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*Prime Minister**CD?
7/5.**Dear Charles***INTERNATIONAL FINANCIAL SCENE**

... I attach the regular report on developments in the international debt scene.

Since our last report at the end of March the Interim and Development Committee meetings have taken place in Washington. These meetings were dominated to a great extent by the problems of world growth, imbalances and exchange rates. The world economic prospect was generally judged to be less buoyant than assumed at the time of the annual meetings, with a greater chance of adverse developments than of improvements - eg upward pressure on US interest rates and slower than expected growth in Germany and Japan.

On debt, the meetings confirmed the growing perception of weaknesses in the present strategy.

As regards middle income debtors many speakers took refuge in ritual incantation of the need to strengthen the Baker strategy. However, the persistent nature of the debt problem is, if anything, leading to an expectation that in the next stage official creditors will be expected to take a more effective lead. This will need to be handled with considerable care.

Discussion of the low-income debtors was marked by the successful launch of the Chancellor's initiative on the debt of the poorest and most indebted countries in Sub-Saharan Africa. Since the Washington meeting, the Paris Club aspects have been taken further in a special meeting on 24 April. That meeting suggested a broad consistency of view about which countries were likely to qualify for any new facility and no serious problems about taking forward the idea of longer term reschedulings for qualifying countries. On the more difficult question of interest relief, the key will be to



get the US, who are worried about Congress, on board. If we can persuade them we would expect the French, Germans and Japanese all to participate. We shall need to keep up the pressure for action at forthcoming international meetings eg the OECD Ministerial meeting and the Venice Summit.

Turning to individual countries, the main focus of attention continues to be Brazil, where the replacement of Funaro as Finance Minister by Bresser Pereira (and Gros by Milliet as Central Bank President) looks a hopeful development against a very poor economic position. Bresser Pereira visited London last month, and made a good impression: not an ideologue like his predecessor and prepared to negotiate. Since taking office the new Finance Minister has announced a devaluation of the Cruzado of 8.49 per cent and outlined his intentions, including a lower short term growth rate (3 per cent to 3½ per cent rather than 7 per cent), early restoration of large trade surpluses, greater control over public expenditure and short term stabilisation of inflation (albeit at present high levels). Debt service is to remain suspended until the Government is able to introduce a non-recessive internal adjustment plan and Brazil is generating sufficient external surpluses to resume servicing the debt. The commercial banks see this appointment as encouraging and Bresser Pereira himself as someone they can negotiate with.

Recent news has been better on Mexico, Argentina and the Philippines. The commercial bank package for Mexico became effective - at last - on 30 April enabling the \$500 million bridging loan to be repaid and \$3.5 billion of new money to be disbursed. The Advisory Committees have reached agreement with Argentina and the Philippines, although there could well be delays before these packages secure sufficient participation to become effective. The Argentine package, however, includes incentives designed to streamline the negotiating process and avoid the delays which have dogged other recent packages.

Other small items worth noting have been the \$50 million FRN signed by Colombia (the first Eurobond issued by a Latin American borrower since 1982) and Bolivia's debt buyback scheme, which remains under consideration by the banks. The news on Nigeria is also a little better. Following action by the government, the Fund programme seems to be back on track and the second tranche of the World Bank loan has been disbursed.

Despite these positive individual developments, the prospect remains in many respects as difficult as ever. For debtors whose packages are at any early stage of negotiation, the key issue, as the Chancellor made clear in his speech to the Interim Committee, will be to resist the weakening of IMF conditionality. On Egypt, and also Zaire, the programmes coming before the Fund Board do not contain nearly enough adjustment. In neither case is there any

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prospect of medium term balance of payments viability. On Egypt, the present position is that while none of the G7 creditors has been prepared to give commitments about filling the financing gap, the Managing Director now seems prepared to put the SBA to the Board on an assumption of "best endeavours" by creditors and of an as yet unspecified further strengthening of the programme in the Autumn. We will need to take a hard look at Camdessus' proposal and the programme before the Board discussion.

Elsewhere, Ecuador's position has deteriorated rapidly, in part reflecting the impact of the earthquake and other natural disasters. In Africa, Anglophone countries (Tanzania, Ghana, the Gambia) seem to have been doing better with their programmes than Francophone countries (problems with Cote d'Ivoire, Mali, Gabon among others). However, the latest news from Zambia is less good.

I am copying this letter to Tony Galsworthy (FCO), Tim Walker (DTI) and John Footman (B/E).

Yours ever,

Tony

A W KUCZYS

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INTERNATIONAL FINANCIAL SCENE

1 Following Brazil's declaration in February of a moratorium on interest payments on its medium and long term commercial debt, and of the freezing of its short term lines, and the consequent concerns that such moves may be followed by other countries, there have been a number of agreements over financing packages between middle-income debtors and the banks. Moreover, the Mexican package agreed last summer has finally become effective, following the signature of the British banks who had earlier held out for a larger contribution from the US. On the other hand, as regards the poorest, most indebted countries - largely those in Sub-Saharan Africa - with their clear inability in many cases to continue to service their debt within existing rescheduling constraints, British and French initiatives to offer debt relief were launched at the meetings of the Interim and Development Committees in Washington.

