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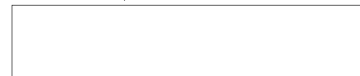

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# International Economic & Energy Weekly

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**16 December 1983**

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*16 December 1983*

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**International Economic & Energy Weekly**

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16 December 1983


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*This article was prepared by analysts from ALA, OEA, and OGI*

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# International Economic & Energy Weekly

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## Synopsis

1 **Perspective—*Major Latin American Debtors: Economic Difficulties Ahead***

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The Brazilian, Mexican, and Argentine economies will not experience rapid growth soon even if a strong recovery in world import demand begins to ease financial strains in 1984. Even if the IMF eases its conditions for continued lending, the economic adjustment programs that would still be required by debtors will preclude a strong demand-led recovery.

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15 **International Financial Situation: Political Update**

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This article is part of our series on the economic and political aspects of the international financial situation. The domestic political climate has improved during the last month in a number of financially troubled Third World countries—Argentina, Venezuela, Jamaica, and Brazil—while slightly worsening in others—the Philippines, Peru, and Bolivia.

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17 **International Financial Situation: Trade Financing Cutbacks**

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This article in the series on the economic and political aspects of the international financial situation examines the cutbacks in Western trade financing for debt-troubled LDCs. Continued difficulties in obtaining trade credits for vital imports will impede many LDCs' ability to expand production for export and in turn to service their debts

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21 **Mexico: Policy Choices and the Economic Outlook**

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President de la Madrid will be forced next year to choose between continued tough austerity or limited economic expansion to ease immediate social problems. Regardless of which course he follows, it is unlikely Mexico can regain its previous access to foreign capital and sustainable economic growth in the next few years.

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27 **Brazil: Medium-Term Financial Outlook Under Alternative Economic Scenarios** 25X1

While Brazil's foreign financial situation would improve under favorable global economic conditions through the end of the decade, it will remain vulnerable to economic shocks. Recognizing the high probability of such shocks in the coming years, we believe Brazil will be plagued by financial difficulties through the rest of the decade. 25X1

35 **Argentina: Economic Prospects in 1984** 25X1

Raul Alfonsin, who assumed the Argentine presidency on 10 December, faces a stagnant economy, 400-percent inflation, and a de facto foreign payments moratorium. We expect the government to have a few initial successes but to encounter economic difficulties by midyear. 25X1

41 **Colombia: Debt Difficulties Weaken the Economy** 25X1

The lackluster world economic recovery and banker resistance to new lending so far have blunted President Betancur's ambitious domestic economic policies. 25X1



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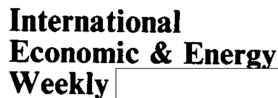

# International Economic & Energy Weekly

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16 December 1983

**Perspective**

## *Major Latin American Debtors: Economic Difficulties Ahead*

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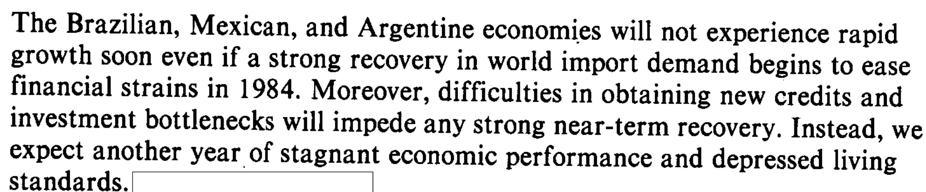

The Brazilian, Mexican, and Argentine economies will not experience rapid growth soon even if a strong recovery in world import demand begins to ease financial strains in 1984. Moreover, difficulties in obtaining new credits and investment bottlenecks will impede any strong near-term recovery. Instead, we expect another year of stagnant economic performance and depressed living standards.

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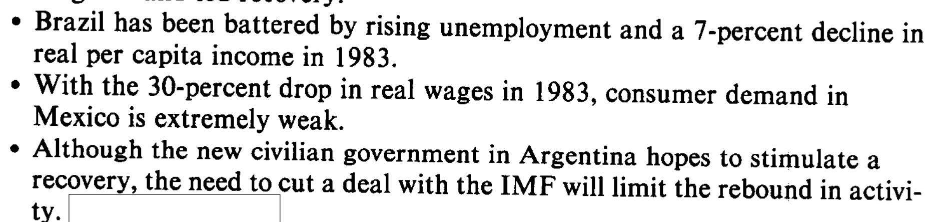

Even if the IMF eases its conditions for continued lending, the economic adjustment programs that would still be required by debtors will preclude a strong demand-led recovery:

- Brazil has been battered by rising unemployment and a 7-percent decline in real per capita income in 1983.
- With the 30-percent drop in real wages in 1983, consumer demand in Mexico is extremely weak.
- Although the new civilian government in Argentina hopes to stimulate a recovery, the need to cut a deal with the IMF will limit the rebound in activity.

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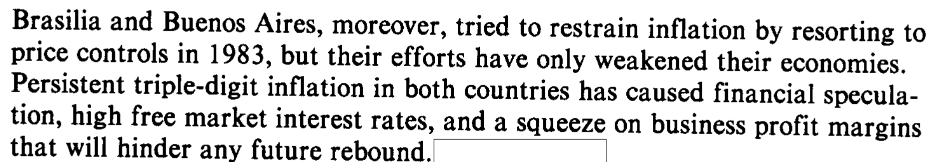

Brasilia and Buenos Aires, moreover, tried to restrain inflation by resorting to price controls in 1983, but their efforts have only weakened their economies. Persistent triple-digit inflation in both countries has caused financial speculation, high free market interest rates, and a squeeze on business profit margins that will hinder any future rebound.

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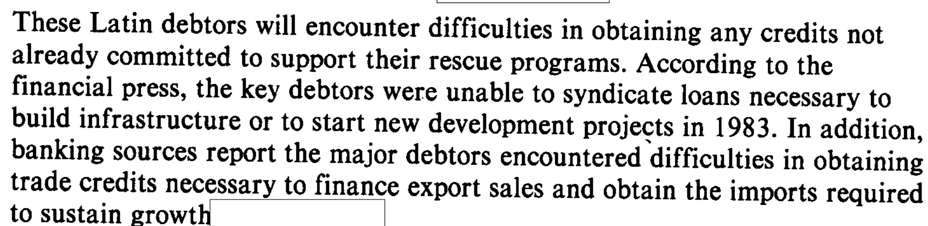

These Latin debtors will encounter difficulties in obtaining any credits not already committed to support their rescue programs. According to the financial press, the key debtors were unable to syndicate loans necessary to build infrastructure or to start new development projects in 1983. In addition, banking sources report the major debtors encountered difficulties in obtaining trade credits necessary to finance export sales and obtain the imports required to sustain growth

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Moreover, investment bottlenecks have emerged that will also restrain the major Latin economies:

- New investment by the private sector—a major engine of growth in the past—will remain depressed because of limited access to foreign exchange and domestic credit, import retrenchments, curtailed demand, and price controls.



