2.10 CONFIDENTIAL

Prime Minister

An important paper. Submit again at the weekend?

MCS 13/7

Treasury Chambers, Parliament Street, SWIP 3AG
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13 July 1983

Michael Scholar Esq.
10 Downing Street
LONDON
SW1

Dear Michael,

INTERNATIONAL FINANCIAL SCENE

In his minute of 8 July the Chancellor mentioned that he would this week be sending the Prime Minister a further monitoring report on the international debt situation. I now enclose a text prepared by the Bank of England and discussed with them and other departments in the Treasury's debt monitoring group last week. As usual, a table is attached showing the exposure of ECGD and British banks to the major problem countries.

We are in touch separately about Brazil, and the developments described in Kit McMahon's letter of 12 July to you.

The Chancellor has asked me to draw attention to the following three particular points:

a. The IMF programme for Mexico is going well. The rescheduling of official guaranteed private sector debt was agreed recently in Paris: the ECGD element amounts to £111 million in total, this year and next. Part can probably be covered by a new guaranteed refinancing line of credit - avoiding any PSBR cost - but the remainder, amounting to some £36 million in 1983 and £31 million in 1984, will have to be paid out in claims.

b. No proposal has yet been made - and we hope none will be -to reschedule Brazil's officially guaranteed public sector debt. The potential PSBR cost to us would, of course, depend on the terms and on the scope for refinancing, but on the "worst cast" assumption it might amount to about £220 million in total over this year and next.

c. The question of Argentine discrimination against British firms should come to a head in the IMF between now and mid-August. Discrimination against British banks appears to have ended - the Argentinian authorities are clearly anxious to secure signature of the £1.5 billion commercial bank loan - but there is as yet no sign of an end to discrimination against other British businesses. In these circumstances IMF funds will cease to be available unless Argentina can secure a waiver, for which the IMF Board approval would be required. The IMF Managing Director has so far been commendably firm and the Americans have told the Argentine authorities that they support our case - and his - against a waiver. We are lobbying other Executive directors in Washington, and the FCO are arranging parallel lobbying in capitals. We have asked the Bank and the Department of Trade to try to accelerate some 'test cases' by British non financial companies; and the Bank, at the Chancellor's request, are making clear to the British banks involved in the £1.5 bn commercial loan that we would not wish signature to take place unless and until Argentina satisfies the IMF on the issue of discrimination.

The Treasury wrote to us undertaking to let us know if the banks were close to signing.
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And I have reminded them again this evening
MCS 13/7

We shall aim to submit the next full report in this series on the normal timetable at the beginning of September. Meanwhile we shall, of course, report on any specific developments as appropriate. We shall also maintain close contact with the JIC (now represented on the Treasury Monitoring Group) which has produced excellent reports recently on the situation in both Argentina and Brazil.

I am sending copies of this letter to Tim Allen (Bank of England) Brian Fall (FCO) and John Rhodes (DoT).

Yours,
Judith

pp J O KERR
Principal Private Secretary (approved by John & signed in his absence)

INTERNATIONAL FINANCIAL SCENE

General Situation

1 On the positive side international economic developments confirm that recovery is under way in the seven major industrial countries, where first quarter GNP figures show a 1/2% rise over the previous quarter. Also, in the US, second quarter preliminary estimates exceed expectations. On the negative side, however, market concern about a rapid expansion of M1 in the US has contributed to an appreciable rise in short-term interest rates since the end of May. Similar pressures have been felt in Germany. If the upward shift were to continue generally it could aggravate debt service problems of certain countries and even possibly precipitate new ones.

Attitudes towards new lending

2 Latest information suggests that on the international banking markets new lending continues to be low, with the greater part going to developed countries. In the London market second quarter lending has been more depressed than in the first quarter. Interbank lending has also been slowing down, and although probably in part a parallel to the slow down in final lending, banks are still generally being more selective in their dealings. Many banks, British and foreign, are feeling the need to slow down international lending for balance sheet reasons; and they are seeking to return to traditional forms of trade-related finance in place of balance of payments lending to sovereign borrowers.

3 In the US it is only large banks, which are less constrained by capital considerations and very concerned to protect their existing heavy exposure, that are showing much appetite for further international lending, whereas most regional banks are trying to draw back. It is still unclear how the willingness of US banks to participate in further rescue packages will ultimately be affected

by the proposed Congressional legislation. The amended capital adequacy guidelines for the 17 largest US banks announced by the Federal Reserve Board and Controller of the Currency may partly have been designed to assuage Congressional pressures but, while not having any immediate effect on lending policies, the changes have been taken as a sign that the authorities will continue to look for a steady improvement in capital resources, and thus could have some deterrent effect on international lending.

Adequacy of new lending

4 It is now clear that many international banks regard the IMF's earlier projection of a 7 - 8% rise in net new lending to non-oil developing countries in 1983 and 1984 as too optimistic; and, following their own talks with banks the IMF have revised the range down to 5 - 7% (ie $15 - 20 bn). German and Swiss banks are probably aiming to avoid any increase in such lending in aggregate: with the UK banks pursuing cautious policies the Fund's newest forecast which pitches somewhat between the continental and American banks' behaviour seems plausible. It remains to be seen, however, whether an increase in international lending of the size of the revised IMF forecast will be forthcoming or, if it is, sufficient to finance the prospective current account deficits of non-oil ldcs (although the IMF assumes other capital flows will at least partly fill the gap).

