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Treasury Chambers, Parliament Street, SW1P 3AG

01-233 3000

Prime Minister

Charles Powell
10 Downing Street
London SW1

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INTERNATIONAL FINANCIAL SCENE

I enclose the regular report on developments in the international debt scene. Though generally quiet, the unexpected resignation of Silva Herzog as Mexican Finance Minister has added a new and unwelcome element of uncertainty to the already difficult outlook for Mexican debt negotiations. The outcome of these will determine the tone for other debt negotiations.

As the paper notes there are no new trends on the economic or political front. There has been some dampening of the euphoria that immediately succeeded the oil price falls as the benefits are inevitably taking time to come through. The estimates of debtor countries' financing requirements made when the Baker initiative was launched are now generally obsolete and the countries concerned are now in a period of reassessment. Over the next few weeks the Treasury and Bank of England too will be finalising their regular summer reviews of debtor countries' economies. On the political front, the UN special session on Africa was carried off without too much difficulty and the Cartagena Group have been quiet.

As for individual countries, the key (as already indicated) is Mexico. The economic situation here continues to deteriorate with persistent rumours of suspension of interest payments. The likelihood of an orthodox solution, with a Fund programme and formal rescheduling, appeared to improve after Volcker's visit to President de la Madrid earlier this month. It remains unclear what the impact of Herzog's resignation will be. We have been watching developments closely and considering what we might do to help accelerate a solution - or, alternatively, what action we might take in the event of further deterioration.

Among the other major Latin American debtors, problems are emerging in Argentina where inflation is rising again and targets under the current standby arrangement missed. Against this background the talks now beginning with the Fund (on a new SBA) and with the IBRD could be difficult. Brazil's external performance continues to be strong, with no sign of any approach to the Fund. In view of this Paris Club Governments have rejected a Brazilian request for a formal rescheduling but will accept payments to export credit agencies designed to reduce arrears.

Elsewhere, the rescheduling discussions between the banks and Poland, mentioned in the last report, have now been concluded on the basis of rescheduling 95% of 1986 and 1987 maturities: Poland rejoined the IMF on 12 June. The outlook for Nigeria remains uncertain. There has still been no formal progress in agreeing a Fund programme. But we continue to get indications that the Nigerians are at last prepared to take the measures that will enable them to conclude a "classical" standby arrangement (ie an agreement without drawings). Recent political developments in South Africa have had no immediate impact on the debt situation, although further damage to confidence would inevitably reduce South Africa's capacity to pay its debts.

Finally, the report draws attention to the marked deterioration in the outlook for Middle East and North African countries as a result of the oil price fall. This has brought to a head underlying domestic financial problems. Commercial banks are now recognising this, and in some cases looking to reduce their exposure. ECGD too are reassessing their considerable exposure in these markets. This brings a wide range of countries into the net of those giving cause for concern.

I am copying this letter to Tony Galsworthy (FCO), John Mogg (DTI) and John Footman (Bank of England).

Yours ever
Rachel

RACHEL LOMAX

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INTERNATIONAL FINANCIAL SCENE

1 The international debt problem has, at least until the last few days, been perhaps less in the news headlines over the past few weeks than at almost any time since 1982. In part this has been because attention shifted, at least temporarily, to the specific problems of Africa, and focussed on the UN special session dealing with the problems of that continent. But in addition the broader debt situation has been relatively quiet as debtors and creditors revise their financing projections in response to the drastic external changes - on oil prices, interest rates, and exchange rates - which took place earlier in the year. With Mexico evidently the most adversely affected amongst the largest debtors, sentiment about the debt situation in general is likely to be very heavily determined over the next few months by the outcome of Mexico's current debt negotiations and its impact on the attitude of other debtors. There are conflicting signals as to how these negotiations are progressing, but the apparent rapid deterioration in Mexico's economic position means that early resolution of this uncertainty is required. Failure of the IMF and/or the banks to reach agreement with Mexico in the near future would cast a serious shadow over debt prospects more widely.

