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Andrew Turnbull Esq
No 10 Downing Street
LONDON SW1

Prime Minister
To note. You need read only to page 3 plus the paragraph on page 7 relating to Nigeria.
AT 6/4

Dear Andrew

INTERNATIONAL FINANCIAL SCENE

... I enclose the most recent report on developments in the international financial scene. As usual, this was prepared by the Bank of England, and revised in the light of discussions in the Treasury's interdepartmental group on debt problems. It has been further revised to take into account this weekend's developments in Argentina.

I sent you a separate report on the Argentine bridging loan, on 2 April. This operation, which as you know we view without enthusiasm, has only bought a limited amount of time. Some small progress has now been made in discussions with the Fund on a few policy objectives but not as yet on implementation. There is a further deadline to be met on 16 April, when the banks' original bridging loan falls due for repayment, and we are in touch with the Bank of England about how this is likely to be handled by the banks concerned.

We reported last month on the outcome of the Quito meeting. There has been further discussion of this at the Inter-American Bank Meeting last week; but in general the moderate line taken by the Latin American debtor countries has been reassuring.

The Prime Minister might also like to note in particular the developments on Poland and on Nigeria. On the former, talks on rescheduling official debt have at last begun again. In the latter case, the UK has taken the lead in trying to organise a collective approach by the creditors to the Military Government, with the object of persuading them to negotiate an appropriate adjustment programme with the Fund, to enter into serious talks with the government creditors, and to produce an acceptable solution to the problem of uninsured trade creditors. We do not yet know whether this has been successful.

Copies of this letter go to Len Appleyard (FCO), Callum McCarthy (DTI) and John Bartlett at the Bank.

Yours ever
David

D L C PERETZ

INTERNATIONAL FINANCIAL SCENE

Attention has tended to focus on Argentina in recent weeks, with market sentiment affected by renewed uncertainties about the intentions of the government. Meanwhile, the short-term outlook for Brazil has improved somewhat, but progress on Mexico's new money has been disappointingly slow - perhaps (perversely) because the sense of crisis is no longer there. The picture in other debtor countries is similarly mixed.

The Bank's latest forecasts, which are broadly in line with those of the IMF, predict average growth of 3.9% this year in the seven major industrialised countries, and an increase of over 6% in world trade, which should benefit exports of developing countries. However, there are some indications that the pace of recovery in the US - it is estimated that real GNP will rise by 7% at an annual rate in the first quarter - and the size of its current account deficit may already be beginning to put pressure on prices, the dollar, and interest rates. Consumer prices have been edging upwards in recent weeks, while the dollar has come down from its mid-January peak. But the associated relief to the debt burden of developing countries will have been offset by a rise of about one percentage point in key US interest rates over the same period. Commodity prices have recovered after a modest decline in February; oil prices remain unchanged.

Argentina's continued failure to tackle its economic and debt problems, not least the continued accumulation of arrears, together with recent rumours of a possible siege economy, have created serious concern among the banks and within US official circles. Around the middle of March, the banks' Working Committee offered to make a two-stage disbursement of last year's new money loan, subject to quite tight conditions. This offer was rejected by Argentina: so it appeared that interest arrears owed to banks would not be paid by 31 March and that, for arrears outstanding for over 90 days, US banks would be obliged to declare such loans non-performing, and would not be allowed to accrue interest on them when they reported first quarter earnings. Such earnings would also have been adversely affected by adjustments for income accrued in the last quarter of 1983. However, towards the end of March, a compromise proposal was worked out between the governments of the US and of four Latin American countries (Mexico, Brazil, Venezuela and Colombia), which was accepted by Argentina and the Working Committee. The Latin American countries have lent Argentina $300 mn, to be repaid by the US Treasury when Argentina agrees a Letter of Intent with the IMF; and the Working Committee has lent $100 mn, to be repaid from the next drawing of the medium-term loan, or by 30 June (whichever is the earlier) from the Argentine central bank's account with the Federal Reserve Bank. These loans, together with $100 mn from Argentina's own resources, are to be used to eliminate arrears up to 2 January on debt owed to non-Argentine banks. A further breathing-space has thus been provided to allow negotiations on debt to continue. The Alfonsin government has consistently aimed to complete negotiations by 30 June, when the banks' share of the new facility expires; but Argentina's good faith in continuing negotiations remains to be proved. In this context, the involvement of the four Latin American states and of the US government may strengthen the hand of the creditors.

Elsewhere in Latin America, recent developments in Brazil, Venezuela, and Chile have generally been favourable. In particular, the short-term outlook for Brazil now seems rather better, thanks to a considerable improvement in liquidity, although the trend in inflation is still a major cause for concern. On the other hand, the resignation of the Minister of Economy in Peru has given rise to uncertainty about the government's commitment to the new IMF programme. And progress on Mexico's new money loan has proved disappointing, with many small banks still not committed, so that final signature is now not likely until mid-April at the earliest. A delay of this length, for a country making such a remarkable economic recovery, is a setback to hopes that economic success might be seen to bring its own rewards, and points up the growing difficulties likely to surround successive loan packages - particularly in circumstances where, as in the present case of Mexico, the sense of crisis and urgency has waned perceptibly.