5 Again, both the IMF and Institute for International Economics of Washington have been arguing that a 3% GNP growth in industrial countries through this year and next will be sufficient to 'float' off the debt problem, by improving debtor countries' export earnings and also by permitting a higher nominal growth of bank lending to them. The 3% growth figure has now acquired a certain air of validity but more cautious policies being pursued by many international banks leave doubt as to whether, even if this rate of economic growth is achieved, the volume of lending predicated in it will be forthcoming. There is a risk that contributions to financing packages for problem countries will crowd out some of the other ldc borrowers who will then face a need for greater or faster adjustment. This in turn could spread liquidity problems to them.

BIS Issues

6 A satisfactory outcome to the financing difficulties could depend on the solidarity of the international banking community. This may soon be tested by Brazil where the authorities seem to be displaying a lack of political will or of administrative capacity to adopt needed new economic measures. Failure to meet the IMF quantitative targets means that Brazil has been debarred from further drawings until fresh talks with the IMF are successfully concluded. Consequently a $400 mn maturity due to the BIS (originally at end-May) has been postponed to 15 July and a decision will soon have to be taken on rolling over for a further period, or bringing into effect the Substitution Agreement whereby the underwriting central banks will assume the bulk of the BIS' rights and obligations.

7 A tendency too readily to think that the BIS can always spring into action to avert liquidity crises has been dispelled by clarifying remarks made by its President at the June AGM in Basle. Leutwiler pointed out that although future bridging finance was not ruled out such assistance could only be made available to meet temporary liquidity problems which would have repercussions beyond the country in question if not dealt with promptly. He stated that the BIS' resources were limited and that, since they derived from the liquid assets of central banks, BIS credit could only provide bridging finance and then only when it was possible to see the source from which the borrowing would be repaid. Normally, he added, the BIS only gave credit against suitable collateral.

Conclusion

8 It is clear from the foregoing that the international financial system could well face further challenging tests in the months ahead, either because existing programmes threaten to come off the rails or because of greater difficulties in putting together the second year packages for the heavily indebted countries or because the list of problem countries grows by contagion. It is also clear that the banking community is increasingly persuading itself that in

future a greater part of the financing burden ought (as in the case of Yugoslavia) to be carried by official agencies. In some instances, too, the debtors themselves will be obliged to take still more unpalatable measures of retrenchment than is already the case. But there is no brooking the fact that pressure will grow for more rescheduling through the Paris Club of debts officially guaranteed by ECGD and similar bodies; and there will be powerful arguments in favour of their maintaining cover towards the debtor countries concerned in the same way as the banks are expected to increase their net exposure to them.

Problem countries

(i) Latin America

9 As already mentioned, Brazil's financial package is in difficulty and the immediate outlook is uncertain. The liaison arrangements between the banks and Brazil have been restructured with the formation of a Co-ordinating Group of some 60 banks and within it a smaller 14 bank Advisory Group. This latter body has suggested that the country will need approaching $5 bn new money this year and $5 bn in 1984 with a rescheduling of that year's maturities.

10 Argentina's failure fully to remove discriminatory sanctions against the UK threatens her continued eligibility to make purchases under the IMF standby. The deadline is 31 July. Recent official contacts with the Managing Director of the IMF have confirmed that he is maintaining his robust line against discrimination. The Fund Staff are about to circulate a technical paper which, while drawing no conclusions and making no recommendations, is understood to demonstrate clearly that discrimination remains. However, following release of the second tranche of the IMF standby on 31 May and Argentine assurances that the country's proposed new bankruptcy law will avoid any reference to discrimination against foreign banks, the Advisory Group of banks has announced (30 June) final agreement with Argentina on the $1.5 bn new money loan. Signature may therefore take place before the end of July. Although there

E (but see my note in covering letter)

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could still be some further postponement over a technical difficulty, following the amendment of Law 22591 which now gives the authorities discretion to relax discriminatory financial restrictions against UK entities, LBI has been authorised and BBI expects authorisation to export Bonex bonds representing dividends. Any drawdown under the loan may not be possible should Argentina fail (or be expected to fail) to meet the Fund's 31 July deadline for the removal of discriminatory sanctions, since the Fund is first required to confirm that Argentina remains eligible to make purchases.

11 In contrast, Mexico has successfully met all first quarter IMF performance targets and is expected to meet second quarter targets too. The second draw-down of EFF funds at end-May was used to make an unexpected partial repayment to the BIS and to the US.

12 In order to safeguard their ability to pay the balance ($1.5 bn) of these bridging facilities by the final maturity date of 23 August, the Mexicans have refrained from drawing on the second $1.1 bn tranche of the $5 bn medium-term commercial bank loan which has become available. Negotiations to reschedule non-guaranteed public and private sector debts due to banks are progressing slowly and it may be some months before agreements are fully effective. However, multilateral agreement on the restructuring of officially guaranteed private sector debt was reached at an informal Paris Club meeting on 20-22 June.