2 Meanwhile, after the major shocks earlier in the year, there have in recent weeks been no very clear trends in oil prices, interest rates, and exchange rates. Oil prices rose in early May from their trough levels, to reach about \$17 pb in mid-month, but subsequently fell back to around \$12 pb. Little real progress has been made within OPEC towards a workable production accord, and the chances of one emerging from the end-June Ministerial Meeting remain slim, although most observers expect some agreement eventually, perhaps by end-year. Three month eurodollar rates have also rebounded slightly from their trough levels, and are now slightly above 7%. The cut in the US discount rate to 6 1/2% in April was widely expected to be the last cut for some time. Meanwhile, the dollar too has rebounded slightly. In effective terms it rose 5% during May, but it still remains 8% below its level at the beginning of the year and 18% below its level at the time of the Plaza Agreement.

3 In contrast, commodity prices, which earlier in the year had stabilised, seem to have resumed their downward trend. At the beginning of June the Economist

commodity index was, in SDR terms, almost 6% below its level of two months earlier. Food prices fell most heavily - almost 10% - with the greatest falls in coffee (25%) and sugar (18%). The four largest producers of sugar (Australia, Brazil, Cuba and the EEC) met to discuss prospects for an international agreement which would include price stabilisation measures. Falls in the prices of timber and cotton (13% each) dominated the downward movement in agricultural non-food prices. Metal prices were little changed.

4 There has recently been some dampening of the euphoria that immediately succeeded the oil price falls about prospects for world economic growth. It is now clear that the world economy is performing more sluggishly than earlier expected, and that the output benefits of the oil price fall will take some time to work through. Although US GNP growth in 1986 Q1 has been unexpectedly revised upwards to 3.7% (ar), this rise was due to a large increase in stocks, and prospects are for much slower growth in the second quarter. The US current account deficit is now projected not to decline significantly this year, despite the fall of the dollar, but this is increasing pressure for further protection. Elsewhere too, growth does not seem yet to have picked up - within Europe, for instance, GNP in France grew by only 1.2% (ar) in Q1, whilst GNP in Germany is estimated to have fallen by 1.0%.

5 The falls in oil prices, interest rates and the dollar this year have had a major impact on the economic prospects and financing requirements of the debtor countries. Estimates of financing requirements made at the time the Baker initiative was launched are now generally obsolete. Full assessment of the new situation is likely to take some time, especially given present uncertainties over whether the new prices and rates will be sustained. Clearly, the oil exporters have been most adversely affected by these changes. Quantitatively, the effect has been greatest on Mexico. Its economic position was deteriorating rapidly even before the recent oil price falls, and the country faces major difficulties in filling its financing gaps. Mexico is aiming to reach agreement with the Fund on a new programme and will then begin discussions with the banks. Mexican officials have stated that a Fund agreement may be close, but others are much more pessimistic. Serious differences remain with the Fund, especially over the appropriate size (and measure) of the fiscal deficit. Concerns over the Mexican debt situation, and the possibility of a declaration of a moratorium on interest payments, contributed to a 25% fall in the value of the free market peso against the dollar in the early part of June. Within the Mexican government, there seems to be increasing divergence between those who favour the continuation of the present strategy and those who consider that the present strategy has run its course. If agreement cannot be reached with the Fund, this is bound to strengthen the hand of

those favouring a unilateral, unorthodox strategy. In any case, without an agreement, the country's financial position does not seem to be sustainable for very long: there are repeated stories that, without some debt agreement, Mexico will not be able to maintain interest payments beyond the summer. If, however, agreement can be reached, it is generally felt that the overall debt situation will be very significantly improved, and prospects will brighten over negotiations covering also other debtor countries. The likelihood of agreement was reportedly increased as a result of a visit by Volcker to President de la Madrid on June 9. The implications of the resignation of Finance Minister Silva Herzog on 17 June, however, are not yet clear; he has been replaced by Gustavo Petricioli, previously head of Nacional Financiera, who is believed to support Silva Herzog's orthodox line.