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- The public sector will be unable to pick up the slack. The Mexican Government plans virtually no real increase in 1984 capital outlays, while Brazilian and Argentine state corporation investment spending will remain depressed because of the need to reduce the public deficit. 25X1

The interdependence of the Latin economies portends tough challenges for keeping financial rescue programs on track. Over the past decade, for example, intra-Latin exports have grown to some $15 billion, about 15 percent of the region's earnings. Moreover, if rising protectionism in the industrial countries thwarts these debtors' ability to increase exports, Latin debtors will be forced to seek additional lending commitments or adopt even more restrictive policies. 25X1

Rising domestic economic discontent will make it hard for Latin governments to comply with their IMF agreements, leading to renewed difficulties with bankers. As the reality of prolonged recession bumps up against expectations of improved living standards, political resistance to IMF-backed rescue programs will intensify. We believe that anti-IMF sentiment could translate into anti-Americanism throughout the region 25X1

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## Briefs

### Energy

*OPEC Production Steady*

OPEC's November output of 19 million barrels per day (b/d) kept pace with October levels, contrary to widespread industry speculation that production had slipped significantly. The cartel's total output remained steady as Saudi Arabia and Kuwait continued to produce about 300,000 b/d as war relief assistance for Iraq. The possible escalation of hostilities between Iran and Iraq apparently prompted the Saudis to store approximately 20 million barrels of oil in tankers in the Gulf of Oman as a precaution against short-term supply disruptions. Technical problems caused output to slip in the Neutral Zone. Libya's production topped its OPEC-mandated ceiling for the first time since March, and Qatar, hoping to meet its quota allocation for 1983, raised output 100,000 b/d.

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**OPEC: Crude Oil Production, 1983** *Million b/d*

| | Quota | 3rd Qtr [a] | October [a] | November [a] |
|---|---|---|---|---|
| **Total** | **17.5** | **18.9** | **19.0** | **19.0** |
| Algeria | 0.725 | 0.8 | 0.8 | 0.8 |
| Ecuador | 0.2 | 0.2 | 0.2 | 0.2 |
| Gabon | 0.15 | 0.2 | 0.2 | 0.2 |
| Indonesia | 1.3 | 1.4 | 1.4 | 1.4 |
| Iran | 2.4 | 2.5 | 2.4 | 2.4 |
| Iraq | 1.2 | 1.0 | 1.0 | 1.0 |
| Kuwait | 1.05 | 1.0 | 1.0 | 1.2 |
| Libya | 1.1 | 1.1 | 1.1 | 1.2 |
| Neutral Zone | [b] | 0.5 | 0.5 | 0.3 |
| Nigeria | 1.3 | 1.4 | 1.3 | 1.3 |
| Qatar | 0.3 | 0.3 | 0.4 | 0.5 |
| Saudi Arabia | 5.0 [c] | 5.6 | 6.0 | 5.9 |
| United Arab Emirates | 1.1 | 1.2 | 1.2 | 1.2 |
| Venezuela | 1.675 | 1.7 | 1.7 | 1.7 |

[a] Preliminary.
[b] Neutral Zone production is shared equally between Saudi Arabia and Kuwait and is included in each country's production quota.
[c] Saudi Arabia has no formal quota; it acts as swing producer to meet market requirements.

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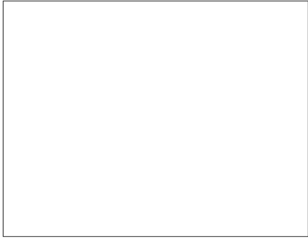
*OPEC Ministerial Results*



OPEC oil ministers meeting in Geneva reaffirmed the current benchmark price of $29 a barrel and the cartel's output ceiling of 17.5 million barrels a day, turning aside demands by Iran and several other members for higher quotas. After acrimonious debate, Saudi Arabia agreed to continue as the cartel's swing producer but refused to accept the specific quota of 5 million barrels a day. The ministers also agreed to name a special group to help OPEC's monitoring committee enforce discipline but failed to agree on a candidate for Secretary General.

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The outcome of the meeting essentially leaves OPEC's problems with the market unchanged. Despite reaffirming its output pact, the cartel still faces the problem of enforcing compliance. The need for a committee to enforce production and pricing guidelines reflects OPEC's fear that some members will not hold the line. Continued violation of the accord will put OPEC in a poor position to confront the weak oil market when conditions further deteriorate early next year.

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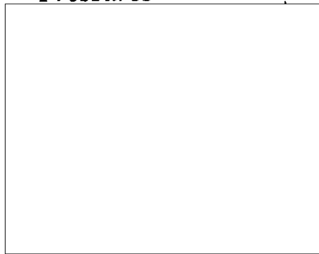
*Downward Oil Price Pressures*



The British National Oil Company has proposed freezing North Sea oil prices at current levels for the first quarter of 1984. With spot prices running more than $1 below official levels, some industry analysts expect buyer resistance to the proposal in the hope of price cuts. Lagos has threatened to cut oil prices if London initiates a reduction. While the British National Oil Company will try to hold the line on the price of its major export crude, prices of its other crudes could be lowered slightly. Continued market weakness and the threat of losing an important contract, however, could force the company to cut prices and would raise concerns once again about an uncontrolled oil price decline.

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*Dutch Natural Gas Policy*

The Economic Committee of the Second Chamber of Parliament has endorsed the Dutch Government's proposed revisions to natural gas policy including higher gas export volumes, higher domestic residential gas prices, and termination of the gas allocation policy. The committee also recommended that new export contract prices reflect the flexible offtake obligations and security implications of Dutch gas. The committee's general endorsement of the revised policy suggests that the Second Chamber will accept the proposals in parliamentary discussions in January. Although the volume of additional gas exports has not been set, it could amount to at least 175 billion cubic meters, or more than four times last year's exports. Because of ample near-term supplies, Dutch export customers will probably be interested only in signing up for gas to be delivered in the 1990s. Any increase in Dutch gas during that period would lessen the need for additional Soviet gas.

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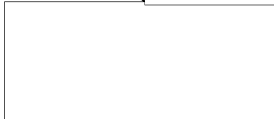
*Big Seven Oil Consumption Registers Small Gain*



Oil consumption in the seven major developed countries during the third quarter rose a scant 0.2 percent—the first year-over-year increase since 1979. Oil consumption rose 2 percent in the United States and Japan in response to strong economic growth; demand in the major West European countries

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**Oil Consumption Trends, Third-Quarter 1983**

*Percent change from year-earlier levels*

| | Total | Gasoline | Diesel Fuel | Light Fuel Oil | Heavy Fuel Oil |
|---|---|---|---|---|---|
| **Big Seven** | **0.2** | **1.9** | **5.4** | **0.6** | **−12.4** |
| United States | 2.2 | 2.4 | 6.3 | 7.4 | −12.3 |
| Japan | 2.3 | 3.0 | 7.5 | 5.0 | −0.9 |
| Canada | −5.1 | −1.6 | 5.7 | −25.6 | −23.2 |
| Western Europe | −4.6 | 0.6 | 3.4 | −12.3 | −20.4 |
| West Germany | −5.2 | 1.7 | 2.7 | −16.3 | −18.1 |
| France | −6.6 | −0.2 | 0.9 | −14.9 | −38.4 |
| United Kingdom | −0.8 | 1.7 | 11.0 | −1.3 | −13.8 |
| Italy | −5.0 | −1.8 | 2.8 | −0.7 | −16.4 |

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(France, West Germany, Italy, and the United Kingdom) and Canada, however, dropped by about 5 percent from year-earlier levels. Sales of all major products except heavy fuel oil increased during the third quarter. Sales of gasoline, diesel fuel, and light fuel oil in the seven countries rose by about 2 percent, 5 percent, and 1 percent, respectively. Increased light fuel oil sales in the United States and Japan more than offset continued declines in Western Europe and Canada. In contrast, heavy fuel oil use dropped by 12 percent and has declined by nearly 45 percent since 1979 in response to substitution of other fuels, conservation, and the recession.

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## International Finance

*Mexico Reaches IMF Agreement*

Mexico City has reached preliminary agreement with the IMF for a 1984 program that continues to emphasize austerity. Mexico's desire that economic recovery begin soon, however, led its negotiators to demand modification of the definition of the public-sector budget deficit, according to US Embassy reporting. As a result, the administration will be able to disburse money from a $1.65 billion reserve fund aimed at generating employment and supporting investment but still claim that the deficit is 5.5 percent of GDP instead of 6.5 percent. Outlays, however, will be made only if recovery is not evident in the first quarter and noninflationary financing is available.