13 Elsewhere in Latin America the Peruvian rescue package was signed on 30 June and signature of the various packages for Uruguay, Ecuador and Chile is expected within the next month. However, some uncertainties still remain. The Venezuelan talks with creditor banks have been hampered by the emergence of substantial public and private sector interest arrears. Formal rescheduling proposals have now been put to the Advisory Committee; but the original moratorium has been extended for yet another 90 days as progress is likely to be held up until a Fund facility - with conditionality satisfactory to the bankers - is agreed. Venezuela seems very reluctant to enter into conditionality in the run up to next December's Presidential elections. The Venezuelans have however applied for a 100% CFF drawing and they might find it easier to

accept the conditionality that would need to be associated with this, although the question of eligibility is still contentious. A Fund mission will leave for Caracas on 10 July.

(ii) Eastern Europe

14 Recent weeks have been a period of relative calm and even modest progress so far as East European indebtedness is concerned. The Romanian agreement with the commercial banks, rescheduling 1983 maturities, was signed on 20 June; and prospects for a new agreement between Poland and the banks are improved now that the Poles have apparently drawn back from earlier proposals that banking debt maturing up to the end of 1985 should be rescheduled for 20 years and seem instead to be seeking extensive relief for a more conventional period on principal and interest due in 1983. Official creditors will shortly be considering their own position in the aftermath of the papal visit to Poland. Meanwhile, the FRG has offered to guarantee a DM 1,000 mn ($400 mn) five-year credit to the GDR, which faces heavy debt maturities this year, and there are hints of approaches to other creditors for debt relief. On the other hand the international support package for Yugoslavia has not yet been completed: agreement with the commercial banks has been delayed by further negotiations on a number of conditions and the moratorium on debt maturities has had to be extended again to 27 July. Signature is now expected in early August.

(iii) Southern Europe

15 There are no immediate problems in Southern Europe, although several countries are faced with uncomfortably large borrowing programmes to refinance their continuing external deficits. The recent 12% effective devaluation by the new administration in Portugal and the prospect of imminent recourse to the IMF should assist market sentiment after a long period of drift and uncertainty. Meanwhile Portugal has borrowed $400 mn from the BIS against pledged gold and another $300 mn to be repaid out of firm gold sales being undertaken by the BIS.

(iv) Far East

16 Recent developments in the problem countries in the Far East are mixed. On the one hand, in the Philippines, both the underlying situation and market confidence have deteriorated. The balance of payments deficit for the first six months of 1983 is thought to have exceeded the originally projected deficit for the whole year; US regional banks have been reducing their credit lines; and a proposed $100 mn market loan is meeting with difficulties. The peso was devalued by 7.3% against the dollar on 30 June and the deferment of five major industrial projects has been announced. In such a situation of increasing strain a debt crisis before the end of the year cannot be ruled out, although the outlook may be clearer after an IMF Mission now reviewing the standby has reported.

17 On the other hand, South Korea continues to make progress with its adjustment. An IMF standby under negotiation includes performance criterion to freeze short-term debt at its end-1982 level, and the government have set a 1987 target for current account surplus - last achieved in 1965 and 1977; the latest large syndicated loan appears to have met with a favourable response from lenders, after some hardening of terms, in line with the general trend for the region.

18 Market sentiment also remains generally favourable towards Indonesia. Earlier measures aimed at limiting the current account deficit in 1983/84 have been reinforced by steps to reduce imports of capital goods, and the adjustment strategy has been endorsed by a recent IBRD report and by the major aid donors whose new commitments of aid at the mid-June meeting of the Inter-Governmental Group for Indonesia (IGGI) were some 10% higher than last year.

July 1983

INDEX

*Brazil: see separate note

Note: An estimate of the country's total external debt is given at the beginning of each note and a statement of ECGD's position and the exposure of UK banks is given at the end.

ARGENTINA

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

Argentina's failure fully to remove discriminatory sanctions against the UK threatens her continued eligibility to make purchases under the IMF standby. The deadline is 31 July. Recent official contacts with the Managing Director of the IMF have confirmed that he is maintaining his robust line against discrimination and has told Argentine Central Bank President Gonzalez del Solar that the IMF Board is unlikely to support a request for the waiver of this condition. However performance under the 15 month standby arrangement was deemed satisfactory for the first quarter of 1983, and the IMF have released the second tranche (SDR 300 mn). This has been well received by creditor banks. Interest arrears, so far only paid to end-April, will be brought up to date by using the last tranche of the bridging loan. This will require a waiver from the banks, as release of the $300 mn involved was originally conditional on the prior elimination of arrears. This money will be placed in an escrow account to enable interest payments to be made and prevent Argentina using the funds for other purposes. A further obstacle to signature of the $1.5 bn medium-term loan (UK share of $159 mn), originally targetted for 31 March has been removed by the issue on 1 June of new regulations for the refinancing of $1.4 bn in foreign currency swaps and private sector loans covered by exchange guarantees, which now concede higher rates of interest than the authorities were formerly prepared to offer. Progress has also been made concerning the problem of discrimination against foreign creditors under Article 4 of the Bankruptcy Law. The Justice and Finance Ministries as well as the central bank all now endorse the implementation of a new law which will exclude any suggestion of discrimination. Following these assurances, the Advisory Group of banks had announced on 30 June that agreement had been reached with Argentina on the medium-term loan, signature of which may now take place before the end of July but according to our sources a number of banks are not happy about the proposal to waive penalty interest which may cause a delay in signature beyond the end of July.

Meanwhile a draft agreement which banks will use as a model in separate refinancing talks with their Argentine public sector debtors is expected to be ready before end-July.