The picture is also mixed in other problem countries. In Eastern Europe, some countries have recently been able to tap the markets; and Yugoslavia has made positive progress with the IMF, official creditors, and commercial banks. Some headway has also been made on Poland's debt problem. But another round of negotiations with the Philippines has again proved inconclusive, leading to a request for a further extension of the moratorium and delay in establishing an IMF programme; while an agreement between Nigeria and its official creditors is now likely to take several months.

Latin American countries are continuing to pursue the Quito initiative for a co-ordinated approach to debt problems - notably at meetings of the Inter-American Development Bank and the Economic Commission for Latin America at the end of March and the beginning of April - but the tone remains moderate. In contrast, there are signs that the solidarity of banks may be weakening: European banks are reported to be considering the establishment of pressure groups to represent their interests more effectively against those of American banks in debt negotiations and discussion of long-term issues.

(i) Latin America

Immediate concern is focused firmly on Argentina. The latest interim solution to the problem of interest arrears was described above. Meanwhile, serious negotiations on rescheduling have yet to begin; and progress on a new IMF programme is also proving very difficult, with formal agreement now unlikely before June, although Argentina has expressed the hope of signing a Letter of Intent by the end of April. It is already clear that the government's piecemeal economic policy is having little impact on the country's problems, but there is little sign that the authorities are willing to adopt a more soundly-based and cohesive economic programme.

The short-term position in Brazil has eased appreciably. In particular, liquidity has improved considerably in recent weeks, largely because the first drawings of new money (amounting to $3 bn) have now been made. The Brazilians are accordingly expected to have eliminated all payments arrears (other than those which might qualify for Paris Club rescheduling) by end-March. Against this background, the authorities have decided to decentralise foreign exchange transactions, which had been under the control of the central bank since last August.

As regards the IMF programme, the main concern remains the rate of inflation which reached 230% (year-on-year) in February. If the upward trend is not reversed by April/May, current policies may need to be reassessed in association with the IMF. The Fund Board is due to meet in April to consider papers on the recent EFF review and Article IV Consultations.

In spite of Mexico's good progress on the economic front and the IMF Board's recent approval of the programme for the second year of the EFF, the $3.8 bn new money loan from the commercial banks is not yet finalised. Banks were requested to increase their exposure by 6% this year: a full response would produce just over $4 bn, in which case each bank's contribution would be proportionately reduced. Although commitments currently amount to nearly $4 bn, some $700 mn of this is conditional upon 100% participation: about 65 banks (out of a total of 530) have still to be rounded up and, even if this can be accomplished quickly, the Advisory Group estimates that signature cannot now take place before mid-April.

Elsewhere in Latin America, further progress has been made, although many difficulties remain. The IMF Board is expected to approve Chile's 1984 programme in early April, provided that creditor banks agree to participate in the proposed $780 mn new money facility. Although the Chileans have obtained from the Advisory Committee better terms than last year, the banks' initial response appears to be favourable. The Peruvians have also secured improved terms for refinancing 1984 and 1985 maturities, but are not seeking new money from banks this year. However, a major uncertainty has now arisen with the resignation on 19 March of the Minister of Economy, following widespread internal political opposition to austerity policies agreed with the IMF: it remains to be seen whether his replacement will accept the new Standby agreement scheduled to be discussed by the IMF Board on 6 April. In Ecuador, no progress on rescheduling 1984 maturities is expected until the outcome of the second round of the elections becomes known in May and a new Standby has been agreed with the IMF. As regards Venezuela, formal debt rescheduling talks are now due to take place in April, and the new Administration is hoping for an early agreement. Although a recently-announced economic package appears to have ruled out the possibility of an IMF programme, it may prove to be an acceptable alternative to the banks. However, interest arrears are reported to have risen to over $1 bn.

(ii) Far East

Further negotiations between the Philippine authorities, the IMF and the Advisory Committee have been inconclusive; and no further progress is now expected before the Philippine elections on 14 May. Any subsequent agreement with the Advisory Committee on a new money/rescheduling package is further complicated by lack of progress over the freezing of deposits with Citicorp, Manila. Meanwhile, an application is to be made to extend the moratorium for a further 90 days from 15 April. Elsewhere in the region, Indonesia continues to show steady improvement, and has recently signed a $750 mn loan agreement which was on favourable terms and over-subscribed.

(iii) Eastern Europe

Some East European countries have recently been able to raise funds in the market. A $150 mn syndicated loan for the USSR was over-subscribed and may be followed by another operation for $100 mn on finer terms. Recent loans for Hungary have received a mixed response, but the authorities may shortly seek further co-finance on a major scale. Czechoslovakia, which raised $50 mn last summer, is expected to return to the market later this year for a bigger loan on improved terms. But neither the GDR (in the absence of a further West German guarantee) nor Romania (which has put itself in technical breach of its rescheduling agreements with the banks by failing to notify them of the premature termination of its Standby arrangement in January) could hope to approach the market at present.