2 Amongst the middle income debtors, Mexico's financing package seemed in some jeopardy in early April. The Advisory Committee, anticipating that by no means all banks would agree to participate, had originally asked banks to contribute 12.9% of their 1982 exposure, although if all banks were to have participated only an 11.6% increase in exposure would have been necessary. The US banks' commitment to the target finance fell significantly short, with a number of regional banks and others refusing to participate or committing for a much smaller figure than asked for. The UK banks accordingly took the line that until the US bank contribution was substantially increased the UK banks would only commit at the 11.6% level. This move threatened to lead other banks also to reduce their level of participation, perhaps causing the entire package to unravel. In the event, after a token additional contribution from certain US banks, the British banks agreed to sign for the full 12.9% increase. The Mexican package finally became effective, and the \$500 mn bridging loan was repaid and \$3.5 bn of new money disbursed on 30 April.

3 The banks' Advisory Committees have reached agreement over financing packages for Argentina, Philippines and Venezuela, although difficulties and lengthy delays are likely to be encountered before these agreements obtain the participation of the banks as a whole, and there are reports that the Philippines already intend to reopen their agreement (having seen that they obtained less favourable terms than

Argentina). In an effort to induce banks to sign up quickly, the Argentine agreement provides higher fees to those banks agreeing to participate by 17 June. In contrast, as a result of the Brazilians' declaration of a moratorium, their refusal to accept any IMF programme, and the lack of any sign that they have any clear policy plan to remedy their poor economic position, the Advisory Committee for Brazil has been unwilling to countenance the longer term rescheduling which the Brazilians are seeking - although maturing short term lines seem to have been informally rolled over by most banks. For their part the Brazilians are also objecting to the fact that most creditor countries are still off cover for new export credit finance, claiming that the restoration of export credit was understood as part of the January Paris Club agreement: most creditors, however, have not accepted these claims. It remains to be seen to what extent the resignation of Finance Minister Funaro as of April 27, and of Central Bank Governor Gros on April 29, will lead to a change in policies.

4 Meanwhile, following the increasing inability of many of the poorest, most indebted - ie sub-Saharan African (SSA) - countries to fulfil their debt servicing obligations, and following some preparatory work at the Paris Club examining the effects of providing alternative forms of debt relief, the Chancellor of the Exchequer launched an initiative at the Interim/Development Committee meetings in Washington designed to provide debt relief for these countries. This relief may include creditors agreeing to retrospective terms adjustment (RTA - ie in effect converting aid loans to the poorest into grants - already largely undertaken by the UK, but not by a number of other creditors), extending the length of rescheduling of official debt, and the rescheduling of such debt at concessionary rates. The French launched a parallel initiative which advocates extended Paris Club rescheduling, a concessional CFF, and the use of an additional concessional World Bank facility to repay some existing official debt. Heads of delegation of the Paris Club met on April 24 to start working out the details of any proposed scheme: which countries should benefit, how conditionality should be enforced, what sorts of debt servicing concessions should be offered, and what comparability should be sought from other creditors (principally the IFIs and the banks). Progress was achieved on most of these issues, but some countries - notably the United States - still see difficulty in parts of the proposals, in particular on concessionary interest rates. Further work on these questions is also being undertaken by World Bank staff.

5 In the wider economic sphere, developments facing debtor countries continue to be mixed. Most debtors will have benefited from the continued decline of the dollar: by the end of April this had fallen over 7% since the beginning of the year

in effective terms, and had returned roughly to its average level of 1980. (On the other hand, the fall in the value of the dollar may lead to a reduction in the amounts available through World Bank programmes if no general capital increase can be agreed.) The authorities of the G7 countries have declared that they feel that exchange rates are now more consistent with fundamentals, and they restated in Washington the February Louvre agreement to co-operate to stabilise exchange rates at around current levels: but with the markets seeking to test this, especially following the announcement of US tariffs on certain Japanese electronic goods and of disappointing US trade figures for February, and with little clear evidence of remedial policies from the Japanese or the Germans, there are concerns that the US may have to raise interest rates to defend the dollar. Most euro-dollar interest rates have risen over half a percentage point in the last six weeks: the six-month rate is now over 7%, compared with 6% at the beginning of the year. And, whilst protectionist moves are at the moment principally directed at Japan, there are concerns that they may (especially in the United States) soon also affect some of the debtors. Meanwhile, forecasts for growth in the industrialised world continue to be shaded down: the IMF WEO discussed at the Washington meetings was somewhat less buoyant than the forecast presented at the Annual Meetings last autumn. And, more recently, the German economic institutes have revised down their forecast for German growth this year, from the 3% expected last autumn, to only 1%-2% now.

6 Spot commodity prices rose during March and April. In the seven weeks ending 21 April the Economist Index rose 2.3% in SDRs (up almost 5% in \$), with rises in all of the sub indices. Food prices rose 1.7% and industrial raw materials almost 3% in SDR terms, with similar rises for both agricultural non-foods and metals. Stronger metal prices reflected short-term supply shortages in several markets. Overall, commodity prices are now roughly back to their level of the middle of last year. However, there remains considerable diversity in performance: coffee prices are still almost 20% below their 1986 low, whilst beef prices are 5% above their 1986 high.