6 The Fund is likely to have to determine rapidly how it will respond to the problems affecting oil exporters, following Ecuador's probable request for a CFF. Of the other oil exporters, Venezuela has irritated its creditors by seeking to have its MYRA reopened at a time when it is not yet even operational and when the country retains a very substantial buffer of reserves. Nigeria has reached agreement in principle with the IMF and IBRD on outstanding issues, in particular the introduction and operation of the two-tier foreign exchange market, but the form of an eventual agreement has not yet been clarified. The Nigerians appear willing to accept the terms of a "classical Standby" (ie a Standby agreement with no drawings) but, for domestic political reasons, do not want to present it as such. In the Middle East and North Africa a number of oil exporters (such as Saudi Arabia) are giving cause for heightened concern in the future, whilst even countries (such as Oman) which have not previously given any serious cause for concern are now being reassessed. In some countries (such as Egypt) already identified as having major difficulties, prospects for containing their debt positions seem increasingly desperate.

7 Meanwhile, most oil importers continue to benefit from recent developments. For a number of smaller countries - such as Yugoslavia and Chile - the external position has improved (although difficulties remain), and agreements with creditors have recently been achieved and/or seem likely to be achieved shortly. In the major debtor oil importer, Brazil, the economy continues to perform strongly, particularly on the external side; the authorities' continued refusal to negotiate with the IMF, and to repay more than token amounts to the Paris Club, is likely to leave creditors in some difficulty over how to handle the situation. In Argentina (now almost self-sufficient in oil) there are signs of a possible resurgence of inflation, the handling of the fiscal deficit remains problematic, and opposition is mounting to the deflationary impact of the Austral Plan.

8 But contrary to earlier fears, there has recently been no serious concertation between debtors over alternatives to maintaining the present strategy. The beneficiaries of the oil price falls seem unwilling to risk their gains through a confrontation with creditors at this juncture. Peru remains very largely isolated, and little has been heard recently from the Cartagena Group. Mexico's reported attempts to seek support from Brazil and Argentina in the event it imposes a moratorium on interest payments have apparently been rebuffed, at least by Brazil. But, as already noted, opposition to further austerity continues to grow in Mexico, and could become much more serious if the country fails soon to reach agreement with the Fund and the commercial creditors. And in Ecuador, hitherto identified as a paradigm of the orthodox approach, the government party was heavily defeated in Congressional elections on 1 June: there is now considerable uncertainty over how the President will deal with the new opposition-dominated Congress.

9 The period since the middle of April has seen further borrowings for the USSR and Czechoslovakia. Vneshtorgbank of the USSR raised two syndicated credits, totalling approximately \$500 mn; both were over eight years and had spreads of 1/4% over LIBOR, this being much in line with other recent East Bloc credits. Czechoslovakia is raising a \$100 mn credit to finance foreign trade on even finer terms. IIB, the CMEA investment bank, has also returned to the market, for \$250 mn over ten years at a spread of 1/4%. In the same period there was a revival of borrowings by LDCs: nearly 80% of the \$1 bn total went to South Korean borrowers, including a two tranche syndicated credit of \$500 mn, and a DM 100 mn fixed rate bond, for the Korean Development Bank. The terms of these borrowings are slightly improved compared with similar issues earlier in the year. Finally, Banco Mexicano Somex issued an FRN for \$50 mn at 0.75% over LIBOR for 5 years, designed to repackage some existing interbank lines.

Further details on individual countries are given below.

10 Latin America

Problems seem to be developing with Argentina's Austral Plan. Inflation has picked up quite sharply, with consumer prices rising by 4% or more in each of the three months to May. Moreover, labour unrest continues, despite a series of measures designed gradually to relax the initial wages/price freeze; the first anniversary of the Austral Plan, in mid-June, has been greeted with another 24 hour protest stoppage. At the end of April the Economy Ministry revealed that some Q1 performance targets under the SBA had been missed, with the fiscal deficit well in excess of its target of 4% of GDP. The Fund granted a further one-month extension

to the SBA (already extended once to end-May from its original end-March expiry date) in the hope that the Argentine authorities would agree to implement appropriate remedial policies, so as to permit the Fund to grant Argentina a waiver, and to allow the final tranche (of SDR 236.5 mn) of the SBA and the final tranche (\$600 mn) of the commercial banks' new money to be drawn. De Larosiere agreed to recommend to the Board on 23 June the release of the final tranche of the SBA. This was too late to secure the parallel disbursement of the bank loan, so the Advisory Committee has had to seek a waiver from the banks before the final tranche of the banks' money can be drawn.