On the IMF requirement that existing discriminatory financial restrictions against UK companies, embodied in Law 22591, be removed in order for further drawings from the Fund to take place after 31 July the authorities have recently opened the possibility of going some way towards this: on 6 June they published an amending law (Law 22820) which allows the Committee of Vigilance overseeing British assets in Argentina to suspend the ban in relation to particular individuals or companies. The law also empowers the government to lift the ban in general terms "taking into account the general interest and equal treatment given to the Argentine Republic". However, in both cases, the ban may be reintroduced.

To date only LBI have received formal authority to remit their dividend by BONEX out of Argentina although it can be expected that BBI will be granted similar permission in the immediate future. Although we have not received official confirmation of the report that all UK non-bank company applications to remit dividends have been refused, Del Solar has repeated on several occasions that any relaxation of restrictions affecting non-banking companies would be linked to UK concessions on the Exclusion Zone. When BBI's application has been approved both British banks will apparently be prepared to proceed with their shares of the new money loan despite the continuing discrimination against UK non-bank companies. However any draw-down under the loan ought not to be possible should Argentina fail (or be expected to fail) to meet the Fund's 31 July deadline for the removal of sanctions, since under the loan agreement the disbursement of each tranche of new money depends on Fund confirmation that Argentina remains eligible to make purchases.

CHILE

Total indebtedness at end-1982 was $18 bn (two-thirds private sector).

At the last count commitments towards the new money target of $1.3 bn totalled around $1.25 bn. Although some smaller creditor banks are reportedly reluctant to give final commitment because of the labour unrest in the country it is believed that the full amount will be reached. The target date for signature of the loan is 21 July. The short-term trade-related facility of $1.2 bn sought has been oversubscribed by some $0.4 bn. The BIS is reported to have increased the $350 mn bridging facility to $400 mn; $250 mn of this had been drawn by the end of June and some, but not all, of the remainder is expected to be withdrawn this month. The Chileans do not expect to have to draw on the bridging loan offered by the Advisory Group (originally $180 mn, subsequently reduced to $60 mn).

A Fund team visited Santiago at the beginning of July to assess economic performance against the revised end-June targets under the SDR 500 mn two-year standby. The IMF Managing Director is scheduled to present a waiver request (of the original targets) to the Executive Board on 27 July.

ECUADOR

Total indebtedness at end-1982 was $6.3 bn ($4.7 bn public sector).

Final agreement on the rescheduling package was reached between the Steering Committee and the Ecuadorians at a meeting on 8 June. Some 400 creditor banks were subsequently asked to ratify the following package by 30 June:

(i) The refinancing, over seven years including one year's grace, at 2 1/4% over LIBOR or 2 1/8% over Prime of both $1.1 bn public sector maturities due 1.11.82 - 31.12.83 and around $950 mn private sector maturities due in 1983 and outstanding on 21. 4.83. Creditors have the option of converting private sector debt into debt of the Banco Central.

(ii) $431 mn new money (representing a 9% increase in exposure for individual banks on levels outstanding at 31.12.82) over six years including 1 1/2 years' grace, at 2 3/8% over LIBOR or 2 1/4% over Prime. Funds to be disbursed as follows: 25% on 15.7.83, 50% on 15. 8.83 and 25% on 15.11.83.

(iii) Maintenance of short-term trade-related lines at level outstanding on 30. 4.83 (around $750 mn).

Disbursements under the SDR 157.5 mn standby (approved in principle on 1 June) are contingent on creditor banks agreeing to the whole package by 15 July.

The rescheduling of "official" debt will be discussed at a meeting of the Paris Club tentatively scheduled for 27-28 July; principal and interest payments on such debt were suspended with effect from 1 June.

MEXICO

Total indebtedness at end-1982 was an estimated $83 bn.

On 23 May, the IMF Board formally acknowledged Mexico's compliance with all first quarter performance targets under the SDR 3.4 bn EFF thereby releasing the second draw-down of SDR 301 mn. This was used by the Mexicans at end-May to make an unexpected advance repayment of $320 mn to the BIS and to the US, reducing the total amount outstanding under the two bridging facilities from $1,850 mn to $1,530 mn; at the same time, the Bank of England's capital commitment (which is covered by HMT's indemnity) has fallen from $140 mn to $115,821,000. The release of IMF funds also opens the way for disbursement of the second $1.1 bn tranche of the $5 bn medium-term commercial bank loan. However, the Mexicans are husbanding their resources and refraining from making an immediate drawing in order to be sure of being able to repay the balance of the BIS and US facilities by the final maturity date of 23 August.

On the economic front, the Mexicans' main success has been with the balance of payments. In the first half of this year, the estimated trade surplus totalled $5.6 bn - well over two-thirds of the forecast outturn for the whole year. Moreover, during the first quarter, net international reserves rose by $1.3 bn compared with the IMF performance criterion that there should be no reduction. The authorities are confident that they will be able to satisfy all second quarter performance targets and that no additional new money will be required for 1983. The international banking community are beginning to share this optimism.

As part of a public relations exercise aimed at speeding up rescheduling negotiations, Gurria, Director-General of Public Credit, toured a number of European capitals, including London which he visited on 23 June. Discussions between the Advisory Group and the authorities on draft documentation covering the rescheduling, over 8 years, of some $19 1/2 bn public sector debt owed to banks are now expected to be concluded by mid-July. However implementation of the model agreement, involving 24 public sector agencies, is unlikely to start much before the beginning of August.

