep them in line with reserves targets. Commercial banks are seeking Fed/US Treasury and BIS contributions to the bridge, which, according to their plan, might be drawn in monthly portions provided the IMF could say the Chileans were in compliance with their "shadow" programme.

At end-1982, ECGD had an estimated £24.4 mn at risk under Section 1 and £13.4 mn under Section 2. Chile remains on cover.

At end-1982, UK-registered banks' consolidated external claims on Chile totalled $1.8 bn, of which $1.7 bn was unguaranteed; claims by British-owned banks totalled $1.2 bn, of which $1.1 bn was unguaranteed.

ECUADOR

Total indebtedness at end-1982 was $6.3 bn ($4.7 bn public sector). Reflecting a severe cutback in foreign credit at a time of reduced earnings from oil (60% of export earnings) and high international interest rates, reserves were more than halved last year to $320 mn and have fallen further since. The central bank is now delaying remitting foreign exchange to importers and is late in making interest payments.

The authorities have had a series of meetings with a Steering Committee of banks (chaired by LBI) to discuss the rescheduling over seven years with two years' grace of $1.2 bn of public sector banking debt maturing between 1.11.82 and 31.12.83. They had unilaterally suspended repayments of principal of such debt with effect from 1 November. Preliminary agreement was reached in January, but the package (which is likely to include $300-400 mn in new money) is subject to agreement being reached over a $175 mn IMF standby. Negotiations with the IMF have been prolonged but it is now hoped that approval will be given by the end of April. The authorities will face a difficult task in implementing the programme given their lack of a congressional majority and the recurrent protest within the country at austerity measures already taken, including a 21% devaluation of the sucre and sharp increases in the price of milk and fuel (announced on 19 March).

At the beginning of March the government announced that it would assume responsibility for $1.26 bn of private sector debt falling due this year to prevent many private companies from defaulting - provided that creditors are prepared to refinance the debt over six years. However a Steering Committee for private sector debt is to be appointed within the existing Committee in order to explore the possibility of treating public and private debt on an equal basis by drawing the latter into the general rescheduling package.

At end-1982, ECGD had an estimated £39.1 mn at risk under Section 1 and £28 mn under Section 2. Ecuador remains on (very restricted) cover.

At end-1982, UK-registered banks consolidated external claims on Ecuador totalled $0.8 bn, of which $0.7 bn was unguaranteed; claims by British-owned banks totalled $0.6 bn, of which $0.5 bn was unguaranteed.

MEXICO

Total indebtedness at end-1982 was an estimated $83 bn. The $5 bn medium term new money loan, from 526 banks to help close the 1983 financing gap was finalised on 15 March. The first tranche of $1.7 bn was drawn down on 23 March, although the Advisory Group of banks (which includes LBI) had already advanced their $440 mn portion of this on 25 February as a bridging loan. As of 8 February, 9 governments (including the UK with a share of $150 mn) had committed some $2.2 bn in new direct/guaranteed lines of credit compared with the $2 bn originally requested by de Larosiere; more recent reports indicate that a total of $3 bn may be sought by the Mexicans. Under the $925 mn BIS bridging facility (UK participation of $140 mn) agreed last August, the last $30 mn of the third (and final) tranche was drawn on 23 February. The parallel US facility (for a similar amount) is also fully drawn. Both facilities terminate on 23 August.

Difficulties in finalising the $5 bn loan have until recently prevented discussion of the proposals, submitted in December, to reschedule public sector debt to banks (excluding i.a. officially insured export credits). Consequently, the moratorium which expired on 23 March has been extended to 15 August. Mexico has a fair chance of completing rescheduling discussions by this date - a condition attached to the third drawdown of new money.

So far as public sector supplier debt (as we understand) and private sector financial and commercial debts are concerned, the authorities unveiled a scheme on 5 April which applies to all such debts contracted before 20 December 1982 that are rescheduled bilaterally over a minimum of six years. The scheme enables companies to discharge the equivalent of their debt in pesos under four repayment options, for which companies must apply between 25 April and 25 October. Since the scheme is much more advantageous than the separate supplier debt scheme announced on 28 February, debtors will presumably wish to change schemes in considerable numbers. Under the latter scheme Mexican public and private sector companies may, between 3 March and 15 July, establish interest bearing dollar-denominated deposits at

the controlled rate of exchange for the amount of debt owed. The arrangement is effectively a refinancing operation, with creditors only able to draw on the accounts over a period of two years or more from an as yet unspecified date, but most probably August 1983.