Yugoslavia recently agreed a Letter of Intent to the IMF, and its new Standby arrangement is expected to be approved in the second half of April. Meanwhile, the official creditors, meeting in Switzerland on 24 March, endorsed their earlier decision to reschedule medium and long-term maturities falling due in 1984 over seven years, including four years' grace. Both the Agreed Minute and the commercial bank agreement - which is on more favourable terms than last year - are likely to be signed in May. The banks are still discussing the possibility of a multi-year rescheduling arrangement with Poland and considering how far and in what form they might provide any new money. Some progress was made by the official creditors in their meeting with the Poles in Paris on 21 March, and serious negotiations may begin at the next Paris Club in early May.

(iv) Southern Europe

The general conclusion of a recent IMF Board discussion of Greece was that a more rapid and decisive adjustment was required; that the government's targets for 1984 were inadequate; and that these were unlikely to be met by current policies. However, both the Prime Minister and the Economy Minister, probably with the European elections in mind, have publicly rejected the Fund's call for greater urgency as unworkable in the Greek context, and have re-affirmed the government's gradualist approach. The latest official forecast of a current deficit of around $2 bn in 1984 - over-optimistic in the IMF's view - implies that the gross external borrowing requirement will be much the same as last year ($1.9 bn). The Bank of Greece is arranging a $500 mn package - a Floating Rate Note issue for 10 years at 1/4% over LIBOR, and a $350 mn syndicated credit for seven years. The terms for the FRN primarily reflect the current popularity of this instrument, rather than the market's perception of Greece; terms for the syndicated loan are not yet known.

After a poor performance under last year's Standby arrangement for Turkey, associated with a sharp deterioration in the economy, the programme has been abandoned, and the Government has negotiated a new one-year Standby to run from April. The pace of adjustment envisaged may not be fast enough to reassure the banks, in view of the prospective hump in debt service from 1985 onwards.

From Spain there are reports of substantial capital inflows in recent months and of official encouragement for the early repayment of external loans by Spanish borrowers. This year's estimated external borrowing requirement is down to $850 mn (from $1.1 bn in 1983), of which around one half is said to have already been raised, and there are signs that market sentiment has become even more favourable to Spain: a recent FRN for the Kingdom was increased from $200 mn to $250 mn, despite the low (1/8%) spread, while the larger semi-state borrowers have been able to command a spread of LIBOR + 1/2% on recent credits, compared with the typical 5/8%-3/4% paid last year. In spite of Portugal's continuing efforts to tighten economic policy, the size of its external debt has - unlike Spain - so far prevented any improvement in the terms of borrowing.

Nigeria's negotiations with the Fund for an EFF are likely to be protracted, as official attitudes towards the step devaluation advocated by the IMF are hardening. To encourage a more flexible stance by the Nigerians, the UK has suggested a concerted approach by the major creditor governments to press for early agreement with the Fund. It has also been agreed to propose to the Nigerians an exploratory meeting to discuss restructuring of official debt (while emphasising that no commitments can be made before negotiations with the IMF have been successfully concluded). While Governments cannot negotiate formally on behalf of the uninsured creditors, the UK interests in Nigeria are very large/ Nigeria is about to make a 'take it or leave it' offer to these creditors which some at least find unacceptable, and is refusing to talk to Morgan Grenfell, who represent a large grouof trade creditors. DTI and Treasury have therefore engineered a meeting in London between the Nigerian authorities and a selection of the creditor companies in an attempt to negotiate a settlement. This approach has the support of other governments.

2 April 1984

INDEBTEDNESS AND BRITISH EXPOSURE

$ billion

	Total external debt	British banks unguaranteed claims	ECGD amounts at risk
	End-Dec 1983 (except where stated)	End-June 1983	End-Dec 1983
Latin America			
Argentina	43.6	2.4	0.1
Brazil	90	4.6	2.1
Chile	17.4	1.1	0.1
Ecuador	6.6	0.5	0.1
Mexico	91.3≠	5.4	1.5
Peru	13	0.4	0.2
Venezuela	34	2.3	0.1
Eastern Europe (convertible currency)			
East Germany	13	0.6	0.2
Hungary	7.4*	0.5	0.1
Poland	28	0.6	1.0
Romania	9	0.3	0.5
Yugoslavia	18.8	0.9	1.3
Southern Europe			
Portugal	14.5	0.8	0.4
Greece	11.5	0.9	0.4
Spain	29**	2.4	0.2
Israel	29	0.5	0.2
Far East			
Indonesia	31	0.7	1.7
Philippines	24.5	1.3	0.3
South Korea	40	1.9	1.0
Other			
Morocco	11.5	0.1	0.3
Nigeria	15	1.1	4.1

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

≠ excluding unguaranteed suppliers credits of some $3 - 5 bn
* end-September 1983
** excludes short-term debt

Econ Pol.

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