7 Of the \$1.6 bn borrowed on the international capital markets by developing country borrowers since the beginning of March, three quarters was raised in syndicated loans. Indian borrowers represented the highest proportion, with the equivalent of \$344 mn through 9 loans (nearly half of which was in deutsche marks). China also borrowed over \$300 mn. Colombia signed a \$50 mn FRN, the first eurobond issued by a Latin American borrower since 1982. The only East Bloc borrowers in this period were from the USSR: Vneshtorgbank raised a \$200 mn euro credit (and doubled its existing sterling bankers' acceptance facility to £200 mn), while the International Investment Bank borrowed \$50 mn.

8 Banks and debtor countries continue to seek new ways in which financing needs can be met; both sides see advantages in offering options between which banks can choose how to participate in financing packages. The Interim Committee endorsed this "menu approach" to financing, and particularly commended local currency financing and debt equity conversions schemes. Chile, Argentina, Philippines and Brazil are amongst the countries operating, or expected shortly to be operating, such schemes; the Mexican scheme remains temporarily suspended, following an administrative backlog trying to clear earlier applications. Amongst other schemes to help particular debtor countries the possibility of using money provided for drug eradication as a vehicle for repurchasing Bolivia's debt at a discount is still being examined. The Japanese authorities have meanwhile announced that they will be granting \$20-\$30 bn of new loans, largely to Latin America, over the next three years. Details have yet to emerge, and it is not yet clear how much of this will actually be additional to earlier commitments.

Further details on individual countries are given below.

Latin America and Caribbean

9 The signing process for Mexico's bank financing package began on 20 March, when commitments had reached \$7.6 bn (98.7% of the \$7.7 bn required for the package, but only some 89% of the total commitments asked for from the banks because of the safety margin). The exercise was not smooth, particularly because of the reluctance of some US banks (mainly the regionals) to participate at the levels sought. The shortfall in the contribution from the US banks, which was only 82.3% of the amount sought, led the major British banks (and some Canadian banks) to make their signatures for the full amount dependent on conditions which in essence were designed to extract a higher US contribution. A token increase was eventually obtained from the US banks; the British banks concluded that no further contributions were likely and signed for the full amount on 13-14 April. The agreement has now become effective, and Mexico repaid the \$500 mn bridging loan and received the first \$3.5 bn disbursement of new money on 30 April. Meanwhile, on 1 April the EXIM Bank of Japan released \$250 mn (part of a \$1 bn loan package) for the Pacific Petroleum Project.

10 The Fund programme appears to be progressing satisfactorily, and targets for 1987 have been agreed. Mexico's external performance continues to be good: the trade account is benefitting from continued peso depreciation and the longer-than-expected recession. The January-February trade surplus was reported to

be \$1.5 bn (up 109% on the same period in 1986), with oil exports of \$1.35 bn (+6%), non-oil exports of \$1.85 bn (+20%) and imports of \$1.7 bn (-21%). However, domestic inflation is currently running above expectations, with the CPI rising by 8.1% and 7.2% in January and February respectively, giving a year-on-year increase of 110% in February: the target of 80% inflation for 1987 would require average monthly increases of 4.5% for the remainder of the year, and seems out of reach. Real GDP fell by 3.5% in 1986, and growth of only 2% is expected in 1987 (even this may prove optimistic). The Mexican debt-equity scheme has been suspended temporarily since March to clear the back-log of existing applications (it is reported that this move was also meant to pressurise banks into supporting the financing package). Nevertheless, Amex Bank has signed a deal to convert \$100 mn of debt into equity for hotel development (it is the first US bank to have used the conversion mechanism entirely for its own account).

11 The rift between the Brazilian authorities and the banks' Advisory Committee has continued to widen since the authorities' suspension of interest payments on \$68 bn of medium and long-term bank debt and the freezing of \$15.5 bn of short-term trade and interbank lines in late February. The banks have been reluctant to enter into full-scale negotiations over the rescheduling of Brazilian debt at this stage; the Brazilians and the Advisory Committee met in the margins of the IDB Annual meetings in Miami (23-25 March), but failed to reach agreement on the "goodwill" interest payment sought by the banks as a prelude to negotiations. The Committee consequently refused to endorse the Brazilians' request, sent to creditor banks on 25 March, for a 60-day extension of short-term lines. Despite this, banks appear to have maintained their lines (initially for between 30 and 180 days), although the Brazilian authorities are believed to be unfreezing individual short-term lines if the banks concerned have threatened legal action. The Advisory Committee met a Brazilian delegation led by Central Bank President Gros on 10 April for discussions on interim arrangements for the maintenance of short-term lines and the rollover of medium and long-term debt. The Brazilians presented the banks with a copy of their general economic guidelines for 1987-91, but appear not to have made more specific financing requests, and no formal arrangements were reached. On 13 April the Brazilians sent telexes to creditor banks requesting a 3-month extension of the rollover of 1986 and 1987 Q1 medium term maturities which was due to expire on 15 April, and a rollover of maturities due between 16 April and 15 June. The Advisory Committee did not endorse the request.