11 Against this background, the discussions for a follow-on SBA (a Fund mission spent three weeks in Argentina in May), and for further IBRD policy-based lending, could prove difficult. Talks with the banks on future new money requirements, and with the Paris Club on a possible further rescheduling, are unlikely to begin in earnest until a new Fund programme is in place. As an interim measure the banks have agreed to extend for 180 days their original roll-over (granted in January for maturities to end-April), to refinance over \$6 bn of debt maturing in the first three quarters of this year.

12 By contrast the Cruzado Plan in Brazil appears reasonably well on course. The country continues to perform particularly well on its external account; exports grew by some 10% (to \$10.3 bn) in the first five months of this year compared with a year earlier, pushing the trade surplus up to a record \$5.0 bn, 8.6% above last year's level. Against this strong performance a further round of talks was held with the Paris Club on 15 May. The Brazilians put forward proposals for dealing with \$2.4 bn of arrears, \$100 mn in overdue interest on arrears, and \$748 mn of interest due between May 1986 and June 1987. However, their proposals were unacceptable to the Paris Club and the meeting ended without substantive agreement. The Paris Club reiterated that any rescheduling must be dependent on Brazil reaching some kind of agreement with the IMF, and that Brazil should make every effort to reduce its arrears in the meantime. Meanwhile, the World Bank has approved two loans, totalling \$149 mn, for rural development and irrigation projects.

13 The economic situation in Mexico continues to deteriorate, with the Banco de Mexico now projecting a 4% decline in real GDP this year. As discussed above, much attention has focussed on the negotiations with the IMF for a new SBA. Claims from the Mexican authorities that these discussions could be successfully concluded in a matter of weeks have been discounted as optimistic by most other sources. Considerable differences remain, in particular over the projected public sector

deficit, and negotiations may be further complicated by the change of Finance Minister. Moreover, until a new SBA is agreed, there is little prospect of a new agreement with the banks and, without new money, reserves will continue to decline (and/or arrears will be run up), following the apparent cessation of the capital reflows which resulted earlier in the year from the credit squeeze. The Mexicans are likely to demand lower spreads on existing bank debt, and have floated various additional proposals to tackle the debt problem on a longer term basis.

14 In Venezuela, the weakness of the oil market has begun to undermine the previously relatively comfortable economic position: the current account is now expected to be in deficit this year (cf earlier projections of a \$3 bn plus surplus). The authorities have yet to announce their intended policy response, although they have declared their intention to invoke the renegotiation clause in their MYRA - which is unlikely to become effective for another two or three months. The banks have already expressed discontent at the invoking of the clause at this stage, particularly given the sizeable cushion of foreign currency reserves which the Venezuelans have available. A meeting with the banks, due on 5 June, has been delayed at the Venezuelans' request. Nor are relations with Paris Club proceeding smoothly, since payments of private debt approved by RECADI are being delayed; the Paris Club is pressing for remedial action.

15 For Chile the improvement in the outlook for the balance of payments because of the lower oil prices should counterbalance the prospect of lower copper prices. Despite internal political disturbances, the country continues to make progress with its external financing arrangements. IMF targets for the first quarter of this year under the EFF were met, enabling a draw-down at the end of May. Discussions with the World Bank on an SAL are under way, and disbursements could begin before the end of the year. The completion of the \$6 bn MYRA is expected this month. The authorities have recently indicated that they will be seeking \$500 mn new bank money for 1987-88 and, in addition, a further 3-year MYRA covering debt due 1988-90.

16 Colombia continues to show a steady improvement. With the country having met its 1985 targets comfortably, the Fund have endorsed the 1986 economic programme. Political changes resulting from the Presidential election on 25 May are unlikely to mark any significant shift in policy stance when Barco succeeds Betancur in August: indeed, if anything Barco is thought likely to adopt an even more positive approach to relations with the IMF.