It is perhaps too early to gauge fully the success of the Mexican scheme to reschedule, over a minimum of 6 years, the non-officially guaranteed element of the total of $14 bn in private sector debt owed to banks. The scheme has been in operation since 25 April and stays open until 25 October. Nevertheless, preliminary indications are far from encouraging. So far only $260 mn owed by 70 companies has been rescheduled via forward dollar purchases, with many companies unable to take up any of the repayment options, even where peso loans are made available. The possibility that the scheme may have to be modified can not be ruled out. A third (small) repayment of private sector interest arrears built up between 1 August 1982 and 31 January was made on 1 June, bringing the total of such payments to date to around $130 mn. Outstanding balances, currently totalling over $600 mn, which remain unpaid by 30 September are to be refinanced.

A multilateral agreement on the restructuring of some $1 1/2 bn of officially guaranteed private sector debt was signed at an informal Paris Club meeting on 20-22 June. Under the agreement, 90% of medium-term maturities (including arrears) falling due in the second half of 1983 will be paid over 6 years, including 3 years' grace; arrears at end-June 1983 on short-term debt must be fully paid off within 3 years; short-term maturities due in the second half of this year together with all interest payments on all categories of debt, are to be paid on schedule. Creditors are to negotiate bilaterally either refinancing or rescheduling, as appropriate, and have agreed to consider, in due course, the treatment of some $450 mn in medium and long-term maturities falling due in 1984. The Mexicans are hoping that the agreement will allow the $2 bn package of new official credits to be finalised. To date, a number of important insurers, including France and Japan, have not been offering medium-term cover. By contrast, ECGD's commitment to provide $150 mn has largely been used up.

PERU

Total indebtedness at end-1982 was an estimated $12 bn.

On 30 June an agreement covering the new money and medium-term refinancing elements of the commercial bank rescue package was signed in New York by most of Peru's 300 or so creditor banks. For unexplained reasons the amount to be refinanced has been raised by some $100 mn from the $320 mn originally understood to be involved. Although the $450 mn new money loan is currently over-subscribed by some $80 mn, 14 banks have not yet made commitments and the Advisory Group has sought the support of central banks, including ourselves, in securing as close to 100% participation as possible. Only when this has been achieved will banks receive a rebate to reduce contributions to the $450 mn requested, and the loan be disbursed. The first draw-down of $250 mn is provisionally scheduled to occur before end-July and will largely be used to repay a $200 mn bridging loan advanced by the Advisory Group to enable the IMF's end-June reserves target under the EFF to be met. The balance of the new money will be available in two tranches of $100 mn each in September and December.

As for the rollover of some $2 bn in short-term debt, numerous loose ends remain to be tied up (including the problem of reconciling figures) before this third element of the rescue package is fully signed.

In the four months since the rescue package was conceived Peru's economic situation has deteriorated markedly, with a series of natural disasters at home having contributed to budgetary and inflationary pressures. And although on 20 May, the IMF Board approved disbursement of SDR 187.5 mn for the second year of the EFF, it remains to be seen whether the authorities are able to tighten policy sufficiently in order to continue to meet performance targets in the second half of this year and avoid the need for additional new money.

Against this background, the Peruvians are seeking to restructure over 8 years, including 3 years' grace a total of some $1.2 bn in official debt maturities falling due between 29 April 1983 and 28 February 1985. They estimate that around 90% of this amount is owed to Paris Club creditors who have been asked to reconcile sums involved in advance of a Paris Club meeting on 27-28 July. The rescheduling does not affect maturities covered by the 1978 restructuring.

ECGD are currently not prepared to underwrite business outside the short-term.

VENEZUELA

Total indebtedness at end-1982 is estimated at $34 bn.

Finance Minister Sosa has recently stated that the authorities intend to implement their own economic programme to restore growth and balance of payments equilibrium in two and a half years. They regard the IMF's conditions for a standby arrangement - including a devaluation of the bolivar and corrective fiscal measures - as being too severe in an election year. Indeed, they appear to be stalling on taking any major decisions which would further undermine their election chances. Although Sosa has assured the banks that he has political backing for the rescheduling negotiations, consensus apparently remains to be reached with opposition parties.

Sosa presented Venezuela's formal rescheduling proposals to the Advisory Committee on 6 - 7 June. These involve rescheduling public sector maturities due in 1983 ($13.7 bn) over eight years and those due in 1984 ($2.6 bn) over seven years - both with four years' grace. Little significant progress is likely to be made in the negotiations, however, until a Fund facility - with conditionality satisfactory to the bankers - is agreed. Meanwhile, the original moratorium (which expired on 30 June) has been extended for 90 days. The Advisory Committee has also insisted that public sector interest arrears be brought up to date and that guarantees be given on the provision of foreign exchange to the private sector where interest arrears total around $250 mn. As a result, the system of obtaining dollars from the Differential Exchange Controls Office has been simplified and the government has stated that interest and short-term trade arrears will be paid off by 15 July. This commitment (if it is translated into action) is welcome to bankers who had become concerned that the question of private sector debt (not included in the moratorium) was being neglected in favour of progress on the public sector rescheduling. It has been confirmed that Venezuela is not seeking new money for 1983.