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During the negotiations, the IMF held fast to a $4 billion ceiling on external borrowing in 1984. This stipulation will force Mexico City to turn to internal sources to finance the reserve fund. US Embassy officials believe, and we agree, that such domestic borrowing would push growth in the money supply beyond the 1984 monetary expansion goal.

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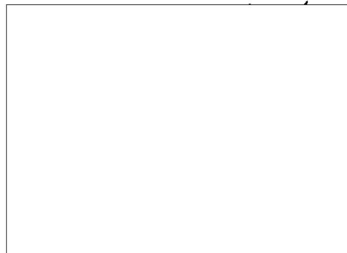
*South American Regional Debt Discussions*



After a temporary respite, discussions are again being held among South American debtors to consider joint action. According to press reports, Ecuador is urging Latin American and Caribbean countries to devise a common position to solve the region's financial problems that can be discussed at an upcoming conference of Latin American heads of state in Quito during January. Ecuador hopes to build a united front to press foreign bankers to ease repayment terms. The Ecuadoreans are proposing longer repayment terms with extended grace periods, a ceiling on debt servicing determined by the level of export earnings, easier IMF adjustment programs, and the exchange of information on debt renegotiations.

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A new initiative by former Peruvian Economic Minister Ulloa also bears watching. According to the US Embassy in Lima, he is urging Argentina to spearhead negotiations with creditors aimed at turning short-term credits into longer term, low-interest debt. The US Embassy in Buenos Aires has reported, however, that the Peruvian approach is being resisted by Argentine financial officials who have lobbied against Alfonsin's accepting a central role in bloc debt negotiations.

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Although we believe collective action still remains unlikely, the January meeting in Quito will provide Latin leaders an opportunity to vent their growing dissatisfaction with IMF austerity. According to numerous Embassy reports, most Latin debtors object to IMF standby accords that require rapid improvements in their foreign payments at the expense of domestic economic growth and slashed social welfare spending. Venezuela, for example, is trying to bypass the IMF in its rescheduling negotiations with creditors. Peru, Bolivia, Costa Rica, and the Dominican Republic are facing difficulties in negotiating with the IMF for 1984 agreements and may not resume talks before the Quito meeting. Argentina, currently out of compliance with its Fund program, is expected to start negotiations early in the year and will probably press for IMF accommodations on spending limits.

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*Yugoslav Debt Refinancing*

Western bankers have offered to refinance Yugoslavia's commercial debt that matures in 1984, extending the payments over seven years with four years' grace, according to US Embassy sources. A 90-day moratorium on payments beginning on 1 January has been granted to give Yugoslavia time to work out the package. The bankers, however, rebuffed the IMF request for new loans of $300 million to $400 million because the bankers believe Yugoslavia does not need new money in 1984. Completion of the commercial refinancing, however, will depend on conclusion of an IMF standby agreement and a refinancing agreement with Western governments. IMF negotiations apparently will not be completed until January at the earliest, and final arrangements could be substantially delayed if the Fund continues to insist that bankers provide new loans. Government creditors meeting next month are likely to offer refinancing terms, but some may be reluctant to extend new export credits.

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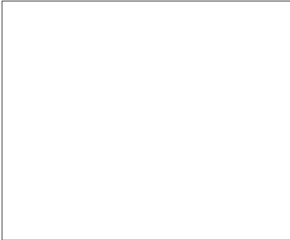
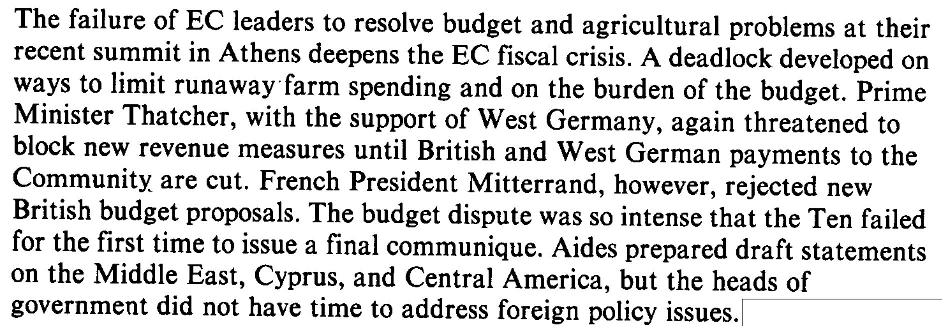
## Global and Regional Developments

*EC Summit Fails*





The failure of EC leaders to resolve budget and agricultural problems at their recent summit in Athens deepens the EC fiscal crisis. A deadlock developed on ways to limit runaway farm spending and on the burden of the budget. Prime Minister Thatcher, with the support of West Germany, again threatened to block new revenue measures until British and West German payments to the Community are cut. French President Mitterrand, however, rejected new British budget proposals. The budget dispute was so intense that the Ten failed for the first time to issue a final communique. Aides prepared draft statements on the Middle East, Cyprus, and Central America, but the heads of government did not have time to address foreign policy issues.

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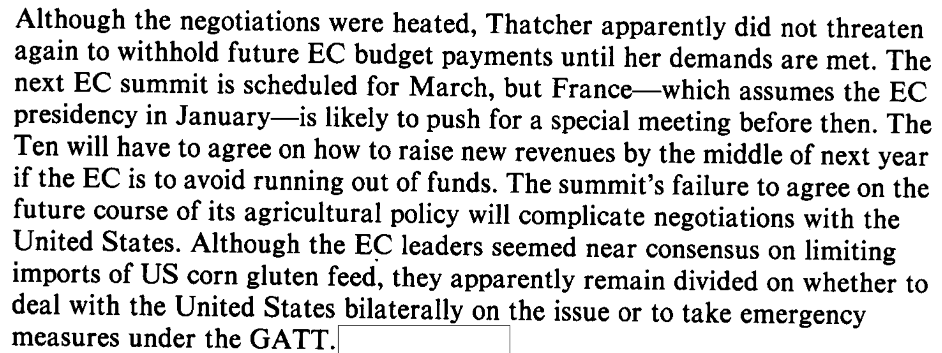

Although the negotiations were heated, Thatcher apparently did not threaten again to withhold future EC budget payments until her demands are met. The next EC summit is scheduled for March, but France—which assumes the EC presidency in January—is likely to push for a special meeting before then. The Ten will have to agree on how to raise new revenues by the middle of next year if the EC is to avoid running out of funds. The summit's failure to agree on the future course of its agricultural policy will complicate negotiations with the United States. Although the EC leaders seemed near consensus on limiting imports of US corn gluten feed, they apparently remain divided on whether to deal with the United States bilaterally on the issue or to take emergency measures under the GATT.

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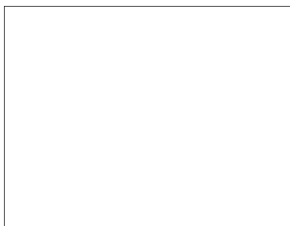
*1984 Poultry Meat Exports*



Weak LDC demand is expected to cause a small dip in world poultry meat exports next year. Intense competition from subsidized exporters, especially the European Community (EC), probably will prevent the United States from

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**Poultry Meat Exports** *Thousand metric tons*

| | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 [a] |
|---|---|---|---|---|---|---|
| **Total** | **1,173** | **1,453** | **1,834** | **1,767** | **1,836** | **1,814** |
| United States | 228 | 316 | 375 | 261 | 237 | 237 |
| Brazil | 81 | 170 | 296 | 350 | 382 | 351 |
| EC | 605 | 678 | 829 | 829 | 859 | 872 |
| External | 267 | 345 | 462 | 477 | 519 | 537 |
| Internal | 338 | 333 | 367 | 352 | 340 | 335 |
| Eastern Europe | 196 | 207 | 287 | 302 | 322 | 320 |
| Other | 63 | 82 | 47 | 25 | 36 | 34 |

[a] Projected.