17 Ecuador is continuing discussions on several fronts on its financing needs in response to the lower oil prices. The US agreed in May to provide a bridging facility of \$150 mn, to be taken out by a bankers' acceptance facility for between \$175 mn and \$200 mn to prefinance oil exports. But there has been some slippage in the signature of the bank MYRA (due to have been completed by end-May) because negotiations on a new one year SDR 75 mn Fund SBA have been delayed and are now unlikely to be completed before late July. A CFF of some SDR 55 mn is also being requested. In Congressional elections on 1 June the government party was heavily defeated; there is considerable uncertainty over how the President will deal with the new opposition-dominated Congress.

18 Peru finally agreed at the IMF Board on 6 May to clear all outstanding arrears (over SDR 100 mn) by mid-August, and so avoided (for the time being) being declared ineligible; but there are some grounds for doubting the country's intention of honouring its undertaking. There are no other signs of a softening in Peru's approach to debt issues, and negotiations with the banks and official creditors tentatively scheduled for June are unlikely to make significant progress.

19 Amongst the smaller countries, Bolivia has made progress in securing IDA and IDB credits. On 19 June the IMF Board is expected to discuss a request for an SDR 50 mn SBA, and an SDR 50 mn CFF; there is also a possibility of a payment from the Structural Adjustment Facility. A Paris Club meeting, at which the Bolivians will request a rescheduling of \$250 mn on exceptionally generous terms, is scheduled for 24 June. Although an IMF Mission arrived at the end of May in Costa Rica to discuss a possible 18 month SBA, the country's external position continues to look grim. Having failed to pay \$19 mn due to banks on 28 April, Costa Rica incurred a major payments default, and is reported to have withdrawn about \$200 mn from banks in major centres, in order to avoid retaliatory action, and has placed the funds in offshore banks. The report from the Paris Club task force visit to Cuba was considered on 14 May. In anticipation of that meeting, the Cubans announced on 5 May that their debt-service moratorium would be suspended for one month. The Paris Club regarded this gesture as inadequate and agreed to adopt a tough stance: it stated that without an indication of corrective measures to reduce the external financing requirements there could be no prospect of rescheduling 1986 maturities. The banks' Steering Group met on 22 May, and despatched a reply to Cuba's rescheduling request: a further meeting will be considered after they have responded. The banks' intention is to liaise closely with official agencies.

20 Relations between the IMF and Jamaica remain notably troublesome. Although Seaga has stated he does not want Jamaica to break relations with the Fund, there

seems little prospect of drawings under the SBA resuming, particularly since arrears (of some SDR 30 mn) have recurred. While Uruguay made good progress in 1985 towards economic adjustment under its SBA, its high rate of inflation - 70% year-on-year in February, compared with a target of 60% in the year to June and 45% for 1986 as a whole - could jeopardise its ability to meet fiscal targets for June 1986. The \$2 bn bank MYRA has still not been signed (now scheduled for later this month); and completion of a \$45 mn co-financing deal has also been deferred, to June or even July. Meanwhile, Paraguay (one of only two Latin American countries so far not forced to reschedule its debts) is running into serious problems following five years of balance of payments deficits. Banking sources believe that the Central Bank could exhaust liquid currency reserves by end-1986. Arrears are accumulating increasingly rapidly, and currently stand at some \$250 mn. Total registered debt is put at \$1.85 bn.

21 South and East Asia

In the Philippines the economy grew by 0.8% (ar) in the first quarter of this year, following declines of 5.5% and 3.9% in 1984 and 1985 respectively. However, the new administration appears to be having some difficulty in establishing a clear set of economic policies. The new Standby Arrangement - to supersede the one arranged by the previous government - which the authorities had hoped to negotiate quickly has consequently been delayed, but is nevertheless expected to be in place later in the year. The new Standby is generally expected to be less restrictive than its predecessor.