Reaction to the schemes has been mixed. International banks appear to have accepted the 5 April arrangement, albeit reluctantly. At least it opens the way for meeting the requirements of the $5 bn loan documentation which makes the second ($1.1 bn due 15 May) and subsequent drawdowns conditional on implementation of a satisfactory private sector debt repayment scheme. On the other hand their is concern and confusion among export credit agencies over the treatment of officially guaranteed/disbursed private sector credits. Following discussions on 11-13 April, Paris Club members (including ECGD) have agreed jointly to telex the Mexicans seeking clarification on the subject by 24 May and to emphasise their understanding until now that Mexico would not request a rescheduling of official credits. However in the (likely) event of a rescheduling, the Mexicans will be encouraged to agree terms on a multilateral basis, although not necessarily under the Paris Club label given concern to avoid drawing in public sector debt. Despite these difficulties, governments are keen not to jeopardise the $2 bn official credit package by coming off cover. Meanwhile, these uncertainties are likely to hamper the supply of essential raw materials and intermediate goods needed by Mexico's export sector.

On the more positive side, an IMF mission, which visited Mexico in March in connection with the first quarterly review of the EFF package approved in December, is reportedly satisfied that the programme is on course despite the estimated $1- 1 1/2 bn loss in export revenue following the cut in oil prices. This view is not shared by key figures in the international banking community who expect that Mexico will need additional new loans later in the year.

At end-1982, ECGD had an estimated £655.3 mn at risk under Section 1 and £470.4 mn under Section 2. Mexico remains on cover for short-term business under Section 1 and all business under Section 2.

At end-December 1982, UK-registered banks' consolidated external claims on Mexico totalled $8.3 bn, of which $7.4 bn was unguaranteed; claims by British-owned banks totalled $5.9 bn, of which $5.2 bn was unguaranteed.

PERU

Total indebtedness at end-1982 was an estimated $11.5 bn. Under an SDR 650 mn 3-year EFF programme approved in June 1982 Peru successfully observed the technical performance criteria up to the first review later in the year, but had difficulty in curbing the public sector and current account deficits in line with objectives - 4% of GDP in 1982 (6.6% outturn) and 6% (7%) respectively. In February this year, after consulting the Fund, the authorities announced austerity measures aimed at reducing the public sector and current account deficits further to 3.8% and 4.5% of GDP respectively in 1983. However, in the present climate for lending to Latin America, these measures came too late and there was a sharp reduction in short-term credit lines from foreign banks in the first two months of the year. Peru's vulnerability to such a move had been heightened by a near-doubling (to $2.2 bn) last year in short-term debt reflecting a steep increase in non-trade related borrowing by the non-financial public sector which were not covered by IMF ceilings. For 1983, the IMF have redefined external financing to include all maturities of debt.

In mid-February the authorities made an abortive approach to the BIS for a $400 mn 180-day facility. Subsequently, Peru requested a facility for a similar amount from the US Treasury but, as far as is known, only received a $120 mn swap through the Exchange Stabilisation Fund. In early March, Peru clarified its 1983 external financing needs at meetings with creditor banks in New York, London and Tokyo, and have sought:

(a) The roll-over of $2 bn in short-term debt - (i) $500 mn public sector trade credits due 7 March-31 May 1983 to be renewed for at least 90 days to allow the authorities to arrange committed lines with individual lenders; (ii) $1.2 bn public sector working capital debt due 7 March 1983-6 March 1984 to be rolled over for 360 days from maturity; and (iii) $300 mn private bank debt due 7 March 1983-6 March 1984 also to be rolled over.

(b) Two 8-year credits (including 3 years' grace) totalling $880 mn - (i) $430 mn to refinance medium-term amortisation payments due to banks in 1983 (officially guaranteed export credits are not affected); and (ii) $450 mn in new money.