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making up market share it has lost since 1981. A strong US dollar and projections of record EC poultry sales next year—resulting from export subsidies that currently approximate $175 per metric ton and producer subsidies—will limit 1984 US poultry sales to this year's level. Brazil's dramatic growth in poultry production and exports in recent years will be put in check next year because of rising feed prices and a cutback in producer subsidies as part of IMF austerity measures.

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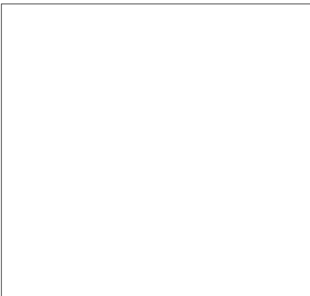
*Indo-Soviet Trade Growth Planned*



The Indo-Soviet trade protocol for 1984, signed on 9 December, reflects the interest of both governments in resuming trade growth as a symbol of overall cooperation. During late 1982 and 1983, Indian exporters complained bitterly about a cutback of Soviet purchases to compensate for an earlier payments surplus in India's favor. By mid-1983, Moscow opened the way for a revival of Indian exports within the framework of balanced bilateral payments by agreeing to sell more crude oil to India. The new protocol projects a six-percent increase over 1983 targets—to about $2 billion—in the value of Indian exports to the USSR next year. Soviet exports under the agreement, which does not cover military sales, are slated to rise as well. Indian preference for Western technology continues to inhibit a more rapid expansion of bilateral trade even though Moscow has been courting the Indian private sector to increase Soviet sales of machinery and equipment.

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## National Developments

### Developed Countries

*1984 West German Budget Approved*

The West German parliament has approved a 1984 budget that calls for expenditures of $95.2 billion and a $12.4 billion deficit. The spending level represents a nominal increase of just 1.5 percent over 1983, well below anticipated nominal GNP growth of 5.7 percent. The deficit is $1.4 billion lower than originally planned and about $1.5 billion below the 1983 figure.

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The Kohl government is fulfilling its campaign pledge to check government spending, largely at the expense of social programs. Holding to the government's austere financial plan, however, will pose several difficulties. Important elements within the governing coalition are urging a relaxation of tight-fisted policies for fear of jeopardizing the economic recovery. The government will also face risks of increased expenditures, such as hikes in EC contributions and subsidies to the beleaguered coal and steel industries that it may not be able to avoid.

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*West German Unemployment Down*

Seasonally adjusted unemployment fell slightly in November to 2.25 million—about 9.3 percent of the labor force. This was the third month without an increase in joblessness following 42 months of steadily rising unemployment. The leveling off results from recovery, increased industrial training programs, and

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the mild fall weather that extended the working season for the construction industry. The respite will help dampen criticism of the government's austerity program, but this will probably prove temporary. We expect unemployment to start rising again next year and remain a major problem through the 1980s. Anticipated growth of the West German economy will not be strong enough to absorb the growing number of labor force entrants, who will far exceed retirees.

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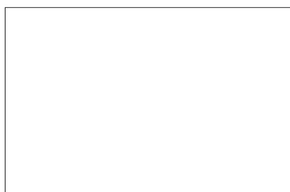
*French Farmers Protest*



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Farmers throughout France have mounted peaceful protests to emphasize their concern about declining farm income and their opposition to proposed changes in the European Community (EC). Poor harvests, increased costs, and reduced government subsidies are blamed for reducing real farm income this year by nearly 4 percent. Hog farmers are irate over increased imports of Hungarian pork that sells for roughly 60 percent of the price of domestic pork. While wine and vegetable producers are particularly concerned with the proposed entry of Portugal and Spain into the EC, French farmers in general are opposed to any reform of the EC's Common Agricultural Policy that would reduce their incomes. Instead several powerful agricultural unions have called for EC policies to raise French agricultural prices by 3 percent.

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*Swedish Wage Negotiations Begin Under New Bargaining System*

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Wage negotiations begin this month in Sweden under a new system that has individual labor unions and employer organizations bargaining directly for the first time in 26 years. The trade union confederation (LO) sought the new system because Swedish workers have suffered a fall in real disposable income for three straight years. The LO hopes to obtain more favorable settlements from employers in the more profitable sectors, such as the auto and aircraft industries. For their part, business leaders have wanted a change in the form of collective bargaining for some time because they want more flexibility to include nonmonetary benefits in the wage-bargaining process.

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Negotiations probably will be protracted. The LO announced in November it would seek one-year agreements with wage increases averaging 7 percent and various other benefits. The Swedish Employers Confederation, on the other hand, is proposing only a 1.3-percent wage increase. The Social Democratic government will probably press its union allies to moderate wage demands in an attempt to bring inflation down to 4 percent in 1984 and help maintain Sweden's foreign competitiveness.

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*Expansionary Greek Budget Unveiled*

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The Greek Government last week announced an expansionary 1984 budget that will disappoint its foreign creditors. The public-sector deficit will be no lower than 1983's 15 percent of GDP. While defense spending as a share of total outlays will decline, the Social Services Ministry share will increase—jumping almost 30 percent in nominal terms. The budget projects a real increase in revenues, with reduced taxes on lower income groups offset by higher taxes on private business and high-income groups.

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The new budget is likely to undermine the willingness of foreign bankers to loan money to Greece. According to the US Embassy, international bankers were hoping that Athens would implement an austerity program that would help its foreign financial situation. Creditors had recommended cuts in public expenditures and encouraged increases in exports and private investment. The bankers probably will conclude that the Papandreou government is unable or unwilling to take the needed economic steps and could reassess their willingness to provide loans.

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*Agriculture Spurs Australian Economy*

The record wheat harvest and good harvests of other cereal crops will boost the Australian economy in 1984—GNP growth is expected to be 5.2 percent. Australia expects to harvest 20 million metric tons of wheat, nearly triple last year's drought-blighted crop and 2 million tons above the previous record. The Bureau of Agricultural Economics expects farm incomes to increase by 75 percent, replenishing farmers' cash reserves and increasing demand for farm equipment. The strong harvest should improve Australia's foreign financial position as well because Canberra has been successful in marketing this year's crop overseas.

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*Australia Shelving Resource Tax*

the Hawke government is backing away from plans for a resource tax on crude oil and coal exports. The tax on profits had been proposed by the newly elected Labor government last March. Under pressure from mining companies and state governments, Canberra apparently has decided the tax would further depress the Australian coal industry and discourage new investment and jobs in coal and petroleum.

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### *Less Developed Countries*

*Iranian Import Problems*

Growing congestion at Iranian points of entry will add to Tehran's economic problems, particularly in major cities that depend on imports for daily needs.

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Early this month, more than 100 ships were in queue to unload at the Persian Gulf port of Bandar-e Abbas, and in September delays at the port were running four to six weeks, Even high-priority military cargo is being delayed two to three weeks before unloading, Goods ordered by Iran are building up in Turkish and Pakistani ports awaiting overland transshipment.