22 Elsewhere, the position of Malaysia has deteriorated since the beginning of the year. Adjustment in 1985 was much greater than had been envisaged, but both the budget and current account deficits look set to widen substantially this year, reflecting the weakness of oil and other commodity prices as well as greater debt servicing costs in local currency terms as a result of yen appreciation. Business confidence is very low, and the stock market has fallen in the wake of the Pan Electric affair. With a general election due to be called before April 1987, it seems that a full policy response to the deterioration in the economic situation may be delayed until after the election. However, latest projections in the Bank indicate that the debt service ratio will not reach 20% before 1990; provided bank confidence is maintained, therefore, the country's position should remain sustainable.

23 Thailand failed to meet its IMF target for the central government deficit in FY 1984/85 (ending September), as a result of which the programme has had to be

renegotiated. The revised programme, which was approved by the IMF Board on 6 June, takes a fairly soft approach this year, but seeks to strengthen adjustment in FY 1986/7 as the economy picks up. Lower oil prices improve prospects for the country, and economic growth may now increase to 5% in 1986 from 4.1% last year. A general election has been called for 27 July. South Korea continues to perform well this year, and economic growth may exceed 9%. Meanwhile, Indonesia is likely to experience negative growth this year, but adjustment measures already taken - together with a high level of foreign exchange reserves and commitments from banks, IBRD, and aid donors - are helping the country to cope with the loss of export and budget revenues that will result from the fall in oil prices. Nevertheless, further measures may still be required.

24 Eastern Europe

On 27 May Poland's membership of the IMF was approved. The US, as expected, abstained on the vote, on the grounds that it was not certain that Poland would be able to meet the economic criteria required by Congress. The IBRD membership poll is to be completed by 20 June. It is now expected that Poland will formally join at the Annual Meetings in September after paying in its IMF quota (SDR 680 mn) and complying with other procedural requirements. The UK announced on 9 June that, subject to certain conclusions, it would be resuming limited export cover to the country. The banks' steering committee reached agreement with the Poles in Vienna on 12 June on the deferral of 95% of maturities falling due in 1986 and 1987 (totalling around \$2 bn) under the 1981 and 1982 rescheduling agreements. In addition, a lower interest rate margin has been agreed. It is hoped that this agreement will enable the Poles to sign the multilateral agreement on 1986 official maturities which was initialled in Paris on 7 March. On 13 May Yugoslavia and its official creditors signed the three-stage rescheduling agreement initialled in Paris in April, following Fund Board endorsement of the principles of enhanced monitoring. Romania's request for assistance with its liquidity problems on 21 May in London met with little sympathy from the banks' steering committee. The banks' economic sub-committee is to report within the next few weeks. Meanwhile, the banks have rolled over maturities of some \$175 mn for a month, and the authorities have renewed their informal approach to the Fund about a CFF; they are also talking about approaching Paris Club creditor governments. The further deterioration in Hungary's convertible-currency trade, and the absence of concrete measures to correct the situation, give some concern about the medium-term position of the country.

Southern Europe

25 In Greece the external position has begun to respond to the economic austerity package (and especially the import deposit scheme) introduced last October. The Bank of Greece has commented that the authorities' current account and inflation targets are achievable on condition that policy is not relaxed. Doubts remain, however, about whether the authorities will meet the PSBR target set under the terms of the Community Loan last November. On the international capital markets the most recent syndicated credit, announced in March for the Bank of Greece, has been increased following initial oversubscription. Portugal is reportedly now expected to achieve a current account surplus of \$800 mn this year, contrary to earlier estimates of a deficit of this size. Oil price falls will save the country \$500 mn, prospects for a good harvest suggest a saving of \$200 mn in food imports, and exports are performing better than expected. The 1986 budget projects a public sector deficit of 11% of GDP, slightly less than last year's 13%. International capital markets continue to take a positive view of economic prospects.

26 Africa

The Commonwealth Eminent Persons Group have concluded that it is not possible to make any further progress in their mission to promote dialogue in South Africa. Their report published on 12 June was highly critical of the South African government. This, along with the reimposition of the state of emergency, has prompted further widespread international calls for economic sanctions to be imposed against the country. On 18 June the financial rand stood at 25 US cents (as against a rate of 45 US cents for the rand early last August). The authorities have projected growth of around 3% for this year, but this seems optimistic. Measures designed to stimulate the economy were announced on 17 June. There remains the possibility that the heightened political tension will further damage confidence in the economy, thereby reducing South Africa's capacity to pay its debt. Work is being undertaken separately on considering policy options for the UK.