All interest payments will continue to be made. The IMF stipulated that commitments to participate in the financing had to be received by 15 April if de Larosiere was to approve disbursement of SDR 250 mn for the second year of the EFF at a Board meeting on 9 May. However, an Advisory Group of 10 banks (including National Westminster), which is co-ordinating responses, has not yet received replies for onward transmission to the IMF because the 265 creditor banks involved are encountering delays in calculating their contributions based on exposure at end-1982. With the Peruvians apparently experiencing considerable difficulties in assembling the necessary data on claims, banks are doing their own estimates.

At end-1982, ECGD had an estimated £39.6 mn at risk under Section 1 and £45.2 mn under Section 2. Peru remains on cover.

At end-December 1982, UK-registered banks' consolidated external claims on Peru totalled $0.8 bn, of which $0.7 bn was unguaranteed; claims by British-owned banks totalled $0.5 bn, of which $0.4 bn was unguaranteed.

URUGUAY

Total indebtedness at end-1982 was an estimated $4 bn of which $2.7 bn was public and publicly guaranteed.

Prompted by a widening financing gap in 1983, following the sharp deterioration in Uruguay's economic position in 1981/82 (highlighted by deepening recession, a rapidly increasing public sector deficit, private sector capital outflows and recourse to short-term borrowing as traditional medium and long-term credit sources dried up) Uruguay's central bank President, Puppo, asked commercial bank creditors, in early March, for a 90-day moratorium on repayment of principal amounts due to allow time for negotiations on rescheduling and new money.

An advisory committee of leading creditor banks (LBI, Bank of America, MHT, Nova Scotia, Bank of Tokyo and Credit Suisse under the chairmanship of Citibank) agreed on 30 March to proposals for rescheduling 90% of $786 mn public sector debt falling due in 1983/84. Uruguay's creditor banks (some 75 in total) are also being asked to grant a new medium-term credit of about $240 mn. One loan agreement is to cover both the rescheduled maturities and the new money which will have a 6-year maturity, including 2 years' grace. To ease the effect of the short grace period repayments are not equal but weighted towards 1988/89. Interest will be paid at a margin of 2 1/4% over LIBOR or 2 1/8% over US prime with front end and commitment fees of 1 3/8% and 1/2%, respectively. The banks are to sign commitment letters to keep trade credit at present levels (total reportedly $120 mn) for the next 12 months and there is apparently an understanding on interbank lines. Disbursement of the new credit will be linked to an SDR 378 mn two-year standby approved by the IMF Board on 22 April. The Managing Director of the IMF had earlier telexed creditor banks requesting their written assurances by 18 April that they would participate in the above arrangements, to enable him to be in a position to present the standby programme to the Executive Board.

Discussions with the World Bank on a Structural Adjustment Loan for $40 mn are proceeding but this will not be available before end-1983 or early 1984.

At end-1982 ECGD had an estimated £6.5 mn at risk under Section 1 and £0.7 mn under Section 2.

At end-December 1982, UK-registered banks' consolidated external claims on Uruguay totalled $0.4 bn, of which $0.3 bn was unguaranteed; claims by British-owned banks totalled $0.3 bn, nearly all of which was unguaranteed.

VENEZUELA

Total indebtedness at end-1982 was an estimated $33 bn ($27 bn public sector). On 22 March Venezuela announced a moratorium on public sector principal payments until 1 July 1983 to allow negotiations to take place on the rescheduling of the country's short-term debt - without the threat of further damaging default actions by foreign banks. An Advisory Committee of banks (chaired by Chase and including LBI) was formed to conduct the negotiations. Finance Minister Sosa subsequently appointed a team to liaise with the bankers. "Official" debt (guaranteed by ECGD etc) and publicly-issued fixed and floating rate bonds of the public sector are not included in the moratorium; and short-term trade-related debt will be paid provided that existing levels of finance are maintained. Inter-bank lines are also not included in the suspension. Interest will be kept current: Sosa has offered to pay either 1 1/4% over LIBOR or 1 1/8% over Prime on deferred short-term debt or the interest rate stipulated in the various loan agreements (the latter will apply to suspended medium-term debt). Although medium and long-term repayments have been included in the moratorium, Sosa is still only expected to present rescheduling proposals on short-term debt ($6.6 bn state agencies plus $3.5 bn state banks). It is still the authorities' intention to repay medium-term debt this year. As regards terms, press speculation suggests that a seven-year refinancing at 2% over LIBOR may prove acceptable to the banks (cf 1 5/8% over LIBOR for a seven-year term proposed last October under the original refinancing programme). Meetings with banks in New York and Tokyo were held in mid-April and Sosa is expected to visit Frankfurt in May.