12 The US Interagency Country Exposure Review Committee has reacted to the suspension of interest payments by downgrading loans to Brazil to "substandard" for regulatory purposes from 1 April. This in itself does not require US banks to take

any action regarding their loans; nonetheless, a number of the major banks have put medium and long-term loans to Brazil on a non-accrual basis in their end-quarter submissions to the US regulatory authorities (ie payments from Brazil are recorded on a cash rather than accruals basis for the previous quarter). This move is reported, for instance, to have reduced Chase Manhattan's net income in Q1 1987 by \$36 mn (including \$5 mn in respect of Ecuador) to \$104 mn.

13 Whilst it is now widely believed that the Brazilian economy is moving into recession, there is little evidence of this in recent economic data. The trade surplus for March was only \$156 mn, giving a 1987 Q1 total of \$546 mn (cf \$2465 in 1986 Q1). Overnight and 60-day interest rates remain at 400-500% pa, and the February rise in the CPI (13.9%) brought accumulated inflation in January-February to 33% (29% in January-February 1986). Finance Minister Funaro resigned as from 27 April, and was replaced by Luiz Bresser Pereira. This led to the resignation on 29 April of Central Bank President Gros who was replaced by Fernando Milliet D'Oliveira, an associate of Pereira. The new Finance Minister has already announced an 8.9% devaluation of the cruzado, and has reduced the projected rate of economic growth for this year from 7% to 3.5%; however, he has also warned that Brazil might have to suspend interest payments on official debt if the country cannot generate at least a \$6 bn trade surplus.

14 Ecuador's earthquake on 5 March which destroyed the country's oil pipeline is estimated by the authorities to have increased 1987's external financing gap to \$950 mn, from the \$325 mn previously expected. Further recent disasters - a major landslide which destroyed a principal link to the Pan American Highway, a gold mine collapse, and flooding on the coastal plain - have doubtless increased the gap further. Ecuador's initial response to the earthquake involved austerity measures including 10% cuts in public expenditure, a price freeze on essential commodities and domestic petrol price increases of up to 80%; external debt service was also suspended. The public response was hostile, reflected in a general strike on 25 March. Arrangements have subsequently been made with Venezuela to borrow 12.5 mn barrels of oil until end-May, of which 40% will be for domestic consumption and 60% for export (such loans will be counted as Ecuadorean production by OPEC). A link to the Colombian oil pipeline should be completed by the middle of May and will enable movement of 50,000 bpd. Emergency assistance may be provided by the IMF and the World Bank, and loans from the IDB and Andean Development Corporation may provide about \$100 mn. The IMF Board deferred discussion of Ecuador's Article IV, originally scheduled for 13 April, to allow for a fuller assessment of the impact of the earthquake. The review of the SBA has not yet been completed and the second and third tranches have not been drawn; there have been indications that

Ecuador no longer wishes to continue following its Fund programme. Meanwhile, the Ecuadoreans have indicated a desire to renegotiate their 1987-88 obligations under last year's Paris Club MYRA, to have them refinanced over 10 years (5 years' grace); they also wish to change the cut-off date from December 1982 to December 1984.

15 Peru's 8.5% economic growth in 1986 produced a deterioration in the external accounts for the year: the trade balance moved from a \$1 bn surplus in 1985 to a \$50 mn deficit, and liquid international reserves fell by \$0.6 bn (to \$1 bn, still nearly 5 months' imports) despite the continuing limitation on debt service. Nonetheless, the Garcia administration remains unwilling to employ tighter demand management. In a package announced on 3 April, the minimum wage was increased by 40% and some other wages by 27-30%, while the price of petrol, which provides a third of tax revenues, was increased only 20%. Instead, the authorities have announced that they may compensate for declining export and fiscal revenues by employing further restrictions on servicing the debt of preferential creditors. On the other hand, there are reports that the authorities may be moving towards a resumption of Article IV consultations.

16 Argentina has reached broad agreement with the banks' Advisory Committee following over two months of negotiations. The package includes \$1.55 bn of new money for 1987, to be repaid over 12 years (5 years' grace) at a margin of 7/8% plus a 4-year \$400 mn trade facility, which carries an interest spread of 13/16%. It also includes the rescheduling of around \$25 bn of debt due to banks in 1986-96 over 19 years (7 years' grace) and the rescheduling of \$4.2 bn of old 'new money' over 12 years (5 years' grace); the rescheduled debt also carries an interest margin of 13/16%. In order to try to avoid the lengthy delays which have characterised the finalisation of recent financing packages for other countries, the Argentine agreement provides for higher fees for those banks which agree to participate by 17 June. The banks have agreed to a scheme of exit bonds which the Argentinians proposed as a means of excluding those banks with small exposure to the country from future new money and rescheduling packages. The rollover of debt due between January 1986 and end-March 1987, which was agreed last August, expired on 31 March. Argentina requested that the rollover should also cover debt falling due in April, and that all the debt covered be rolled over for a further 180 days, giving a new expiry date of 31 October. Talks on a Paris Club rescheduling are tentatively due to take place on 19 May, although not all the bilaterals under the previous Paris Club agreement have yet been signed; the UK bilateral remains unsigned, largely because of a dispute over two ECGD claims. On the economic front, inflation continues to be a significant problem: the CPI rose by 8.2% in March (106% year-on-year).

