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PRIME MINISTER

ARGENTINA: COMMERCIAL BANK LENDING

In my minute of 17 January I reported that I proposed to ask the Bank of England to press the British banks to insist that an extension of the draw-down period of the current medium-term bank loan to Argentina should be granted only on condition that further drawings were conditional on Argentina reinstating its IMF programme (and being in conformity with it at any time when drawings on the loan were made).

2. The Bank of England have reported the following further developments. The Working Committee of banks meeting in New York last week failed to reach agreement, so the draw-down period has now technically lapsed. They are, however, envisaging the issue of a message to all the banks concerned recommending its reinstatement. The British representative (from Lloyds Bank International) has at the Bank's request argued very strongly that reinstatement should only be agreed on the conditions I had proposed. But I am told that, whereas he was at first supported by 3 or 4 other banks, he is now isolated, and that a looser linkage, to a letter of intent by the Argentine Government rather than to the actual reinstatement of the Fund programme, would command general acceptance, for there is general concern that failure to reinstate the draw-down period could cause the whole of the existing financial package to unravel. The US banks in particular are anxious to be able to make further disbursements before the end of March, so that interest arrears due to them may be repaid out of the proceeds, thus preventing their own assets from becoming classified as "non-performing".

3. I have asked the Bank of England to continue to press Lloyds Bank International to hold the line. They will, however, probably have to decide later this week what to do when the crunch comes. I am advised that a unanimous recommendation from the Committee is required, so LBI would in practice be able to block any further disbursements of the loan. If, on the other hand, they acquiesce in the majority view, this would not necessarily commit the other British banks, but they would be likely to follow the LBI recommendation.



4. If LBI hold out, they will no doubt make it clear that their action reflected the wishes of the British Government. If they acquiesce, we should equally feel free publicly to criticise the British banks' action as contrary to our wishes, should we find it necessary to do so.

5. The question now is whether we need to stiffen them further. I have not so far spoken to Sir Jeremy Morse though the Bank have made my views very clear to LBI, and LBI appear so far to have argued the case for tight conditionality very strongly. My instinct is against raising the stakes, but I would welcome your views, and those of Geoffrey Howe.

5. Copies of this minute go to him, and to the Governor of the Bank of England, and Sir Robert Armstrong.

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7 February 1984

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File

Argentina
was to respond

INTERNATIONAL DEBT - ARGENTINA, BRAZIL AND MEXICO

Line to Take

Argentina's current debt problems are of her own making. It is for her, as for other debtor countries, to put her own house in order by making the necessary adjustments in line with the IMF programme and by removing obstacles to agreement with the commercial banks. Meanwhile, international loans, from the IMF and the banks, remain frozen.

2. On Brazil, welcome the recent signature of the IMF letter of intent. Hope it will be backed up by the measures necessary to reinstate the IMF programme. In the provision of financial support, HMG will play its part both in the IMF and in the forthcoming rescheduling of official debts. Beyond this, the introduction of economic adjustment measures under a convincing IMF programme is the crucial step in restoring international confidence in Brazil.
3. Mexico continues to make encouraging progress helped by domestic economic adjustment, the IMF programme and the growth in the world economy.
4. In general, any durable solution to country debt problems must depend above all on economic adjustment by debtor countries. Developed countries' best contribution is non-inflationary growth and avoidance of protectionism.
5. Support the role of the IMF and World Bank in promoting sound adjustment policies, by ensuring they have the necessary resources.
6. Governments contribute through the IMF, BIS and official rescheduling, and should not normally be expected to make further contributions to the financing burden. To do so could weaken the discipline on creditors and debtors and involve unacceptable increases in public spending or financial exposure. It is up to the debtor

countries to regain the confidence of commercial banks and other creditors by pursuing sound adjustment policies.

Background

7. The general outlook for the international debt scene has been improved by the economic recovery which is now clearly under way in the major industrial countries. Most notably the Mexican economic recovery appears to be continuing. However the Brazilian situation remains critical and certain other countries are facing increasing difficulties, including Argentina where debt service payments appear to have ceased, bringing closer the prospect of a complete default.

8. The largest single problem is Brazil. The revised letter of intent to the IMF has now been signed but the Managing Director has not been prepared to recommend the programme to the Executive Board until the position is clearer on the new Brazilian wages law and until he is satisfied that sufficient financing has been committed in support of the programme. There are now renewed doubts over the Brazilian Government's intentions on wage deindexation and uncertainty about the adequacy of financing. In addition to \$6.5 billion to be raised by the commercial banks (including British banks) and up to \$2 billion from official Paris Club rescheduling, the Managing Director looks to export credit and other official sources for a further, say, \$2½ billion. The USA have indicated a willingness to participate by providing export credit facilities of \$1.5 billion through Exim Bank, but have made it a condition that other governments should also contribute. HMG have refused to do so, on the premise that, in general terms, debt problems are primarily a matter for the debtor countries as borrowers and the commercial banks as lenders, who should together bear a continuing responsibility for their past decisions.

9. On Argentina drawings of IMF funds are suspended because of arrears and the need for further adjustment measures as the IMF programme drifts increasingly off course. Drawings of the commercial

banks loans are also suspended mainly because of the breakdown in debt rescheduling caused by judicial rulings on the Aerolineas Argentinas agreements, intended to serve as a model. The Argentines have responded by suspending foreign currency payments to protect dwindling reserves.

10. The Mexican economic recovery appears to be progressing well. The detailed application of debt rescheduling is being negotiated and implemented and the Mexican authorities are confident they will not need further money from the banks in 1983. Requirements for 1984 remain at some \$4 billion, but this is as originally expected.

Total indebtedness
to UK banks.

ANNEX

CURRENT IMF FACILITIES

		<u>SDR billion</u>
Argentina	15 month standby expiring April 1984	1.5
	Compensatory Financing Facility (CFF)	0.5
Brazil	3 year Extended Fund Facility (EFF) expiring February 1986	4.6
	CFF	1.0
Mexico	3 year EFF expiring December 1985	3.6