Private sector debt is not covered under the moratorium and will not be included in the formal rescheduling proposals. Eligibility for the preferential rate of Bs4.29/$1 has now been extended to principal and interest payments on all private sector debt incurred up to 18 February. Foreign-owned companies are no longer excluded from the preferential arrangements and various restrictive clauses on types of eligible private debt have been removed. Although there is now no longer a direct requirement to extend maturities to four years, the release of preferential rate funds will be in three equal

annual payments beginning in 1984. The government has reserved considerable flexibility for the operation of the system which will be dependent on the underlying reserves position.

There has as yet been no suggestion that new money will be required. However, Sosa confirmed this week that the authorities would shortly make a formal approach to the IMF for use of facilities. Around $1.2 bn is available to Venezuela through encashment of SDR's/drawings on its reserve tranche, but further loans combined with an IMF programme may be needed to satisfy the bankers. Sosa indicated that additional loans may be sought "later in the year" depending on income trends. An IMF mission has just completed its annual Article IV consultations two months' early. It is believed to have recommended a devaluation of the preferential rate to Bs6/$1 and ultimate unification of the exchange rate. The mission was dismayed by the quality of economic leadership in Venezuela and felt that the government was not facing the fundamental question of living within its reduced oil income. The 1983 Budget has only been cut by 3.1% and may prove to be based on optimistic assumptions. Current projections allow no margin for any further fall in revenues.

At end-1982, ECGD had an estimated £50.6 mn at risk under Section 1 and £6.9 mn under Section 2. Venezuela remains on cover.

At end-1982, UK-registered banks' consolidated external claims on Venezuela totalled $3.1 bn, of which $3.0 bn was unguaranteed; claims by British-owned banks totalled $2.5 bn, of which $2.4 bn was unguaranteed.

EASTERN EUROPE

EAST GERMANY - GDR

Total convertible currency indebtedness (perhaps as much as $15 bn at the end of 1981) is now probably declining, owing largely to a drawing down of reserves and drastic import cuts which cannot be sustained for long. Gross debts to BIS area banks (excluding banks in West Germany) had declined from over $10 bn at the end of 1981 to $8.5 bn by the end of September 1982. Existing undrawn credit facilities, though considerable, have fallen sharply and, because of its inability to raise substantial new medium and long-term credit from Western banks over the past year, the GDR has been forced to run down its balances with Western banks and confine its borrowing to the short term. Debt repayments probably exceeded $5 bn in 1982 and are unlikely to fall much below that in 1983 and 1984. GDR importing organisations in general have been obliged by the government to seek longer credit terms; ECGD is still on limited cover but has introduced tighter market limits. Serious debt servicing problems and even rescheduling are still possible.

At end-December 1982 UK-registered banks' consolidated external claims on East Germany totalled $1.5 bn (of which $1.4 bn unguaranteed). Claims by British-owned banks totalled $0.9 bn (of which $0.8 bn unguaranteed).

HUNGARY

Although Hungary is meeting the Fund's performance criteria under the one year standby the country's external accounts remain weak and threatened by weakness of banking confidence. Despite the availability of IMF drawings and the eventual success in raising a $200 mn club loan from the international capital market in April, Hungary's liquidity position continues tight. Hungary may have suffered substantial outflows of short-term deposits earlier this year when in January reserves fell by $400 mn to $785 mn. There are also indications that exports are lower than planned; consequently the surplus on the convertible currency current account may fall short of the $600 mn target. In order to avoid placing further undue strain on Hungary's liquidity position when the $300 mn BIS facility fell due for repayment on 26 April the BIS is considering extending a further $100 mn credit line to run from the April maturity date to 30 June, when an IMF drawing of SDR 83.1 mn becomes available. Although the convertible currency current account is forecast to improve in the second half of the year maturities of medium and long-term debt will also rise substantially during that period. Hungary's liquidity position is likely therefore to remain precarious throughout this year; the country's reserves could not sustain further substantial withdrawals of short-term funds and a failure to raise more medium-term credits from the international capital markets may still result in payments difficulties later this year or in 1984, though the planned $500 mn increase in reserves during 1983 may provide a safety valve. There is unlikely to be any net increase in 1983 in Hungary's debt from its end-1982 level of $7.5 bn. ECGD commitments are modest and under tight control.