17 The Venezuelan authorities' most recent forecast for the 1987 balance of payments indicates a current account deficit of \$0.8 bn (cf \$2.3 bn in 1986) and an overall balance of payments deficit of \$1.2 bn (cf \$4.5 bn in 1986). But although international reserves are projected to fall by over \$1 bn this year, this would still leave them at around \$8.6 bn at end-1987. Meanwhile, following the agreement in principle of amendments to Venezuela's public sector MYRA at end-February, a new term sheet which includes details of a debt-equity conversion scheme has been endorsed by the Advisory Committee and has been sent to the creditor banks. The Advisory Committee hopes to have the arrangements finalised quickly, but many banks have indicated that they will not sign the MYRA until some long-standing issues on the private sector debt repayment plan are settled. They are concerned that the government is still refusing to accept responsibility for certain private sector debts such as those of private banks which were intervened by the government. Nevertheless, the first major agreement under the private sector debt plan has just been signed: the finance company Inversiones Cremerca has agreed with international bank creditors to reschedule \$58 mn. The Central Bank has meanwhile begun signing foreign exchange contracts with private sector debtors whereby the Central Bank will provide dollars at a preferential exchange rate on payment of a premium. This premium, it seems, is likely to prove excessively burdensome for a number of private sector debtors, particularly finance companies.

18 Chile's trade surplus in February, at \$120 mn, was slightly above the level of a year ago (\$105 mn). Consumer prices rose by 2% in January and by 1.7% in February bringing the year-on-year rate to 17.5% (against 17.4% in December and an IMF target for end-1987 of 13%). Following the agreement in principle of the commercial bank package, the Chilean authorities have renegotiated their Paris Club debts: 85% of principal due between 15 April 1987 and 31 December 1988 will be repaid over 7 years, including 3 years' grace. Of the remaining amounts, 5% of principal and 100% of contractual interest is to be repaid on original due dates, whilst the final 10% of principal will be repaid on 31 March 1989. The rescheduling will save approximately \$150 mn in 1987 and 1988. As the consolidation period runs beyond the end of the existing Fund EFF, the Paris Club agreement has been backed by a specific commitment by Chile to seek a Fund agreement covering 16 August 1988 to 31 December 1988.

19 Colombia signed a \$50 mn FRN in London on 6 April, the first eurobond issued by a Latin American borrower since 1982; it carries a spread of Libor +1 1/8% and has a term of 7 years (4 years' grace). Further use is expected to be made of the euromarkets to fulfil 1987's proposed \$2 bn borrowing programme. The Colombian authorities are also expecting to receive \$87 mn through an IDB complementary

financing to be marketed jointly in London and New York at end-April. Colombian export performance this year is likely to be weaker than last because of lower coffee prices, although export volumes will be higher as a result of the suspension of ICO quotas. Expectations are for a trade surplus of \$200 mn and a current account deficit of \$1-1.6 bn. In the domestic economy the government hopes to achieve GDP growth of 4-4.5%. Lower coffee revenues mean that the PSBR is expected to rise to 3% of GDP (0.8% in 1986). The inflation rate has remained fairly steady, with the CPI rising by 8.2% in Q1 (8.8% in Q1 1986) bringing year-on-year inflation to 20.4% (cf 20.6% at end-1986); the authorities' target for the year is 20%. Uruguay's SBA programme expired in March, and there are no indications that a follow-on programme will be sought. On 19 March Uruguay drew down the \$45 mn which commercial banks had provided in a co-financing with the World Bank for a power sector rehabilitation project.

20 There has been little further progress recently on Bolivia's proposed debt buy-back scheme. Although the major US banks have apparently reacted quite favourably to the scheme, most other banks have not yet responded. Bank of America, which chairs the Advisory Committee, intends to revert to recalcitrant banks to obtain their support. The Advisory Committee is still working on the premise that funds for the buy-back will be available from foreign governmental sources; it has been rumoured that West Germany and Holland have agreed to provide \$30 mn and \$20 mn respectively. Costa Rica has reached a provisional agreement with the Fund, and a Letter of Intent has been accepted by management as the basis for a new SBA; a Fund Board discussion is expected by end-May/early June. The draft documentation for Jamaica's 1987 rescheduling agreement was sent to the 150 banks involved in early April, and signing has been tentatively scheduled for 29-30 April.

21 Final agreement on the IDB's Seventh Replenishment has yet to be reached. The IDB had hoped to announce the decision at the Annual Meeting in Miami on 23-25 March, but failure to agree on the US proposal for a change in the Executive Board's voting procedure prevented a final decision on the size of the lending programme and the amount of the Replenishment required. Agreement is not now expected before the next meeting of the Board of Governors in June. The gap between the US and the major Latin borrowing countries has widened, meaning that a smaller Replenishment now seems likely. This would result in the IDB's lending over 1987-90 being no greater than over 1983-86 (\$13 bn).

