



RECORD OF A DISCUSSION BETWEEN THE CHANCELLOR AND THE IMF MANAGING DIRECTOR, AT NUMBER 11 AT NOON ON 28 JUNE

M. de Larosiere expressed concern about the overall world economic situation. The two key problems were the US deficit, keeping interest rates high, and the financial situation of many developing countries, who badly needed interest rate reductions, and the sustained recovery in world markets which would permit improved export performance. There was no sign of the Americans taking action to forestall deficits of \$200 billion a year, which would absorb more than 80% of net US domestic savings. US monetary policy was likely to tighten, bringing higher interest rates. And while the US recovery was now fairly rapid, interest rate increases could again put it in jeopardy. And if world recovery were to falter, the world financial system would be threatened, for a number of countries would find it very difficult to keep to agreed debt servicing and repayment programmes.

2. M de Larosiere said that, among the three countries which had caused most concern over the last year, the performance of Mexico and the Argentine was now rather better than the IMF had expected. The situation in respect of Brazil was however very different. Brazil had breached a number of key performance targets, and the IMF had accordingly been obliged to stop payments. A negotiation on the measures which Brazil would have to take in order to have the IMF programme reactivated had so far brought no agreement. The Brazilian Government seemed to lack determination and political will: the President was being advised from certain quarters to dig in against essential measures, and in particular against changes in the pay and pensions indexation arrangements. There was a risk that he might feel tempted to move to an outright default on external debt obligations. The IMF had asked that the White House should warn ^{Brazilian} ~~the~~ President, in inominatory terms, that he was playing with fire. But what was quite certain was that if Brazil did not meet the agreed performance criteria, no IMF money would be forthcoming.



3. M. de Larosiere added that of course some in Brasilia might see attractions in a Polish solution, under which, while receiving no new IMF finance, Brasilia might enjoy a de facto moratorium on outstanding debt. It must be made plain in advance, and proved if the eventuality arose that this would be a very much more costly route for Brazil to go down. The risk of the contagion spreading made it essential that Brazil should realise, and that it should if necessary be demonstrated, that default would be sharply punished, with no new trade credits from any source, and, if necessary, the seizure of assets abroad.

4. The Chancellor entirely agreed that it was essential to maintain the principle, and demonstrate in practice, that the IMF was not a soft touch. Some in Brazil might think that the world financial community could not afford to see them go under: it must be made plain that this was an illusion. He agreed with M. de Larosiere that discreet planning among the principal IMF members might now be in order, and that this might conveniently take place at the meetings of G5 and G10 Deputies in the first week of July.

5. Turning again to Argentina, M. de Larosiere said that the problem of discrimination against UK non-banking concerns remained, and that the IMF had again stressed to the Argentine authorities that all such restrictions must be lifted by the end of July if the IMF drawing then due were to go ahead. The Argentine authorities argued that a political gesture, in the form of some relaxation of the exclusion zone, would be required from the United Kingdom before they could remove the restrictions in question: but they had been told in reply only that continuing discrimination would mean no further IMF finance.

6. The Chancellor said that he was glad to hear that the IMF were continuing to take this line, which was clearly right. It was a question of principle, and of law. M. de Larosiere said that he did not think that the problem would be quickly solved. The Argentine authorities were likely to seek a waiver from the Fund, but he had told the Argentine central bank governor that he would get little support on the IMF Board for such a waiver, and none from the Fund

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itself. The legal issue was perfectly clear, and the Board was rightly very hostile to discrimination of the kind which the Argentine was practicing.

7. M. de Larosiere added that the Mexican programme was going very well. The Mexican authorities, by contrast with the Brazilians, had grasped the nettle, and had got their Budget back on track, with massive public expenditure reductions and tax increases. Following the devaluation, there had been a huge increase in exports, and the balance of payments position was now better than envisaged when the programme was negotiated, even though the expected future oil price had fallen.

8. The Chancellor said that it was important to try to reduce the risk of further future crises such as those which had affected Mexico, the Argentine and Brazil. He recalled earlier efforts to secure closer supervision and co-ordination of commercial lending: had they produced any results? M. de Larosiere said that there had been some progress. It was important too that the Fund should give clearer and earlier warning about worsening country debt situations. Governments too should envisage earlier warnings to their commercial banks. And the co-ordination of Fund and commercial bank lending policies should be further improved. The most pressing problem was however to encourage banks to avoid unco-ordinated and over-rapid withdrawals from problem areas.

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29 June 1983

PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Mr Middleton
Sir T Burns
Mr Littler
Mr Lavelle
Mr Carey
Mr Ridley
Mr Bottrill
Mr Peretz

Mr Coles No 10
PS/Secretary of State, FCO
PS/Governor, Bank of England
Mr Wicks, UKDEL-IMF/IBRD, Washington