At end-December 1982 UK-registered banks' consolidated external claims on Hungary totalled $0.8 bn, largely unguaranteed. Claims by British-owned banks stood at $0.5 bn.

POLAND

Total convertible currency indebtedness is about $25 bn. Bank and official creditors both negotiated rescheduling agreements in respect of debts due in 1981. Following the declaration of martial law in December 1981 virtually none of the $10 bn convertible currency obligations falling due in 1982 has been paid. On 3 November the banks signed a rescheduling agreement covering 95 per cent of the $2.4 bn repayments of principal due in 1982. Under the agreement half the interest due in 1982 is being lent back in the form of new three-year credits. Western official creditors agreed after the imposition of martial law not to resume talks on official rescheduling for the time being and did not attempt to negotiate a rescheduling agreement for 1982. In practice, the effect of this refusal has been to give Poland a pretext to stop all payments to governments, thereby gaining 100 per cent de facto relief on both principal and interest, including amounts for which a rescheduling agreement was concluded in 1981.

The resumption of negotiations with Poland on rescheduling official debt was raised at the recent Paris Club meeting; it was agreed that the task force should reconvene to examine available data with a view to holding a full meeting of official creditors in Paris in mid-May. The commercial bank task force held preliminary negotiations in Warsaw on 21-22 March. Whilst Poland agreed to honour 1981 and 1982 commitments they pressed for a moratorium on 1983 principal and interest at least until 1990 and preferably 1992. Thereafter they sought an eight to twelve year repayment at concessional rather than market interest rates. There has been no bank response to the Polish proposals. ECGD is off cover.

At end-December 1982 UK-registered banks' consolidated external claims on Poland totalled $1.7 bn of which $0.8 bn was unguaranteed. Claims by British-owned banks totalled $1.4 bn, of which $0.5 bn was unguaranteed.

ROMANIA

At end-1982 convertible currency debt totalled $9.8 bn. Bilateral agreements covering 1982 payments have now been signed with all Paris Club governments except West Germany. Negotiations on the 1983 banking agreement, which provides for 30% of this year's maturities to be repaid in the second half of 1983, 10% in 1984 and the balance over six and a half years with four year's grace, are likely to be concluded shortly. However, a Paris Club meeting to open negotiations on 1983 reschedulings, originally scheduled for 14-15 April, was postponed because of arrears under the 1982 agreement. The meeting is now to take place on 18-19 May on the condition that all arrears are settled by 6 May. ECGD is off cover.

At end-December 1982 UK-registered banks' consolidated external claims on Romania totalled $0.9 bn of which $0.6 bn was unguaranteed. Claims by British-owned banks totalled $0.6 bn, of which $0.4 bn was unguaranteed.

YUGOSLAVIA

Total indebtedness is about $20 bn. Notwithstanding an IMF upper-tranche programme, Yugoslavia failed to come to grips with increasingly severe payments imbalances in the late 1970s. These resulted from high growth and from investment financed by heavy foreign borrowing for projects which often would not yield convertible-currency earnings to service the debt. With reserves now largely exhausted, an international package involving both governments and banks has been devised under IMF auspices to provide Yugoslavia with new credit whilst restructuring existing debts.

Funds totalling $0.5 bn net should be available from the IMF and IBRD. A memorandum of understanding signed in Berne in January by representatives of 15 creditor countries envisages that governmental funds amounting to about $1.4 bn will be made available in medium-term credits, mostly in the form of export credits. The first instalment (£19 mn) of the £38 mn HMG loan has been disbursed and negotiations have begun on the £40 mn loan guaranteed by ECGD to refinance payments due to UK exporters. In addition ECGD will remain on cover for short-term business.