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Tehran has had to shift import traffic away from its major Persian Gulf port of Bandar-e Khomeyni as a result of Iraq's attempts to interdict shipping in the northern Gulf. The resulting dislocation has been worsened by a 30-percent increase in Iranian imports this year. Much of the increase is probably to compensate for declines in domestic production, especially in agriculture. In



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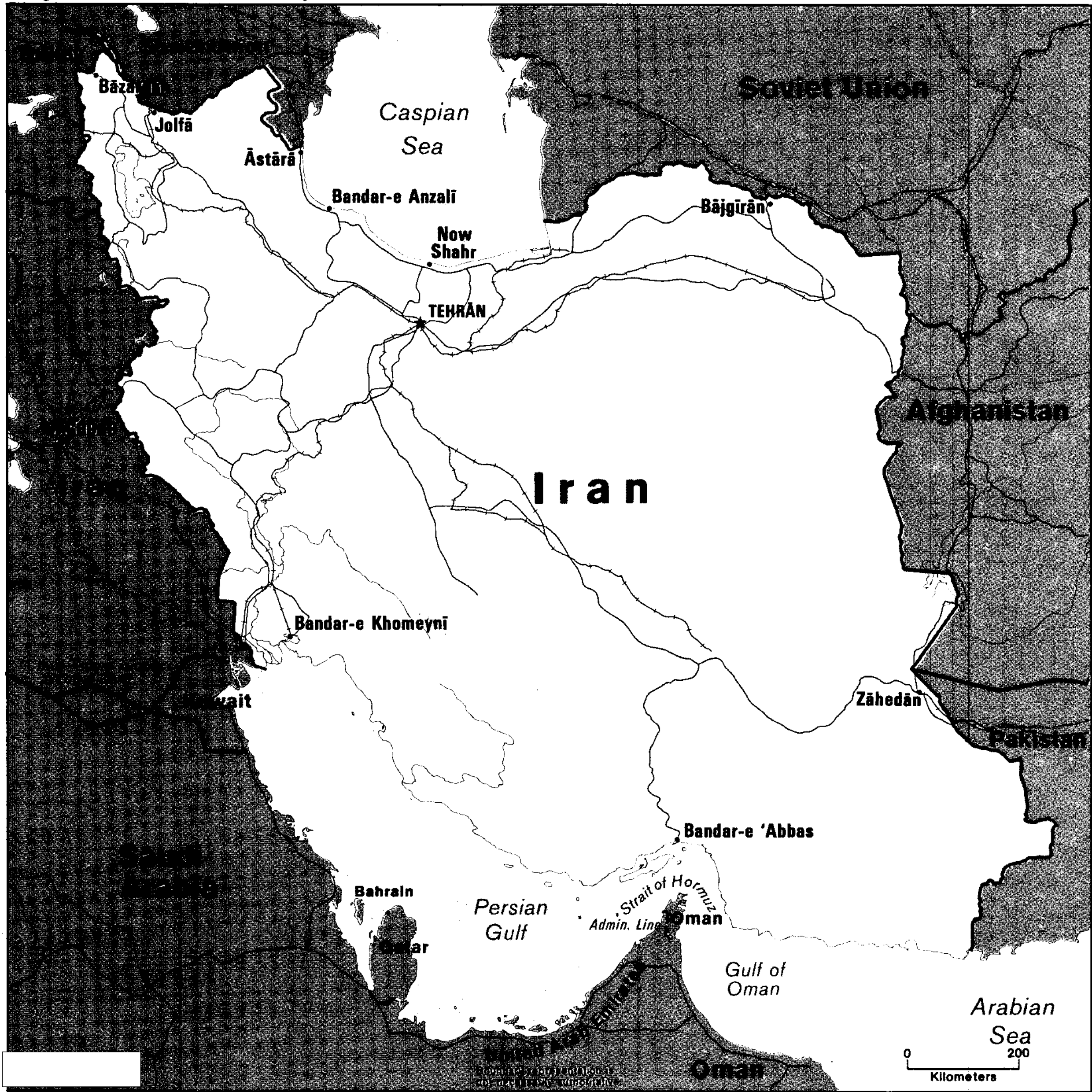
**Major Iranian Ports of Entry**

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addition, the regime has restarted some large, import-intensive projects begun under the Shah. The arrival of winter will slow imports further and delay the flow of goods within Iran. If Iraq further disrupts shipping at Bandar-e Khomeyni—where 20 percent of Iranian imports still are being handled—Iran's transportation and economic problems will increase.

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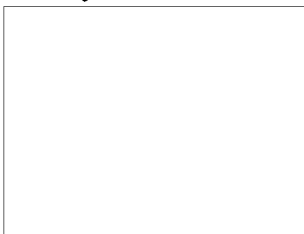
*Burma's Industrial Reforms*



Burma's Central Executive Committee (CEC) has initiated a number of industrial reforms in response to a party committee study detailing the failure of the country's four-year plan. The study cited shortages of electrical power, transportation, and proper storage as factors causing most industrial projects to be behind schedule and over cost. The CEC called for modernizing existing factories and the development of natural gas reserves and hydroelectric projects. The CEC reforms are not likely to result in any near-term improvements in the economy, however, because they will not solve the primary problems of serious shortages of fuel and foreign exchange.

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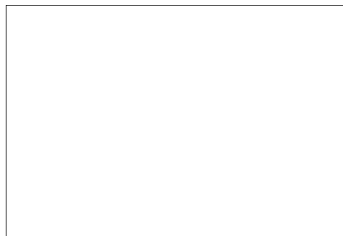
*Polish Economic Reform Stalled*



Progress toward economic reform is being stalled by the regime's concern about maintaining political control. Over the last two years the government has not permitted most firms to use their own hard currency earnings, has continued to bail out firms in financial troubled instead of permitting bankruptcy, and has severely curbed workers' self-management powers. These actions conflict with what were once considered the most important of the reforms. Furthermore, at last month's party Central Committee plenum, the new head of the Planning Commission, Manfred Gorywoda, pledged tighter central control of wages, prices, production, and raw material procurement. In January 1982 the government agreed—on paper—to allow enterprises to make these decision.

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The regime has weakened economic reform because it fears the political consequences of further price increases and links between wages and productivity. It also fears that economic reform eventually will intensify pressure for political reform. Without economic reforms, however, prospects remain dim for economic recovery and for the improvements in export performance needed to help deal with the debt problem.

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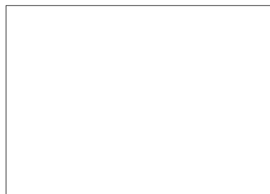
*Inflation in Yugoslavia at Record High*



Yugoslav retail prices rose 7.2 percent in October after jumping a record 7.6 percent in September. Prices in December are now expected to be at least 50 percent higher than levels a year earlier, far in excess of the government's target of 20 percent and of last year's rise of 32 percent. The primary causes of the acceleration in inflation are buoyant aggregate demand, the sharp depreciation of the dinar—47 percent against the dollar so far this year—and the lifting of a price freeze on 1 August. Prices of some food products soared by 400 percent in September.

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Real wages could fall by 10 percent or slightly more this year, continuing the trend since 1978. Worker pressure to reverse the decline is likely, and grumbling probably will be most noticeable this winter as price increases for heating oil and electricity are felt. Government-sponsored trade unions, which so far have supported austerity, are now beginning to call for wage increases as real buying power falls. Worker demands and the likely further depreciation of the dinar should keep inflation high at least through 1984.

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*USSR Seeking To Increase Exports*

The USSR is pressing those trade partners with which it traditionally runs large trade deficits to increase purchases of Soviet goods. recent grain negotiations with the Canadians broke down when Moscow insisted on achieving a better bilateral trade balance. Talks on terms for a possible Australian meat sale were terminated as a result of demands that Australia buy more Soviet goods. In October negotiations with the Japanese for large-diameter pipe reportedly also were halted because the Soviets demanded that the Japanese buy an unusually large amount of machinery and equipment.

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The Soviets for years have been urging their trade partners to keep bilateral accounts in better balance by increasing their purchases of Soviet goods. They have had only limited success, however, because of the poor quality of their products. The good Soviet grain crop and record meat output this year, however, have improved the Soviets' negotiating position. As the USSR has begun to produce its own large-diameter pipe, Moscow also may believe it is in a stronger position to demand concessions from companies that export such pipe.