The authorities are to apply for a first credit tranche drawing equivalent to 25% of quota (currently SDR 990 mn) and a CFF of

$1.1 bn; they also intend to withdraw the $1.3 bn available to them unconditionally through encashment of SDR's/reserve position draw-down. The conditionality associated with a CFF might be easier for the Venezuelans to accept, but the question of eligibility remains contentious. A Fund mission will depart for Caracas on 10 July. The 1983 Article IV paper, which was discussed in the Board on 1 July, is highly critical of current policies.

EAST GERMANY (GDR)

Total convertible-currency indebtedness (perhaps as much as $15 bn at end-1981) probably declined in 1982.

Gross debts to BIS area banks (excluding banks in West Germany) fell from over $10 bn at end-1981 to $8.9 bn at end-1982. The GDR gives considerable publicity to its BIS position but the $0.5 bn increase in deposits with BIS area banks to $2 bn at end-1982 probably owed much to window-dressing. Existing undrawn credit facilities remain considerable but inability to raise substantial new medium and long-term credit from Western banks has largely confined the GDR to short-term borrowing. Gross debt maturities (including short-term), which probably exceeded $5 bn in 1982, are unlikely to fall much below that in 1983 and 1984. GDR importing agencies 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. A substantial improvement in the trade account in 1982 was achieved primarily by drastic import cuts (other than from the FRG, with which there was an increase in bilateral indebtedness after the decline in the earlier part of 1982). At the end of June the FRG government (from which the GDR had sought support for a loan of DM 3,000 mn to DM 5,000 mn in the latter part of 1982) announced that it would guarantee a DM 1,000 mn ($400 mn) balance of payments loan to the GDR. This may mitigate the immediate liquidity position but prospects for the longer term remain uncertain and serious debt-servicing problems and even rescheduling are still possible; indeed, there is a - so far unconfirmed - report that the GDR is already conducting negotiations with some creditor countries on possible debt rescheduling.

At end-December 1982 UK-registered banks' consolidated external claims totalled $1,498 mn, of which $1,393 mn was unguaranteed (cf $1,543 mn and $1,463 mn respectively at end-June 1982). Claims by British-owned banks totalled $906 mn, of which $811 mn was unguaranteed (cf $941 mn and $863 mn respectively). ECGD has £113 mn at risk.

HUNGARY

Convertible currency debt at end-1982 totalled $7.5 bn.

The performance criteria under the one-year IMF standby arrangement are being met and the recent mid-term review passed smoothly. The formal target for the surplus on the convertible-currency current account has been reduced from $600 mn to $500 mn following Hungarian pessimism about the prospects for exports and particularly prices for agricultural exports. However, in view of recent and prospective measures (including further depreciation of the exchange rate, price increases and a wage freeze in the government sector) the IMF staff remain confident that a surplus of $600 mn can be achieved.

Hungary repaid $100 mn to the BIS on 30 June when it became eligible to make a drawing of SDR 83 mn ($89 mn) from the IMF. Two IBRD loans totalling $239 mn have recently been agreed but a review of the methodology of computing per capita GNP may disqualify Hungary from further such borrowings (the question of IBRD procurement in Centrally Planned Economies is also being studied). The capital account remains weak - there was an outflow of $400 mn in the first quarter partly as a result of a reversal of end-year window-dressing - and the financing gap is proving difficult to cover despite IMF drawings and a recent club loan for $200 mn. Negotiations are currently taking place with Arab and Japanese led syndicates for cofinancing loans totalling $250 mn following the IBRD agreement. A further approach to the banks may be made later this year. The liquidity position is unlikely to ease next year when medium and long-term capital outflows are set to rise from $1 bn to $1.6 bn.

UK-registered banks' consolidated external claims, largely unguaranteed, fell from $833 mn at end-June 1982 to $802 mn at end-December 1982. Claims by British-owned banks rose from $488 mn to $527 mn during the same period. ECGD commitments are modest and under tight control with £17 mn at risk at end-December.

POLAND

Total convertible-currency indebtedness is now about $27 bn.

Commercial bank and official creditors both negotiated rescheduling agreements in respect of debts due in 1981. Following the declaration of martial law in December 1981 official creditors agreed to suspend negotiations on further rescheduling of official debt for the time being. In practice Poland has used this as a pretext to stop all payments to governments and so gain 100% de facto relief on both principal and interest (including amounts due under the rescheduling agreement for 1981). Last November the banks signed an agreement rescheduling, over 7 1/2 years, 95% of the $2.3 bn repayments of principal due in 1982. The Poles have continued to meet repayments under both commercial bank agreements; and, under the terms of the second agreement, half the interest due in 1982 has been lent back in the form of new three-year credits.

Negotiations on the rescheduling of official debt due in 1982 and later remain in abeyance, although the consensus in the creditors' group is under some strain. There is to be an inter-governmental meeting in early July to assess the situation following the Pope's visit. In recent discussions with the banks the Poles drew back from earlier suggestions of relief up to 20 years on debt payable during the period 1983/85 and seem now to be concentrating on extensive rescheduling for less than ten years of principal and interest due in 1983 only. Talks are scheduled for 29/30 June in Zurich with a further meeting in Warsaw from 13/15 July. Bankers hope that an outline agreement will be reached by end-July.