27 Latest estimates suggest that Nigeria's export earnings will fall by about \$2 bn to \$8.5 bn this year, having already fallen by \$3 bn in the last two years. Following the banks' agreement to a 90 day moratorium on principal payments beginning 1 April, Nigerian officials have drawn up, with the aid of a World Bank team, a medium term adjustment package which, they hope, will form the basis for a rescheduling of official and commercial debt. At talks with Fund and IBRD staff in Washington on 11 June, agreement in principle was reached on three outstanding issues: introduction within 90 days of a two-tier exchange market; unification of the two markets within twelve months; and the phasing out of existing capital controls thereafter. But the form of an agreement with the Fund remains

problematic. The Nigerians appear willing to accept the terms of a "classical Standby" but for domestic political reasons do not wish to present it as such. A meeting with Paris Club creditors will be sought, possibly for October. A commercial bank economic team visited Lagos in the week beginning 12 May, and presented its report to a meeting of the banks' steering committee in New York on 12 June. At the meeting the banks stressed the linkage between a London Club and Paris Club rescheduling. In the meantime, the Nigerians have suspended until 30 June the issue of further promissory notes under the scheme to reschedule trade arrears, so as to facilitate cross-checking of claims.

28 Elsewhere in sub-Saharan Africa there has been encouraging progress towards new IMF agreements for Tanzania and Gambia, but difficulties have emerged (probably transitory) in the implementation of IMF programmes for Zambia, Zaire and Somalia. This underlies the fragility of recovery programmes in much of sub-Sahara Africa.

29 Middle East & North Africa

The position and outlook for the Middle East/North Africa region as a whole has changed markedly for the worse in recent months. The sharp fall in oil prices, and the prospect of continuing volatility, has put growing pressure on the fiscal and external accounts of oil-producers and non-producers alike. In the Gulf States, budgetary cutbacks have been imposed across the board (even in Kuwait), payments delays and/or arrears have emerged on a large scale (notably in Saudi Arabia) and expatriate workers from neighbouring countries are being sent home. Private sector activity is depressed, particularly in construction, with a number of well-publicised bankruptcies, and several foreign firms have pulled out. The banks face the growing problem of non-performing loans with recovery complicated by Islamic law, especially in the UAE. Although supervisory authorities have moved, in some cases, to support the banks and tighten up provisions (as in Kuwait), several foreign banks, including in particular US banks, are looking to reduce their presence and their exposure in the area.

30 Among oil-producers, Saudi Arabia's oil export earnings have fallen by over 80% since 1981 and are likely to fall further this year despite the higher volume of its oil exports. The postponement of the FY 1986-7 budget, the devaluation of the riyal, and the rapid erosion of usable official foreign assets are indicative of the Kingdom's mounting difficulties. Useable foreign assets could be exhausted in 2-3 years. Oman has also devalued, suspending the new 5 year Plan (and deferring purchases of Tornado aircraft), and has stepped up foreign borrowing with a \$500 mn

loan signed last month. Both Iraq and Iran face serious foreign exchange shortages at a time when the Gulf War has escalated. Iraq is close to bankruptcy, with Gulf aid now less certain, and is seeking to reschedule large amounts of official debt (some previously rescheduled) with all its major creditors. Even the suggested reduction of non-military imports by 30-50% may be inadequate to offset losses from the oil price fall.

31 Egypt, already in difficulties before the oil price fall, has failed, for much of the year, to market its oil. Foreign exchange earnings from remittances and tourism will also fall sharply in FY 1986-7. Agreement on an IMF programme is not yet close to being reached, and there are few signs, as yet, of the government's commitment to the necessary reforms (including devaluation). Algeria has reacted swiftly to falling oil and gas prices with sizeable expenditure cutbacks, notably for imports, and the postponement of major projects. Even so the current account deficit could rise to around \$2 bn this year and, although foreign exchange reserves are comfortable, Algeria has already come to the markets this year for \$600 mn. Further borrowing is likely to be sought in the coming months, but banks are reportedly becoming more cautious. Tunisia also faces a widening current account deficit and a rising debt-service burden (over 20% of budgeted expenditure in 1986). The government has recently raised \$120 mn from the markets, less than the \$175 mn originally sought. (The tax-spared element had to be dropped following legal difficulties concerning Tunisia's eligibility under the 1982 double taxation treaty with the UK.)