On 25 March the commercial banks' International Co-ordinating Committee reached agreement in principle on the terms of a package incorporating the refinancing of $1.4 bn medium-term debt and $2 bn short-term credits maturing in 1983 and the provision of $0.6 bn new money. The banks have asked governments to refinance officially supported debt in 1983 on no less favourable terms; at a creditors' meeting in Zurich on 16 April governments agreed to provide details of the Berne package to the banks. Satisfactory progress towards signature of the commercial bank package is a condition of the IMF for release of the May drawing although in Zurich the Fund indicated that they were content for final signature to be delayed until end-June.

The BIS have offered a $0.5 bn facility; backed partly by central banks (release of $0.2 bn of this, which is backed by gold, is conditional on the removal of certain outstanding problems concerning

title to the gold). The Bank of England's share is $25 mn; the second instalment of the financial loan to be made available by HMG in August will take out the Bank.

At end-December 1982 UK-registered banks' consolidated external claims on Yugoslavia totalled $1.7 bn of which $1.3 bn was unguaranteed. Claims by British owned banks totalled $1.2 bn, of which $0.9 bn was unguaranteed.

FAR EAST

INDONESIA

Total medium- and long-term indebtedness is estimated at $20 bn at end-March 1983. Short-term exposure of BIS banks (the only available source for this category of debt) was $3.2 bn at end-June 1982.

With oil and LNG accounting for around 80% of export receipts, and other primary products for the bulk of the remainder, Indonesia has been badly affected by the world recession. The current account has swung from a surplus of $2.1 bn in 1980-81 to an estimated deficit of $7.3 bn in 1982-83 (ending 31 March) and over the past 12 months alone reserves have fallen by $4.9 bn to $6.4 bn (including $3 bn with the state commercial banks).

It is estimated that the reduction in the oil price, with consequential effects on LNG export prices, will cost Indonesia a net $2 bn of foreign exchange earnings in 1983-84. On 30 March, the rupiah was devalued by 27½% against the dollar and further measures of monetary and fiscal retrenchment are expected. The most significant result of the devaluation will be in restoring fiscal revenue of which 70% is derived from oil. There is some scope for import reduction but the direct benefit to exports from the devaluation is likely to be only modest. Following the devaluation, the authorities have forecast a current deficit of only $6 bn for 1983-84 but this looks optimistic, unless there is a very severe cut back on high-import content government development spending, and it might be more realistic to expect an outturn of, say, $7 bn.

The debt service ratio for 1982-83 is estimated to have been around 22% and is unlikely to be significantly higher in 1983-84. Indonesia has already obtained some $1.5 bn from the market this year. After expected inflows of development aid, direct investment etc, it seems probable that a financing gap of some $3-4 bn will still need to be covered. The Indonesians are in discussion with the Fund about a CFF purchase but their eligibility in respect of an oil export shortfall has yet to be established. A standby, however, could bring in $1.2 bn.

Indonesia has a good standing in the market, based on a reputation for sound economic management, good performance and a prudent strategy

in the past of diversifying borrowings. This year the Indonesians should be able to cover their financing needs by a combination of further borrowing, probably including the IMF, and use of reserves but they must expect to encounter increasing resistance from lenders if they attempt to step up their calls on the markets very substantially.

Before the oil price cut the IMF were projecting current account deficits for Indonesia of between $4.8 bn and $3.3 bn up to 1987-88 on the assumption of an unchanged nominal oil price through 1984-85, increasing thereafter in line with world inflation. In the light of the latest developments, Indonesia's prospects of avoiding debt problems after this year will depend critically on world recovery and the future trend in the oil price.

As at end-February 1983, ECGD had an estimated £230.6 mn at risk under Section 1 and £333.0 mn under Section 2. At end-December 1982 UK-registered banks' consolidated external claims in Indonesia totalled $1,159 mn; claims by British-owned banks totalled $1,014 mn of which $598 mn was unguaranteed.

PHILIPPINES

Total indebtedness at end-1982 was estimated at $19 bn. The external position of the Philippines has been deteriorating for some years. The country's dependence on imported oil, high interest rates and the world recession have all contributed, but the overall economic strategy - notably the commitment to a number of large industrial projects - and policy weaknesses have played their part. In 1982, the visible trade and the current account deficits, which have increased in each year since 1977, reached $2.8 bn and $3.4 bn (8½% of GNP) respectively and there was an overall payments deficit of $1.1 bn. Medium- and long-term debt increased by 17% and reserves fell by $0.2 bn to $2.5 bn (3.7 months' imports).