South and East Asia

22 The Philippines finally reached agreement with the banks' Advisory Committee in New York on 27 March. The main elements in the \$13.2 bn package included a rescheduling of previously unstructured medium-term debt maturing between 1987 and 1992, amounting to \$3.5 bn, over 17 years with 7 1/2 years' grace, a further rescheduling of previously rescheduled debt falling due between 1987 and 1992, amounting to \$5.8 bn, also over 17 years with 7 1/2 years' grace, a rescheduling of private financial sector debt falling due between 1987 and 1992, amounting to \$1 bn, over 16 years including 6 years' grace, and a four-year extension to the revolving short-term trade facility of just under \$3 bn with a reduced margin of 3/4%. The banks conceded a 7/8% spread on the medium and long term debt, but only on condition that the Philippines make annual pre-payments of \$37 mn in each of 1987, 1988 and 1989 of part of the \$925 mn new money facility, amortisation on which was not otherwise due to begin until 1990; otherwise the spread would be raised to 1%. For the years after 1989 the lower spread would apply if the Philippines continued to meet their payment obligations under the new money facility and the rescheduling agreement. The Philippines expected to have no difficulty in meeting the prepayment conditions; prepayment was expected to be financed out of expected sales of \$150 million a year of Philippines Investment Notes (PINs). Recent reports suggest, however, that the Philippines may now reopen negotiations with the banks, seeking to obtain instead similar terms to those agreed for Argentina. The Philippines are expected to achieve real growth of around 4% this year, after sharp declines in 1984 and 1985 and a virtually static performance last year.

23 Two syndicated loans for Indonesia, each for Y25 bn (\$175 mn), and each for 10 years (5 years' grace) were signed by Japanese financial institutions on 10 April. Meanwhile, the first contract (worth £10.9 mn) under the UK-Indonesian £150 mn soft loan agreement has been signed. For the financial year ending March 1987 real GDP is estimated to have grown by 2.4%, with the central government deficit rising to 5.5% of GDP (cf 2.9% in 1985-6 and a surplus in 1984-5). The current account deficit rose to \$4.2 bn (cf \$2.0 bn in 1985-6), with a 6% increase in non-oil exports and a 13% cut in imports only partially offsetting a 45% fall in oil and LNG exports. For the coming financial year, projected 10% and 17% increases in energy and non-energy exports respectively, and a further 6% cut in imports, are expected to cut the current account deficit for the year to \$2.3 bn. Indonesia's request for a CFT will come to the Fund Board on 4 May. Deflation last year in Malaysia, and the consequent fall in imports, meant that the visible trade surplus last year, at \$3.2 bn, was virtually unchanged from 1985. The current account deficit narrowed to \$0.5 bn, 1.8% of GNP (cf \$0.7 bn, 2.5% of GNP in 1985). Latest figures

from Bank Negara Malaysia suggest that the economic downturn may have bottomed out. GDP growth in 1987 may be as high as 2%.

Eastern Europe

24 Both Poland and Yugoslavia attended the Paris Club in the week beginning 30 March. No agreement was reached with Poland whose arrears to the Paris Club now total around \$4.5 bn. The Poles are seeking a long-term debt consolidation (covering up to 1989 at least), which official creditors are not prepared to contemplate until Poland has agreed an SBA with the IMF. In the meantime, creditors propose an interim agreement covering arrears outstanding and payments falling due in the rest of 1987 (although the US is unwilling to go beyond end-September or to support an IMF programme for Poland). Further discussions may take place at the May meeting of the Paris Club. At their meeting with the banks' steering committee on 10 April, the Poles submitted ambitious debt consolidation proposals encompassing all maturities due from 1988 onwards excluding those covered by the 1986-7 agreement. The banks are, however, only willing to discuss obligations due in 1988 and 1989; a further meeting is planned for mid-May. Meanwhile, Yugoslavia and the Paris Club reached provisional agreement on the implementation of the second stage of the country's official MYRA (covering the period 16 May 1987 to 31 March 1988). Despite the inadequacy of recent Yugoslav performance, the agreement was made subject only to consultations by Paris Club creditors on the basis of an IMF assessment of recent economic measures undertaken by the Yugoslavs on interest rates, the exchange rate, enterprise accounting, and public expenditure. The IMF assessment was debated in the Executive Board on 20 April, and the MD's summing up will be discussed by the Paris Club at their May meeting. For their part, the banks are unwilling to proceed until the Paris Club agreement is properly in place, and they have therefore rolled forward the implementation date of the second stage of their MYRA, initially to 27 May. The Yugoslav convertible-currency trade deficit in 1986 rose over 25% to \$2.0 bn, but the deficit in the first quarter of 1987 (\$245 mn) was less than half that of 1986 Q1, as exports stabilised and imports fell back sharply.

25 Romania has cleared its arrears to the IMF. In a meeting with the commercial banks to discuss a reduction in interest rate margins (from the 1 3/8% set in last year's re-rescheduling), the Romanians reported also that they had prepaid \$300 mn of debt due to official creditors in the period 1987 to 1989. In a move aimed at reducing its budget deficit (which in 1986 was equivalent to 3.7% of GDP), Hungary announced significant price rises on a range of food and consumer products from 13 April.