At end-December 1982 UK-registered banks' consolidated external claims totalled $1,749 mn, of which $811 mn was unguaranteed (cf $1,839 mn and $791 mn in June 1982 respectively). Claims by British-owned banks totalled $1,449 mn, of which $543 mn was unguaranteed (cf $1,553 mn and $542 mn respectively). ECGD is off cover: the amount at their risk is £821 mn.

ROMANIA

At end-1982 convertible currency debt totalled $9.8 bn.

Commercial bank and official creditors last year rescheduled 80% of 1982 maturities (and 1981 arrears). Both sets of creditors have reached agreement on a less extensive rescheduling for 1983 maturities whereby 30% of principal is to be repaid this year, 10% in 1984 and the balance over 6 1/2 years including 3 years' grace. The commercial banks' agreement was signed on 20 June.

The Romanians have indicated that they expect to avoid the need for further rescheduling, but it is too early to say whether their confidence is well founded. It could be hard to sustain the drastic cuts in imports that have turned their position round and the repayment of rescheduled debt will begin to impose financial strains from 1985 on.

At end-December 1982 UK-registered banks' consolidated external claims totalled $851 mn, of which $582 mn was unguaranteed (cf $840 mn and $598 mn respectively at end-June 1982). Claims by British-owned banks totalled $644 mn, of which $383 mn was unguaranteed (cf $633 mn and $399 mn respectively). ECGD is off cover; its amount at risk is £352 mn.

YUGOSLAVIA

Total indebtedness is about $18 bn and early this year an extensive support operation was mounted involving governments, banks and international institutions.

A memorandum of understanding signed in Berne in January by representatives of 15 creditor countries envisaged governmental funds of about $1.3 bn being made available in medium-term credits (mostly export credits). The first half of a £38 mn financial loan from HMG has been disbursed; negotiations have begun on terms for a £40 mn loan guaranteed by ECGD to refinance payments due to UK exporters.

On 25 March the commercial banks' International Co-ordinating Committee (ICC) reached agreement in principle on a package incorporating refinancing of $1.4 bn medium-term debt and $2 bn short-term credits maturing 1983 and the provision of up to $0.6 bn new money. Negotiations over conditions (the waiving of sovereign immunity and the application of the right of set-off) in the draft agreement have led to some delays and the moratorium has been further extended until 27 July. Following a heated debate in the Yugoslav legislature, compromise formulae have now been agreed and signature of the agreement is expected to be concluded in early August.

Funds totalling $0.4 bn net should be available this year from the IMF/IBRD. An IMF team has recently discussed revisions to the current programme which should go to the Board before end-July, by when negotiations with the banks should be completed. The BIS has granted a $500 mn facility in two tranches; of which $300 mn backed by central banks has been disbursed, including a Bank commitment of $25 mn (to be taken out by disbursement of the second half of the HMG loan on 15 August). Release of the $200 mn gold-backed tranche now looks increasingly unlikely since Kuwaiti banks still appear unwilling to waive their negative gold pledge clause.

At end-December 1982 UK-registered banks' consolidated external claims totalled $1,660, of which $1,301 mn was unguaranteed (cf $1,745 mn and $1,395 mn respectively at end-June 1982). Claims by British banks totalled $1,226 mn of which $899 mn was unguaranteed (cf $1,271 mn and $941 mn respectively). ECGD remains on cover for short-term business, the amount at risk totalling £839.3 mn.

INDONESIA

Total indebtedness is estimated at $26 bn at end-March 1983, excluding short-term debt of the public sector. (A new element in these figures, compared with earlier returns, is an estimated $4 bn of private sector debt.)

The Indonesian authorities plan to limit the current account deficit in 1983/84 to $6.5 bn. To supplement earlier measures taken in support of this objective (a restrictive budget, a wages freeze and a 28% devaluation), they are aiming to make major savings on capital goods' imports. Following the announcement in May of the deferment of four major industrial projects with a total cost of some $5 bn, a review of all projects with foreign exchange costs has been initiated.

Debt service in calendar 1983 is estimated at $2.6 bn. Of the total net financing requirement for 1983/84 of $6.8 bn (which allows for an increase in reserves of $0.3 bn), some $1.8 bn is expected to come from disbursements from the pipeline of existing commitments. The balance of $5 bn in new money is broken down between $2 bn official development assistance (oda), $1.4 bn commercial import-related credit, and $1.5 bn from other market borrowing. Reserves at end-March 1983 stood at $7.6 bn (of which $3.4 bn was held by the state commercial banks).

In a report prepared for the mid-June meeting of the Inter-Governmental Aid Group for Indonesia (IGGI), the IBRD project a foreign exchange requirement of $20 bn over the three years 1983/84-1985/86 to cover estimated cumulative current account deficits over this period - with the deficit assumed to be reduced to $3 bn (3% of GDP) in 1985/86 - together with debt service. The indication of how this financing requirement might be broken down is $1.2 bn use of reserves, $17 bn medium- and long-term loans ($4.9 bn oda, $5.7 bn import-related credit, and $6.4 bn financial markets) and $3.8 bn short-term and other capital (direct investment etc). The IBRD commend the Indonesian Government's policy approach and their debt management record and suggest that, against this background, the proposed level of external borrowing should not present undue difficulties. A similar endorsement of present policies was given by the IGGI meeting which made new aid commitments of $2.2 bn, some 10% more than last year. The IBRD emphasise the uncertainties surrounding even the current account forecast for this year (notably as regards the prosects for OECD recovery and the oil price) and their judgment about Indonesia's prospects needs to be seen in this light.

