

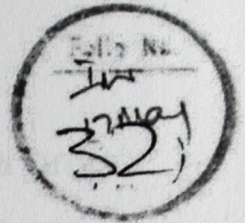
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STATE OF THE ARGENTINE ECONOMY

The attached paper by the Foreign and Commonwealth Office in consultation with the Bank of England has been circulated to provide a single agreed source of financial information in relation to the Argentine as an input into Ministerial and Official discussions over the next few days. In addition, as a matter of urgency, the FCO have been instructed at this morning's ODO(SA) to prepare a paper for Ministers/brief for the Prime Minister on the extent to which the United States could apply economic pressure on the Argentine.

R.M. H-S

7 April 1982

R M HASTIE-SMITH
DUS(P)

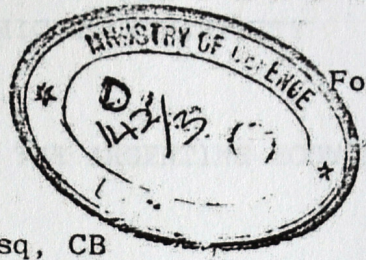
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C O N F I D E N T I A L



Foreign and Commonwealth Office

London SW1A 2AH

J G Littler Esq, CB
HM Treasury
Rm No 46/2

6 April 1982

Dear Gifford,

HOW VULNERABLE IS THE ARGENTINE ECONOMY?

1. I enclose a copy of a paper on the Argentine economy and its vulnerability, which has been prepared by our Economic Service, consulting the Bank of England. Its main purpose is to provide a single agreed source of financial information for our discussions over the next few days. This does not, of course, rule out a further, more extensive assessment by the JIC(EA) or others.

2. The main points to emerge from the paper are:-

- (a) The performance of the domestic economy, which is marked by very high inflation, has been erratic. But Argentina is self-sufficient in energy.
- (b) They have at present a visible trade surplus. But this is more than off-set by an invisible deficit made up largely of interest payments on debt.
- (c) The structure of their debt is such that a large amount matures in 1982 (including nearly \$6 billion of short-term debt from the United States). This will need to be rolled over or new credits must be found.
- (d) The total estimated requirement for external borrowing in 1982 is some \$17.4 billion. In the present quarter some \$3 to 4 billion will need to be raised.
- (e) Argentina is therefore vulnerable to a crisis of confidence and to capital flight.

Yours sincerely Nicholas

N P Bayne
Economic Relations Department

- cc:-
- M J Balfour Esq, Bank of England
 - R Williams Esq, Dept of Trade
 - C Farrow Esq, Dept of Industry
 - J Breach Esq, ECGD
 - R M Hastie-Smith Esq DUS(P) MOD
 - Commander G Middleton, Cabinet Office

ARGENTINA: ECONOMIC VULNERABILITY

PRESENT STATE OF THE ARGENTINE ECONOMY

1 The performance of the Argentine economy has been erratic in the past few years; gross domestic product expanded by 6% in 1977, fell by 3% in 1978, expanded by 7% in 1980 and fell by an estimated 6% in 1981. This unevenness stemmed primarily from erratic and inconsistent public policy against a backcloth of inflation of some 150% per annum. Changes in income, exchange rate, interest rate and monetary policies had significant effects on real output. Recent policies have emphasised the need both to reduce inflation, to reduce the public sector deficit, to maintain the exchange rate at a realistic level. But this course will entail a further squeeze of public sector spending, greater control of the large para statal sector and a continuing squeeze on private sector liquidity together with some reduction of living standards through incomes policies. Past experience is that the Argentines have found it very difficult to implement such a policy, particularly a reduction of the para statal sector and substantial reduction of private sector liquidity.

2 The external sector has reflected and contributed to the erratic course of the economy. Argentina's exports are primarily agricultural - cereals predominate - and their value significantly responds to weather conditions and international prices. Imports are mainly intermediate manufactured goods dependant on the level of domestic demand in Argentina (the country is close to self-sufficient in energy). The trade balance has shifted in response to these factors from plus US\$2.5billion in 1978 to minus US\$2.5billion in 1980 and plus US\$1 billion in 1981. The Bank of England forecast for 1982 is plus US\$1.9 billion.

3 There is a substantial deficit on services account which has increased in recent years from interest payments on a growing external debt. These interest payments were US\$3.4 billion in 1981 out of a total services deficit of US\$3.9 billion.

4 A substantial amount of external debt, US\$30.5 billion in April 1981 compared with US\$12.5 billion in 1978, was contracted in response to liquidity difficulties and interest rate differentials rather than reflecting more directly a need to finance a balance of payments deficit. The current account balance of payments deficit in the period was only some US\$5 billion and direct investment of some US\$2 billion was available to offset this in the period. The volatility of international capital flows is demonstrated by the movement of total net international reserves from minus US\$0.5 billion at the end of 1976 to plus US\$9.4 billion at the end of 1979 to their present level of US\$4½ billion (they are equivalent to three to four months' imports at this level).

VULNERABILITY

5 Given Argentina's energy self sufficiency, her developed, if inefficient, industry, and the wide spread of her import and export trade, the volatility of foreign capital flows perhaps represents her most significant external economic weakness in the next year or so.

6 Total Argentine external debt is US\$34.5 billion approximately now with around 70% owed to commercial bank. Two thirds of the debt was short term last year with the Argentine public sector owing between 55% and 60% of the total.

At the end of last year the Bank of England calculated that Argentina needed to find some US \$14.4 billion to refinance debt falling due for repayment in 1982. These debts were split as follows:

Short term: that is debt of a maturity of one year or less

extended by commercial banks in most cases as a sort of overdraft facility. It is made available, for example to finance trade by banks with major dealings with the market. Other than these, the Bank is aware of specific short term loans by Wells Fargo (USA), Credit Commerciale of France and the Long Term Credit Bank of Japan.

7. The amount due this year is US \$9.7 billion split as follows.

	US \$ Billion
Owing to the USA	5.8
UK	2.9
FRG	0.3
Japan	0.3
France	0.3
Switzerland	0.4
Others	2.4

(These figures total to more than US \$9.7 billion as they are earlier ones. The Argentines have been converting short term to long term debt where they are able).

The majority of short term debt is due in the last quarter of the year.

Long term: commercial bank, official and multilateral debt on over a year's terms.

8. The maturities on this debt this year is US \$4.7 billion.

Payments are likely to be due regularly throughout the year.

[In addition to this US \$14.4 billion, Argentina will need to borrow some US \$3.0 billion to meet a estimated current account deficit of US \$3.8 billion, less assumed private capital inflows.

9 To meet this estimated total borrowing requirement of US \$17.4 billion she must rely on the confidence of lenders, and more immediately on the seasonal flow of export receipts and on liquid foreign exchange reserves and on immediate borrowing from multilateral sources. At the end of February, liquid foreign exchange (mainly held with banks abroad) were US \$2.8 billion, virtually non-conditional IMF drawings were US \$0.7 billion and gold reserves were US \$0.2 billion, (valued at 35 SDRs per ounce). Export receipts are received relatively evenly throughout the year, though with some bunching in the second and third quarters. Given the bunching of receipts and obligations a guessestimate is that in the present quarter, Argentina may need to raise US \$3-4 billion.

10 Her problems at the moment and the potential dangers she sees have led to fluctuations in the peso and the imposition on 5 April of a regulation restricting the use of foreign currency to payments for imports and debt.

11 Argentina is clearly vulnerable to a crisis of confidence by lenders and to capital flight. Such difficulties, if they were associated with the dispute with the United Kingdom, would be a pressure leading to a settlement.