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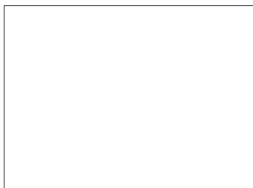
*Limited Soviet Gold Sales*



Soviet gold sales this year will probably be about equal to those of 1982—approximately 100 tons—because additional revenues are not required to cover hard currency import payments.

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## International Financial Situation: Political Update

*This article is part of our series focusing on the economic and political aspects of the international financial situation.*

Political developments in the past month have improved the domestic climate in a number of financially troubled Third World countries. Recently concluded national elections in Argentina, Venezuela, and Jamaica have temporarily put opposition parties on the defensive. Mexico's ruling party swept municipal elections in November, although opposition groups are protesting alleged ballot fraud in some towns. In Brazil the government has managed over the past month to gain IMF and banker approval of new austerity measures providing a few months' respite from opposition political agitation.

In a number of other countries the situation has taken a turn for the worse. Government opponents remain highly active in the Philippines, Peru, and Bolivia. We expect unrest in the Philippines to center increasingly on economic issues as the impact of harsh austerity measures begins to be felt. In Peru's municipal elections on 13 November voters repudiated President Belaunde's austerity program.

Although by far the majority, moderate opposition groups in the **Philippines** have been forced to yield ground to new alliances of radical groups that are taking the lead in organizing protests. As many as 50,000 workers participated in a 27 November rally in Manila to commemorate the birthday of murdered opposition leader Benigno Aquino. The rally was sponsored by several organizations, including the May First Movement, a national labor organization that is a front organization of the Communist Party of the Philippines. Increasing leftist penetration of the "Justice for Aquino, Justice for All" alliance, a new coalition of about 90 professional, labor, and human rights groups opposed to Marcos, is the main reason for the recurring anti-US themes in demonstrations.

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We believe the opposition's success in organizing large demonstrations—more than three months after Aquino's death—confirms that the breach between President Marcos and the people is deep and possibly irreversible. In addition, the apparent ability of the May First Movement to stage a large rally suggests that the economy has become a critical political issue. Rescheduling negotiations are on hold because of an impasse with the IMF over the size of the Philippines' financial gap in 1984. In the meantime, foreign exchange markets are in disarray, and the Central Bank has enacted foreign exchange controls. Philippine business groups are predicting that even with new loans there will be massive layoffs in coming months because of the sharp drop in imports and domestic production.

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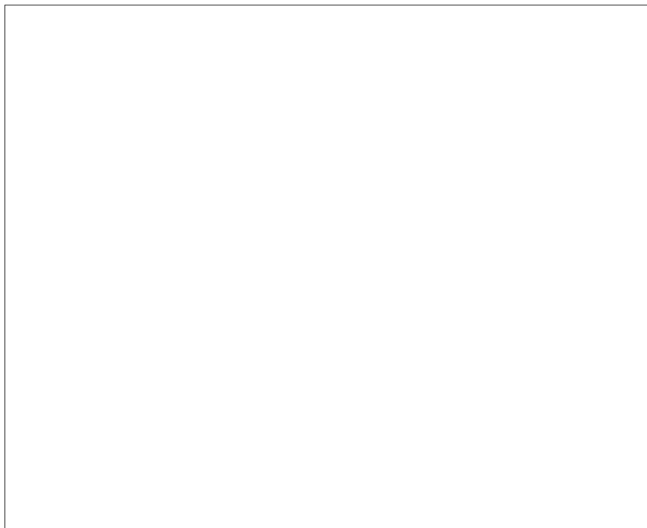





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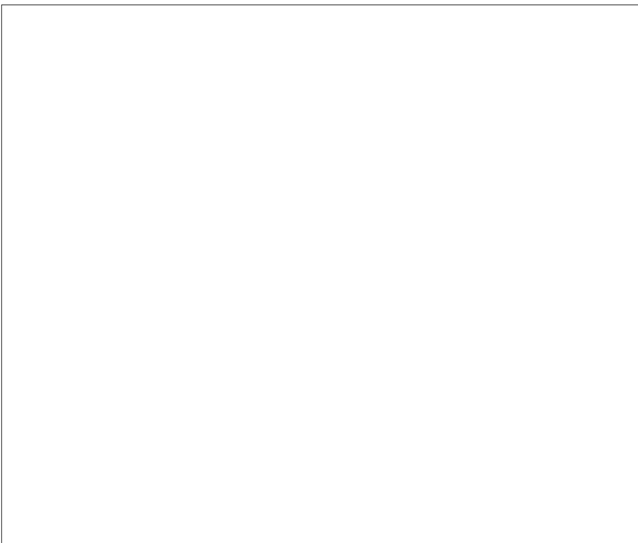

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The swing to the left in **Peru's** municipal elections will increase pressure on President Belaunde to adopt more populist policies. The voters' repudiation of his economic austerity program mainly helped the center-left American Popular Revolutionary Alliance, which captured most major municipalities except Lima and 38 percent of the total vote. A Marxist group, the United Left coalition, came in second overall and won the important mayoralty in Lima, where the government finished a distant fourth. 25X1

Belaunde has announced plans to change his economic team and its policies in an attempt to improve his party's chances for the presidential and congressional elections in 1985. Such moves would be politically popular, but they would damage Peru's position in talks with the IMF. Failure to get the IMF program restarted soon will jeopardize Lima's chances for rescheduling existing debt and obtaining new loans. 25X1

In **Bolivia,** the survival of the 13-month old Siles government is threatened by popular unrest 25X1 25X1 The government's announcement in mid-November of a 60-percent devaluation and price increases for basic goods and services—moves designed to pave the way for an IMF loan and renegotiation of the country's foreign debt—provoked a demonstration in La Paz and strikes by transport workers and civil servants.

On 14 December Bolivia's legislature rejected the government's austerity measures, prompting the resignation of Siles's 18-member cabinet. This action followed a two-day general strike that closed down most economic activity throughout the country. Foreign Minsiter Ortiz told the press the resignations were intended to permit the formation of a new cabinet of national unity and establish "a political and economic truce." Opposition legislators have called for the Supreme Court to take over the government and call general elections. 25X1

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## International Financial Situation: Trade Financing Cutbacks

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*This article is part of our series focusing on the economic and political aspects of the international financial situation.*

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Cutbacks in trade financing pose yet one more complication to economic management by the debt-troubled LDCs. Prior to mid-1982, Western exporters readily assumed short-term risks and extended trade credits, thus supporting rising LDC imports. LDC financial problems, however, have disrupted short-term trade financing by prompting Western exporters and bankers to demand prepayment or collateral. Continued difficulties in obtaining trade credits for vital imports will impede many LDCs' ability to expand production for export and in turn service their debts.

### Recent Developments

Debt reschedulings and foreign exchange shortages have seriously undermined the confidence of Western traders in the integrity of traditional short-term financial instruments used to conduct international trade. Liquidity problems of some debt-troubled LDCs have required lenders to refinance short-term trade-related debts, converting them into longer term maturities. Strict foreign exchange controls have also prevented many importers in these countries from acquiring foreign currencies needed to clear their trade bills, resulting in arrearages. While reliable statistics on the contraction of trade credits are unavailable, Department of Commerce officials report that exporters have stopped doing business in many debt-troubled LDCs on the basis of short-term lines of credit because they expect defaults or other repayment difficulties.

A similar aversion to risk-taking has affected Western banks and trade finance houses. Prior to mid-1982, most banks considered short-term, trade-related financing to be low risk and assumed trade credits would not be included in debt rescheduling packages. Now export credit managers of trade finance houses are under strict orders from senior management not to increase exposure in countries with widely publicized financial problems, according to Commerce officials.