Southern Europe

26 In Greece the government has indicated that the economic austerity programme adopted in October 1985 will continue in some form into 1988. However, the targetted reductions in the public sector and current account deficits this year appear ambitious in the light of less favourable external conditions and the imminent dismantling of the import deposit scheme. On the international capital markets, the Commercial Bank of Greece raised \$75 mn through a commercial paper programme in March, and the Bank of Greece announced a \$300 mn eight-year syndicated credit in April at slightly finer terms than on a similar loan last year (5/8% over LIBOR compared to 3/4%).

Sub-Saharan Africa

27 Nigeria has met the criteria for the release of the second tranche of its World Bank loan, and disbursement is expected to be imminent. The Fund Mission has returned to Lagos, and a successful completion of the first review is expected shortly. In the wake of the roadshow to Tokyo in early March, three more Japanese banks have agreed to contribute to the new money element of the commercial bank rescheduling agreement, bringing the overall Japanese bank commitment to 54%: the overall level of commitments has consequently risen to around 91.5%. However, progress recently made towards the rescheduling of uninsured trade arrears seems to have stalled. The Central Bank of Nigeria (CBN) issued a further \$1.5 bn of new promissory notes on 7 April, but the majority of noteholders still have a large proportion of their debt unverified and are unlikely to consider any rescheduling proposals put to them by the CBN until the Nigerians have taken steps to speed up the verification process. In addition, creditor frustration has been heightened by the non-payment of interest due on notes on 6 April for which, as in January, there was no prior notification.

28 Cote d'Ivoire is in difficulties following the Fund's failure in March to complete the first review of the current 13-month SBA. Lower-than-expected prices for cocoa and coffee (on which the country relies for over half of its export earnings) mean that export earnings figures for 1987 have been revised downwards by around \$1 3/4 bn (about 6% of 1986 GDP), resulting in a projected overall balance of payments deficit of \$1.7 bn. The Fund has suggested that the authorities adopt a series of austerity measures worth about 2-3% GDP, leaving the remaining shortfall to be made up by faster IBRD lending, additional French funds and possibly new commercial bank money. However, the authorities have declined to countenance such cutbacks in their spending and, at present, the position is one of deadlock. If no

solution is found in the near future the position will worsen as, without a Fund programme, the Paris and London Club MYRAs only agreed last year will be void, and disbursement of the second tranche of a World Bank SAL worth \$150 mn, due this summer, will be in jeopardy. Cote d'Ivoire may seek to reopen its MYRAs, under which it is due to pay some \$1.3 bn in debt service in 1987; this would be strongly resisted by the Paris Club.

29 Following on from discussions with the 12-bank Technical Committee, the South African Standstill Co-ordinating Committee presented its proposals for a follow-on debt arrangement to the creditor banks on 24 March. The proposals are broadly as expected; they allow for \$1.42 bn of blocked debt originally caught in the standstill to be released over three years. The option of converting blocked debt into long term loans has been retained. In Sudan, routine discussions with the IMF took place in mid-March. A further round of talks in May will examine budgetary proposals and possibly also the long delayed "Economic Salvation Programme". But although relations with the Fund are easing, the prospects of early agreement on a programme remain slim: fundamental differences on key issues such as devaluation and the removal of subsidies - both of which the Finance Minister refuses to contemplate - are still very much in evidence.

30 In Zimbabwe the authorities have now signed an export promotion loan - designed for the manufacturing, agricultural and mining sectors - with a group of commercial banks (£35 mn facilities have been signed with Barclays and Standard Chartered and £10 mn facilities are expected to be agreed with Grindlays and BCCI) to supplement the existing, fully drawn, IBRD Export Promotion Loan designed for the manufacturing sector only. The Zimbabwe authorities had hoped to negotiate the new facility with the IBRD, but were unable to agree to the conditions the IBRD proposed. The Barclays and Standard Chartered loans have a maturity of 6 years (2 1/2 years' grace) and carry an interest rate of LIBOR +1 1/4% for the first three years and LIBOR +1 3/8% thereafter. Zambia has reintroduced its foreign exchange auction, but with some alterations: some transactions (debt service, educational and medical supplies) will be conducted at an alternative official rate, and others (agriculture and small enterprises) at the marginal rather than bid rate. A new IMF programme could go to the Board by the end of May, but this depends on budgetary reforms which at present remain unsettled. It also assumes that arrears to the IMF (currently SDR 170 mn, rising to SDR 220-230 mn by end-May) can be repaid by bridging finance. Zaire has reached agreement with IMF staff over the details of a new programme (including SBA, SAF, CFF) which is expected to go to the Board around 15 May. It is also likely to seek a further Paris Club rescheduling in May; this would be too early for the country to benefit from the recent SSA initiatives.

