Econ Pol
Indebtedness Pt 2

Treasury Chambers, Parliament Street, SW1P 3AG
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5 August 1983

W F S Rickett Esq
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Dear Willie,

CURRENT INTERNATIONAL DEBT QUESTIONS

The Chancellor thought that, before leaving for Switzerland, the Prime Minister might like a note on current international debt questions. No decisions are required now on any of the points covered: this letter is intended to provide background information.

Argentina

There have been some developments since the note I sent to you on 1 August. US attempts to look for some concession on fishing rights, mentioned in paragraph 8 of the earlier note, began to look like a slippery slope, particularly given the Argentinian incursion into the exclusion zone, and, without rebuffing the Americans, we have told them that this issue will have to be pursued separately, and through more appropriate channels. We have indicated to the IMF our minimum conditions (set out in paragraph 6 of the earlier note) for a further Argentine drawing: they have responded sympathetically, and we are now trying to nail them down on the detail, and to ensure that the US Treasury knows our requirements (which are no more than are needed to ensure that the IMF's own conditions are met and continue to be met).

In spite of further lobbying by Argentina, our impression is that we still have firm support from the IMF, the Americans, most EC colleagues and some others - more than sufficient to block any Argentine move in the IMF Board. (Time for any early move is in any case running out, for the IMF itself takes a two-week holiday from this weekend.)

Meanwhile, contacts between the Bank of England and British banks potentially involved in the commercial loan to Argentina

Redeem - term loan.

have resulted in a clear determination by the British banks not to sign the loan until the IMF position is clarified. (It has also been made clear to them that, if the IMF situation were not satisfactorily resolved from our point of view, the Government would not wish them to sign, and would be prepared to say so publicly.) The British banks appear to have persuaded their colleagues on the international Argentina Advisory Group to their view about signature. We understand that the Group have sent the Argentine authorities a stiff telex saying that it will not recommend signature in advance of a satisfactory response on four outstanding issues, including that of discrimination.

Brazil

The news from Brazil is somewhat discouraging. The external trade performance is good; and the target surplus this year looks attainable. But other economic indicators have been worsening, and inflation in particular is accelerating, with prospects of 140/160 per cent for calendar 1983. Political opposition against the IMF may be strengthening, and there have been suggestions that the important decree which reduces indexation (the key measure, announced and put into effect by the Brazilian government last month, which gave encouragement at the time to the IMF and BIS) may meet opposition in the Brazilian Congress.

The IMF Managing Director is taking a severe line. He was dissatisfied with the likely consequences in 1984 of the terms negotiated by his team in Brazil in the second half of July, and sent them back again to do better. He is nevertheless still confident that a satisfactory agreement will soon be reached.

Meanwhile, although interbank deposits have stabilised, Brazil is in continuous cash-flow difficulty. Arrears on some payments have been increasing and are probably near $2 billion. The risk of a default is that much greater.

A further tranche of the BIS credit is due for repayment at the end of August. It seems unlikely that it will be repaid and in any case the expectation must be that it will be dealt with in the same way as the postponed 31 May tranche. The BIS meeting on 10 September will plainly be critical. It seems best to defer judgement on the action which should be taken then; in the first week of September we shall need to take stock of progress between Brazil and the IMF.

Mexico

Reports continue to be good. It is believed that Mexico is ready and able to make the repayment due shortly to the BIS, which will eliminate the bridging loan.

Venezuela

The IMF mission got nowhere in July, but may try again this month. The Venezuelans, who are trying for unconditional assistance, against much resistance in the IMF Executive Board, are muddling through with successive agreements to postpone immediate banking debts. There seems little chance of the right political and economic decisions being taken until the elections late this year are out of the way. Although the Venezuelan debt is very large (some $34 billion at end-1982), and the conduct of the present government inspires no confidence, the country of course has very substantial assets.

Poland

At a recent meeting of creditor government representatives, the United States indicated that they were now in principle (but subject to release of political detainees) willing to participate in rescheduling, at some stage during the autumn. This is (long overdue) good news.

Hungary

Hungary appears to be contriving some improvement without the need for a major rescue operation. Their temporary BIS support has been completely repaid. They have recently negotiated a $200 million loan from commercial banks, and may well seek another such loan later this year, without calling on special official assistance.

Yugoslavia

A re-appraisal by the IMF is due. Delays on commercial bank credits, which have been agreed in principle, continue mainly because of difficulties in obtaining the waiver of an earlier negative gold pledge clause in an agreement with Kuwait. The waiver would permit BIS to increase its bridging facility to $500 million, which is a condition for disbursement of $600 million of new commercial bank lending. The first $300 million of the BIS facility already made available has been partially repaid, on schedule.

IMF

After strenuous efforts by the US Administration, the legislation to authorise and finance US contributions to increased IMF quotas and the GAB enlargement was eventually passed by the House of Representatives, although with the bare majority of 217 against 211, and with some unhelpful amendments. There remains a reconciliation process to marry this with the different (less amended) version which the Senate passed some weeks ago, but at least we do not now have to face the very difficult problems which could have arisen had Congress rejected the proposals.

At the last BIS meeting in July, attended by the IMF Managing Director, there was some discussion of the possibility of a further financing operation for the IMF, in which the BIS would play a prominent part. This is a little complicated, because it involves an attempt to kill two birds with one stone - helpfully if it can be successfully worked out:

- on the one hand, the IMF does need, for the last few months of this year, before the quota increases are ratified, an arrangement to underwrite future disbursements. This will not require immediate cash financing, but simply a promise that funds would be available if the quota increases were delayed or frustrated. However unlikely the contingency, the IMF are obviously right to be unwilling to enter into commitments until sure that they will have sufficient resources. So the suggestion is that the BIS could offer a standby credit to the IMF, guaranteed by participating central banks (and the governments behind them), which would not need to be drawn until some time in 1984 at the earliest, if at all.

- The second objective arises from IMF attempts to secure a further substantial loan, of perhaps $3 billion, from Saudi Arabia. It is the judgement of the Managing Director that the Saudis will not sign up unless there is some parallel loan from industrial countries, which could however be on a shorter-term basis. G5 countries are considering a German suggestion that this condition be met on the understanding that a new loan from industrial countries would be offset by reductions in the amount which they would otherwise have been prepared to commit under the enlarged GAB.

Further discussion on these two linked issues is needed, but there does in principle seem to be a possibility of a helpful arrangement through the BIS, which would both provide the contingent cover which the IMF believe they will need in the later months of this year, and new resources as an alternative to drawings on the GAB. If a consequence was that the IMF did secure a substantial new Saudi loan, the costs to us of the new arrangement would probably be lower than those of the original GAB arrangement.

These issues will of course be for discussion at the ECOFIN meeting in Greece on 9/11 September, the BIS meetings in Basle on 11/13 September, and the Interim Committee and IMF (and G5, G7 and G10) meetings in Washington on 23/28 September.

I am sending copies of this letter to Brian Fall at the FCO and John Bartlett at the Bank of England.

Yours ever,

John Kerr.

J O KERR
Principal Private Secretary