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Western banks are increasingly unwilling to fill the financing gap created by the cutback in exporter credits.

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Among the key LDC debtors:

- **Brazilian** importers are having a hard time securing Western financing for imports.

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- **Philippine** companies are unable to purchase foreign exchange for trade transactions, according to Embassy reporting. New commitments for letters of credit or bankers' acceptances are unlikely during Manila's 90-day moratorium on principal repayments.

- Lagos is negotiating with its major nonbank creditors to refinance $3-5 billion of overdue short-term trade credits over a five-year period, according to press reporting.

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- Western exporters are wary of shipping goods to **Argentina** without prepayment or a confirmed letter of credit. Strict exchange controls, lack of a





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***Trade Credits in Brief***

*Trade credits refer to open account transactions, sight and time drafts, confirmed and unconfirmed letters of credit, bankers' acceptances, and similar instruments used to finance specific trade transactions. Typically these lines of credit mature in less than one year. Most financing (for example, open accounts, unconfirmed letters of credit, and drafts) places the exporter at risk if default occurs. Other instruments (for example, confirmed letters of credit and bankers' acceptances) have the banks assuming the risks.*

*An* ***open account*** *is an open book (charge) account. After shipping goods, the exporter sends an invoice to the importer indicating when payment must be made.*

*A* ***draft*** *is a written demand for payment. The importer makes payment to the exporter by a check drawn on the importer's demand deposit account. A sight draft is payable upon presentation and a time draft matures on a fixed or determinable future date.*

*A* ***bankers acceptance*** *is a time draft accepted by a bank. If a bank accepts a time draft, it agrees to pay the face value of the draft at its maturity in the event the importer does not pay. Banks may sell the acceptance at a discount prior to its maturity.*

*A* ***letter of credit*** *is a contractual letter issued by a bank. Letters of credit are flexible, varying in format, phraseology, and content. Generally when a bank opens a letter of credit for an importer, the importer agrees to reimburse the bank and the bank agrees to pay the exporter upon presentation of specific documents (that is, an order bill of lading) in exact conformity with the terms of the letter of credit. Most letters of credit are irrevocable. If a letter of credit is confirmed, then a well-known second bank has agreed to guarantee the primary bank opening the letter of credit.*

new IMF standby program, and the de facto payments moratorium are delaying repayment of some trade credits and increasing the difficulty of securing new trade financing.

- Many Western banks are hesitant to provide **Peru** new trade credits because Lima is attempting to include some outstanding trade bills within its 1983 debt refinancing plan and the banks oppose this action.

- US bankers express concern that any new credits offered **Ecuador** are likely to be rescheduled later because Quito is arranging a $750 million trade financing facility, effectively extending existing short-term trade debts another 13 months.

- **Venezuelan** importers are unable to purchase foreign currencies to clear their trade bills because of strict foreign exchange controls. Embassy reporting indicates that many Venezuelan companies have had their foreign lines of credit closed, with Western exporters requiring confirmed letters of credit.

In contrast, **Mexico**'s previously cut trade credits have been partially restored. Mexico has been able to secure trade credits primarily because of its strong performance in meeting the 1983 austerity targets.

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**Implications**

Exporter and banker reticence to continue extending trade credits will hamper debt-troubled LDCs' financial recovery. Not only are most debt-troubled LDCs reducing imports as part of their austerity programs, but the shortage of trade financing is preventing purchases of goods required for export production. If foreign exchange earnings suffer, the ability of these countries to service their debts will be further eroded. Cutbacks in trade financing will also strain liquidity, forcing the debt-troubled



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LDCs to draw from already depleted reserves to finance imports. Although we anticipate that medium-term borrowing will replace some short-term trade financing, this will mean stretching out repayment problems.

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## Mexico: Policy Choices and the Economic Outlook

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President Miguel de la Madrid's tough austerity measures have eased considerably the economic crisis he inherited last year. By bringing Mexico's foreign financial accounts largely into balance he has helped the country regain some access to foreign capital markets, but to continue making progress he will have to hold the economy on a tight leash during the next two years. If de la Madrid can hold fast to austerity and lay a sounder foundation for eventual economic recovery, inflation would be reduced, the foreign exchange rate would begin to stabilize, and financial independence would be partially regained through restraining the expansion of the debt service burden. Accompanying such a policy, however, would be greater unemployment and a steeper drop in living standards.

His task will not be easy. De la Madrid will be forced to weigh whether reducing unemployment through a partial rebound in industrial production is worth the costs of continued high inflation and expanded foreign debt. He will also be under some pressure to loosen investment and trade controls to reduce the number of bankruptcies of inefficient domestic firms and show he has not forfeited control of national decisionmaking authority.

Regardless of which course is followed, we believe it is unlikely that Mexico will regain normal access to foreign capital markets and reestablish economic growth—and job creation—on a sustainable basis within the next few years. The depth of Mexico's problems and the magnitude of its foreign debt overhang ensure that it will be two or three years until production reaches the level of the early 1980s. Real personal consumption will remain below the 1980-81 levels during the remaining five years of de la Madrid's term

### De la Madrid's Economic Objectives

Mexico's economic agenda for the next couple of years will largely be determined by de la Madrid's priorities and his actions in the coming months. Mexico's National Development Plan, recent speeches,

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indicate President de la Madrid has four basic economic objectives—each backed by various politically relevant groups and commanding wide support in Mexican society. These goals, however, cannot all be achieved simultaneously.

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***Price and Exchange Stability.*** During the past two years, hyperinflation has shaved one-third off real minimum wages and led to a drop in the value of the peso. The higher costs of imports has antagonized organized labor and the middle and upper classes because of their great dependence on foreign purchases. In de la Madrid's only formal press conference in October and during the 1984 budget presentation in late November, the President emphasized that the fight against inflation would remain the core of his economic policy.

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***Regain Financial Independence.*** De la Madrid is scaling back development projects and increasing local taxes to pay government debt and capital purchases out of domestic savings so Mexico can live within its means. This has led to a greatly reduced foreign borrowing program and delays in loan drawdowns when possible.

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***Economic Recovery and New Jobs.*** Only if the economy recovers can ambitious Mexicans achieve upward mobility and the growth in unemployment and underemployment be stemmed. Currently, Mexico is resorting to job sharing and reduced labor productivity while cutting real wages to hold the line on unemployment, even though these aggravate underemployment.

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**Mexico: Foreign Revenues and Import Capacity**