There have been no major recent tests of market sentiment since the $1 bn syndicated credit earlier in the year (which offered two equal tranches at 1/2% over LIBOR and 0.2% over US prime). Smaller borrowings have however been made, including a D.Fl.100 mn ($36 mn) bond issue in Amsterdam in March, and a ¥24 bn ($100 mn) syndicated yen credit in June. In August a ¥10 bn ($41 bn) samurai bond issue is planned. Indications are that market sentiment, while cautious, remains generally favourable to Indonesia and, in the absence of a collapse in the oil price, Indonesia should get through this year without a payments crisis.

As at end-March 1983, ECGD had an estimated £209.1 mn at risk under Section 1 and £802.4 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.

THE PHILIPPINES

Total indebtedness at mid-1983 is estimated at up to $25 bn, including an additional $4-5 bn of short-term banking debt which was not included in earlier estimates.

The latest indications are of a deterioration in the external position in recent months and a weakening of international banking confidence. Governor Laya has said that balance of payments performance so far this year has been disappointing and, although no figures have been published since the first quarter, official sources are reported to be anticipating an overall deficit of some $0.8 bn for the first six months of 1983 compared with an originally projected deficit of $0.6 bn for the whole year. Leads and lags appear to have contributed towards this result. There is evidence that US regional banks have been reducing lines of credit to the Philippines and there are signs that this may already be causing liquidity problems. Margins between the official and the black market rates for the peso have been widening. An additional adverse factor which may affect export earnings next year from major crops (sugar, coconuts, grain) is a long drought.

In this situation, the peso was devalued by 7.25% against the US dollar to 11.00 on 23 June. At the same time the deferment of five major industrial projects costing $3 bn has been announced and the price subsidy system for oil products has been abolished.

In reflection of the current poor state of sentiment, a $100 mn syndicated loan for the Development Bank of the Philippines (DBP) now in the market has attracted a very limited reponse. At best the final result looks likely to be a club deal with few banks involved. The position overall looks to be one of increasing strain. A debt crisis before the end of the year cannot be ruled out, and if the Philippines get through 1983 the situation next year is likely still to be critical. The short-tem outlook may be clearer on the return to Washington of an IMF Mission which is currently conducting a mid-year review of the standby agreement in Manila.

As at end-March 1983, ECGD had an estimated £217.5 mn at risk under Section 1 and £7.4 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-March 1983 was $37.5 bn of which $14.0 bn was short-term.

Satisfactory progress with adjustment continues to be made. In the first quarter of 1983 real GNP was 9.3% higher than in the corresponding period of the previous year and strong growth is expected to be sustained through 1983. Consumer prices rose by 4.3% in the 12 months to April, an improvement on the end-December 1982 figure of 4.5%. After a disappointing performance in the first quarter - when they were 0.9% lower than in the first quarter of 1982 - exports picked up in April and, for the first four months of 1983 the current account deficit of $0.7 bn was on course for meeting the projected outturn for the whole year.

Korea is seeking an SDR576 mn IMF standby - to be discussed in the Board on 8 July. Real growth of 7.5% is envisaged for both 1983 and 1984, and the standby programme aims at reducing the fiscal deficit to 4% of GNP in 1983 (from 4.6% in 1982), keeping inflation below 5% in both 1983 and 1984, and bringing the current account deficit down from $2.5 bn in 1982 to $2.3 bn this year and $2 bn in 1984. The authorities have set a target of moving into current account surplus in 1987 - in recent years surpluses have been recorded only in 1965 and 1977. Performance criteria limit the increase in external indebtedness to $4.2 bn in 1983 (+11%) - when the debt service ratio will be 19.5% - and freeze short-term debt at its end-1982 level. The authorities are committed to a reduction in short-term debt during 1984.

In the meantime, market confidence in Korea appears to be holding up satisfactorily. Korea's second large syndicated loan of the year, a $300 mn eight-year loan for the Exim Bank was a two-part deal with one portion priced at 3/4% and 7/8% over LIBOR for the two four year tranches and the other at 1/4% over US prime. Although the terms were harder than for the Korea Exchange Bank loan earlier in the year, this hardening was not out of line with the recent trend for the region, and the loan appears to have been well received.

As at end-March 1983, ECGD had an estimated £209.1 mn at risk under Section 1, and £503.4 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.

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	83	4.4	2.5
Chile	18	1.1	0.06
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	34	2.4	0.08
Eastern Europe (convertible Currency)			
East Germany	15	0.8	0.2
Hungary	7	0.5	0.07
Poland	27	0.5	1.3
Romania	10	0.4	0.6
Yugoslavia	18	0.9	1.3
Far East			
Indonesia	26⌿	0.6	1.5⌿
Philippines	25	1.2	0.3⌿
South Korea	38⌿	2.0	1.0⌿

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

* Because of Hong Kong's position as on offshore centre the available figures for external indebtedness and banking exposure to Hong Kong are not comparable to those for other countries shown above and do not provide a meaningful indication of the territory's debt exposure.

Elon Par
Indebtedness
Pt 2