Middle East & North Africa

31 Serious difficulties emerged in finalising the IMF Standby for Egypt, now scheduled for Executive Board approval on 15 May. After earlier encouragement to the staff to accept a Letter of Intent in February for an acknowledged weak programme, the attitude of major creditors hardened. On 2 April their EDs rejected Camdessus' unprecedented proposals for some form of guarantee that the IMF would be repaid. Subsequently, however, they have given sufficiently positive responses to alternative proposals on rescheduling terms (including subordinating Paris Club claims to those of the IMF) to enable Camdessus to issue the staff paper. Although Mubarak, whose party was successful in the parliamentary elections on 6 April, but who himself faces re-election in October, had been ruling out faster or more comprehensive adjustment at present, the Central Bank Governor gave written assurances to the Fund MD on 8 April that there would be some acceleration on exchange rates, interest rates, and pricing policy. Egypt has meanwhile benefited from recent substantial Gulf aid, and has also reached agreement with the USSR to reschedule \$2 bn military debts over 25 years (with 6 years' grace and no interest payments). But Egypt has not yet formally accepted an earlier US offer to reschedule FMS debts of approximately \$5 bn.

32 Elsewhere, Algeria continues to experience market resistance to its borrowings. A proposed 5 year bankers' acceptance facility organised by Lloyds Merchant Bank has recently been abandoned. Payments arrears persist. The first review of Morocco's SBA has been completed and the programme is back on track. No date has yet been set for the signing of the rescheduling agreement with the commercial banks. 37 banks (out of 304) have not responded to the proposals circulated by the Steering Committee some two months ago, and problems have arisen as regards the Belgian and Swedish banks, who are not allowed by their authorities to convert overdrafts into term loans as is being proposed. Iraq has largely eliminated arrears to UK creditors, but is only making a few, erratic repayments elsewhere and is involved in complex bilateral negotiations, with official and commercial creditors, to reschedule overdue and projected repayments of principal (amounting to some \$71.25 mn) on a 1983 \$500 mn syndicated Euroloan.

INDEBTEDNESS AND BRITISH EXPOSURE

\$ billion

	Total external debt	British-owned banks' exposure [1]	ECGD amounts at risk	
	End-Dec 1986*	End-Dec 1986	End-December 1986 [2]	End-December 1986 [3]
<u>Latin America</u>				
Argentina	49 [4]	3.0 (0.2)	0.2	0.2
Brazil	104	6.6 (1.4)	1.0	1.8
Chile	19	1.3 (0.1)	-	0.1
Colombia	15	0.6 (0.1)	0.1	0.1
Ecuador	8	0.5 (0.1)	0.1	0.1
Jamaica	4	- (-)	-	-
Mexico	98	6.3 (0.7)	0.6	1.2
Peru	15	0.3 (-)	0.1	0.2
Uruguay	4	0.3 (-)	-	-
Venezuela	35 [4]	2.1 (0.1)	-	-
<u>Far East</u>				
Indonesia	42	0.8 (0.3)	0.8	1.6
Malaysia	21	1.1 (0.3)	0.1	0.1
Philippines	28	1.3 (0.2)	0.1	0.2
<u>Eastern Europe</u> (convertible currency)				
Hungary	15	0.3 (-)	-	0.1
Poland	34	0.6 (-)	1.2	1.3
Romania	6	0.2 (-)	0.3	0.4
Yugoslavia	19	0.8 (0.1)	0.7	0.9
<u>Southern Europe</u>				
Greece	18	1.2 (0.2)	0.2	0.3
Turkey	29	0.5 (0.3)	0.2	0.5
<u>Sub-Saharan Africa</u>				
Cote d'Ivoire	8	0.3 (-)	0.1	0.1
Nigeria	23	1.3 (0.2)	2.4	3.3
South Africa	22	3.6 (0.6)	0.8	2.5
Sudan	10	- (-)	0.2	0.2
<u>Middle East and North Africa</u>				
Algeria	27	0.4 (0.1)	0.2	0.4
Egypt	45	0.2 (0.2)	0.3	1.2
Iraq	55 [5]	0.1 (-)	0.5	1.2
Israel	31	0.4 (0.1)	0.1	0.2
Morocco	17	0.2 (-)	0.2	0.3
Oman	3	0.1 (0.1)	0.7	1.9
Saudi Arabia	14	0.6 (0.2)	0.2	0.2

[1] Defined as consolidated external claims including portfolio investments with a contractual repayment date, 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. Other portfolio investments in these 30 countries amounted to \$9 million at end-December 1986.

[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.

[4] Medium and long-term debt only.

[5] Includes \$30 bn from Arab countries.

* current estimate

OVERDUE FINANCIAL OBLIGATIONS TO THE FUND*

Country	Due Date of Earliest Arrears Outstanding	Total Outstanding (SDR mn)
Kampuchea	13 March 1975	28.9#
Guyana	31 May 1983	50.3#
Viet Nam	6 February 1984	60.1#
Sudan	12 July 1984	323.8#
Liberia	25 January 1985	97.5#
Peru	9 September 1985	210.9#
Zambia	30 April 1986	170.0
Somalia	20 November 1986	11.9
Sierra Leone	16 January 1987	5.3
Uganda		<u>10.0</u>
		<u>968.7</u>

NB The above figures are derived from Fund papers issued with respect to individual country complaints. There will have been further overdue obligations falling due subsequently, so the figures are not completely up-to-date. A Fund source indicates that total arrears were SDR 1044.5 mn as at 12.3.87 but this figure is not divided country by country.

* for members with at least one obligation with respect to repurchases or charges overdue for more than one month.

Guyana, Viet Nam, Sudan, Peru and Liberia are ineligible. Kampuchea is out of contact with the Fund.