32 Among non-oil countries, Morocco's external prospects have improved somewhat as a result of the fall in oil prices, lower international interest rates and a good harvest. But the budget deficit remains high and the external financing gap has increased to \$500 mn this year. The current IMF programme is now inoperative and the Fund are looking for new adjustment measures before opening discussions on a new programme. Agreement with the banks on rescheduling 1985-7 maturities and possible new money remains distant. Sudan has achieved a peaceful transition to civilian rule, but the civil war has since escalated and the economic and financial position has deteriorated further. The new government has good intentions, but there is no prospect for immediate or decisive action on the economy. Sudan is still ineligible to draw from the IMF, and its IMF arrears have now reached \$300 mn. Initial contact has been made with the World Bank and the Fund, but agreement on a programme will be difficult given the widespread hostility to the IMF in the country. Jordan's economic prospects have worsened considerably with the Gulf recession which has jeopardised the principal sources of foreign exchange. Syria (still a net oil importer) is also in severe financial difficulties. Foreign

exchange reserves have reportedly been run down to the equivalent of two weeks' imports, and arrears on official payments and on the part of Syrian banks are now substantial.

INDEBTEDNESS AND BRITISH EXPOSURE

\$ billion

	Total external debt	British-owned banks' exposure [1]	ECGD amounts at risk	
	End-Dec 1985*	End-Dec 1985	End-March 1986 [2]	End-March 1986 [3]
<u>Latin America</u>				
Argentina	50	2.8 (0.1)	0.2	0.2
Brazil	102	6.3 (1.0)	0.9	1.9
Chile	19	1.3 (0.1)	-	0.1
Colombia	14	0.6 (0.1)	0.1	0.2
Ecuador	8	0.5 (-)	0.1	0.1
Mexico	97	6.3 (0.3)	0.6	1.3
Peru	14	0.3 (-)	0.1	0.2
Venezuela	37	2.1 (-)	-	-
<u>Far East</u>				
Indonesia	35	0.7 (0.3)	0.8	1.7
Philippines	27	1.3 (0.1)	0.2	0.2
South Korea	45	2.2 (0.5)	0.4	0.8
<u>Eastern Europe</u> (convertible currency)				
Hungary	12	0.4 (-)	-	0.1
Poland	30	0.5 (-)	1.2	1.3
Romania	7	0.2 (-)	0.3	0.5
Yugoslavia	19	0.9 (-)	0.7	1.0
<u>Southern Europe</u>				
Greece	17	1.3 (0.2)	0.2	0.3
Portugal	16	1.1 (0.2)	0.2	0.2
Turkey	25	0.3 (0.2)	0.2	0.5
<u>Africa</u>				
Egypt	40	0.3 (0.3)	0.4	1.0
Morocco	15	0.1 (-)	0.1	0.3
Nigeria	19	1.0 (0.1)	2.1	3.2
South Africa	22	3.9 (0.8)	0.8	2.6
Sudan	10	0.0 (-)	0.3	0.3
<u>Middle East</u>				
Israel	30	0.5 (-)	0.1	0.2

[1] This column now shows exposure defined as consolidated external claims, adjusted for certain inward and outward risk transfers in respect of guaranteed loans, plus any net claims on local residents in local currency.

Amounts in brackets represent total unused commitments adjusted for certain inward and outward risk transfers in respect of guaranteed loans.

[2] Defined as ECGD-guaranteed loans disbursed, plus political claims paid and claims under examination.

[3] Defined as ECGD-guaranteed loans (disbursed and undisbursed) and contractual interest, plus political claims paid and claims under examination.

* current estimate