An SDR315 mn IMF standby and an SDR189 mn CFF purchase were approved in February. The standby programme provides for a reduction in the fiscal deficit - an area of major weakness - to 2.4% of GNP (1982 4.2%) and a cut in the current deficit to $2.5 bn, the improvement coming mainly from exports and increased invisible receipts (primarily remittances from the Middle East where the authorities are offering incentives to bring into the system a greater proportion of workers' earnings). Net long-term capital inflow of $1.9 bn is expected, of which some $0.7 bn is to be accounted for by commercial borrowing; a syndicated loan to the central bank has already raised $0.3 bn. The projected overall deficit of $0.6 bn, will largely be financed by IMF assistance. Besides ceilings on new medium- and long-term borrowing, the programme incorporates an undertaking not to permit any net increase in trade related short-term debt and to monitor closely other short-term debt. The precise total of the short-term debt is not clear - BIS banking figures probably include some double-counting but the IMF estimate is around $6 bn.

The IMF report that performance criteria were being met up to March and a mission will visit Manila in June. The oil price reduction will save an estimated $300 mn on the oil bill this year, and further restraints have been placed this month on foreign exchange expenditure and borrowing by state enterprises. IMF projections of only gradual improvement in the external position over the next few years, however, with the balance of payments not returning to overall surplus until 1985, and the debt service ratio - estimated at 24.8% for this year - still only just below 25% in 1987 are indications of continuing strain.

The Philippines now feature regularly in discussion of likely candidates for rescheduling. There is no evidence yet of banks reducing credit lines, but the talk is that most major banks are at or close to their limits for the Philippines and reluctant to increase exposure further. World recovery would ease the situation, but if a debt crisis is to be avoided confidence will have to be maintained, and policies of restraint followed for some time ahead.

As at end-February 1983, ECGD had an estimated £203.5 mn at risk under Section 1 and £8.9 mn under Section 2. At end-December 1982 UK-registered banks' consolidated external claims in the Philippines totalled $1,777 mn; claims by British-owned banks totalled $1,609 mn of which $1,162 mn was unguaranteed.

SOUTH KOREA

Total indebtedness at end-1982 was estimated at $37.2 bn.

The second oil shock in 1979 was imposed on an economy already strained by rapid and unbalanced growth, and the current account deficit rose to $5.3 bn in 1980. Firm policies of domestic restraint, flexible management of the exchange rate and weak commodity prices combined to bring down the deficit to $2.5 bn last year. Heavy borrowing over this period of adjustment, however, more than doubled the external debt between 1978 and end-1982.

For 1983, the official forecast is for a further reduction in the current deficit to $2 bn. In January/March the deficit, at $1.0 bn (January/March 1982 -$0.3 bn), was sharply up on the corresponding period of last year, but there will be an estimated net gain to the current account from the reduction in the oil price of some $0.6 bn ($0.8 bn saving on the oil bill, less $0.2 bn loss of earnings from Middle East construction projects). The total projected financing requirement for this year is $6.3 bn, of which $1.4 bn is to come from new bank borrowing; a syndicated loan to the Korea Exchange Bank has already raised $0.5 bn, though on somewhat harder terms than previous Korean borrowing.

Reserves were $6 bn at end-March (three months' imports), and the debt service ratio for this year is 19%. Korea has made a relatively successful adjustment and is still, generally, well regarded in the markets, but attention has recently focused on her position as the fourth largest ldc borrower after Brazil, Mexico and Argentina and on her large stake in construction business in the Middle East, and the high level of her short-term debt - $14.1 bn at end-1982, 38% of the total - makes her vulnerable to changes in confidence. During recent discussions in Seoul the IMF Staff were pushing the Koreans for a current surplus within two to three years. The Koreans have now approached the IMF with a view to a standby. It is understood that they have in mind a modest amount, more, at this stage, as a seal of Fund approval of their policies than because they need the funds.

As at end-February 1983, ECGD had an estimated £235.9 mn at risk under Section 1, and £345.2 mn under Section 2. At end-December 1982 UK-registered banks' consolidated external claims in South Korea totalled $3,060 mn; claims by British-owned banks totalled $2,596 mn, of which $1,995 mn was unguaranteed.