*Billion US $*

| | 1980 | 1981 | 1982 | 1983 [a] | 1984 [b] | 1984 [c] | 1985 [b] | 1985 [c] |
|---|---|---|---|---|---|---|---|---|
| Foreign exchange income | 26.2 | 32.0 | 31.3 | 30.7 | 33.0 | 31.7 | 36.0 | 33.5 |
| Merchandise exports | 16.8 | 20.9 | 22.2 | 22.0 | 23.0 | 22.5 | 24.5 | 23.5 |
| Oil | 10.3 | 14.4 | 16.4 | 15.5 | 15.8 | 15.5 | 16.5 | 16.0 |
| Other | 6.5 | 6.5 | 5.9 | 6.5 | 7.2 | 7.0 | 8.0 | 7.5 |
| Services | 8.1 | 9.9 | 8.5 | 8.4 | 9.5 | 8.9 | 10.5 | 9.5 |
| Tourism (including border sales) | 5.4 | 6.5 | 5.6 | 5.7 | 6.5 | 6.2 | 7.0 | 6.5 |
| Other | 2.7 | 3.4 | 2.9 | 2.7 | 3.0 | 2.8 | 3.5 | 3.0 |
| Direct foreign investment | 1.3 | 1.2 | 0.6 | 0.3 | 0.5 | 0.3 | 1.0 | 0.5 |
| Nonimport outflows or obligations | 22.4 | 34.4 | 34.1 | 26.8 | 28.5 | 30.1 | 31.2 | 35.2 |
| Debt service due | 10.8 | 15.0 | 19.4 | 19.4 | 20.6 | 21.2 | 23.0 | 24.0 |
| Interest | 5.5 | 8.4 | 10.9 | 11.4 | 11.6 | 12.2 | 12.0 | 12.5 |
| Principal (medium and long term) | 5.4 | 6.6 | 8.5 | 8.0 | 9.0 | 9.0 | 11.0 | 11.5 |
| Other service obligations | 7.9 | 11.0 | 8.1 | 6.4 | 7.4 | 7.9 | 8.2 | 9.2 |
| Tourism (including border purchases) | 4.2 | 6.2 | 4.4 | 3.7 | 3.7 | 3.9 | 4.0 | 4.5 |
| Remittance of profits, royalties, etc. | 0.4 | 0.6 | 0.5 | 0.2 | 0.3 | 0.4 | 0.4 | 0.5 |
| Transportation, freight, and insurance | 1.9 | 2.4 | 1.8 | 1.2 | 1.7 | 1.8 | 2.0 | 2.2 |
| Other | 1.3 | 1.9 | 1.4 | 1.3 | 1.7 | 1.8 | 1.8 | 2.0 |
| Errors and omissions | −3.6 | −8.4 | −6.6 | −1.0 | −0.5 | −1.0 | NEGL | −2.0 |
| Net foreign exchange earnings before imports | 3.8 | −2.4 | −2.7 | 3.9 | 4.5 | 1.6 | 4.8 | −1.7 |
| Change in reserves | 1.1 | 1.0 | −3.2 | 3.0 | 2.0 | NEGL | 2.0 | −1.0 |
| **Foreign exchange earnings available for merchandise imports** | **2.7** | **−3.4** | **0.4** | **0.9** | **2.5** | **1.6** | **2.8** | **−0.7** |
| Foreign borrowing | 16.1 | 27.3 | 14.0 | 8.1 | 8.5 | 11.4 | 10.2 | 15.7 |
| New medium- and long-term capital | 10.9 | 17.1 | 12.1 | 6.1 | 3.5 | 6.4 | 10.2 | 15.7 |
| Rescheduled medium and long term | | | 4.0 | 19.0 [d] | 5.0 | 5.0 | | |
| Net short-term capital | 5.2 | 10.2 | −2.1 | −17.0 [d] | NEGL | NEGL | NEGL | NEGL |
| Merchandise imports | 18.8 | 23.9 | 14.4 | 9.0 | 11.0 | 13.0 | 13.0 | 15.0 |
| Memorandum items | | | | | | | | |
| Trade balance | −2.0 | −3.0 | 7.8 | 13.0 | 12.0 | 9.5 | 11.5 | 8.5 |
| Current account balance | −7.2 | −12.5 | −2.7 | 3.6 | 2.5 | −1.6 | 1.8 | −3.7 |
| External debt (at yearend) | 50.7 | 74.9 | 80.8 | 84.1 | 83.6 | 86.5 | 82.8 | 91.2 |
| Short term | 11.1 | 22.5 | 25.0 | 10.0 | 10.0 | 10.0 | 10.0 | 10.0 |
| Debt service ratio (*percent*) | | | | | | | | |
| Due | 43.5 | 48.7 | 63.1 | 63.6 | 63.4 | 67.3 | 65.7 | 72.7 |
| After debt relief | 43.5 | 48.7 | 53.3 | 43.9 | 48.0 | 51.4 | 65.7 | 72.7 |

[a] Projected.
[b] Projected, assuming Mexico maintains tough austerity through the three-year IMF stabilization program.
[c] Projected, assuming Mexico relaxes austerity, increasing imports and public spending.
[d] Includes $14 billion short-term debt rescheduled as long-term obligations.

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***Balanced Economy.*** Economic nationalism has long been an overriding principle that has led to protection of local industry, restrictions on foreign investment, and conservation of natural—and especially oil—resources. This has forced the government—and large public enterprises—to assume larger roles in the economy. Even so, Mexico's private sector provides the bulk of employment, and decisionmakers believe free enterprise is most likely to generate the jobs needed to satisfy the rapidly expanding labor force.

**Financial Constraints**

The unprecedented foreign debt expansion during Lopez Portillo's six years as President—and the recent restructuring of the debt—ensure that Mexico's debt service burden will rise in coming years. While debt reschedulings have postponed most principal payments, this will produce a bunching of amortization payments in later years. Moreover, debt rescheduling has substantially increased interest rate spreads charged to Mexico, largely offsetting the decline in international interest rates. Debt service in 1983 and 1984 will average $15 billion per year—nearly matching earnings from foreign oil sales. Unless Mexico undergoes another massive debt rescheduling in 1985, debt service will exceed $23 billion that year. In 1987, debt service will again soar when the roughly $30 billion rescheduled during 1982-84 by the public and private sectors begins to come due at a rate of about $8 billion each year.

The huge and growing debt burden and continuing weakness in world oil prices have seriously undermined Mexico's import capacity.[1] Our analysis indicates that—as in the recent past—imports are likely to be only slightly greater than gross foreign borrowing. In 1983, largely because of the need to replenish depleted foreign exchange reserves and repay short-term emergency loans, import capacity from domestic resources remained depressed and imports plunged 40 percent for the second consecutive year. In 1984 import capacity will recover slightly with expanded exports and a stronger initial foreign exchange reserve position. Thus, a major boost in imports next year will depend on new foreign loans. For 1985, even with tough austerity, we project Mexico would need to increase foreign borrowing substantially to support import volume at even one-half the 1981 level.

The public sector will absorb the bulk of what foreign loans are available because of the financial problems of Mexico's private firms. We believe it will be several years at least before foreign commercial bankers consider extending limited credits to the private sector. Restructuring privately held commercial debt has proceeded slowly, and many firms are in de facto default. Despite recent agreements to reschedule private debt under the generous terms offered by Mexico City, foreign and domestic business sources are gloomy about long-term repayment prospects. Many businessmen now expect defaults on one-fourth to one-half of these loans. As a result, firms reorganized from the remnants of former high-riding enterprises will have difficulty obtaining new foreign credits.

**Alternative Projections**

To understand the bounds of likely economic trends during 1984 and 1985, we compared the results from maintaining tough austerity to those of considerably relaxing the stabilization program. We see actual policy and economic trends falling between these paths. In either case, during the next two years, we believe Mexico's financial problems and limited access to world capital markets will preclude any substantial increase in Mexico's productive capacity. Nevertheless, by shifting imports toward raw materials and intermediate goods, Mexico City can increase capacity utilization, boosting the supply of goods for the consumer market or export.

[1] We calculate Mexico's foreign purchasing power by projecting its available cash flow during 1984-85. Net Mexican resources available for imports each year are calculated by subtracting nonimport obligations and projected changes in foreign exchange reserves from foreign exchange earnings. These net domestic resources plus gross foreign borrowing—including new loans and rescheduled loan obligations—equal total import capacity.

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**Mexico: Macroeconomic Implications of Alternative Courses**

| | Continued Tough Austerity [a] | | Relaxed Austerity [b] | |
|---|---|---|---|---|
| | 1984 | 1985 | 1984 | 1985 |
| GDP growth (*percent*) | 0 | 2 | 4 | 6 |
| Jobs created | NEGL | 250,000 | 500,000 | 750,000 |
| Growth in per capita consumption (*percent*) | −3 | −1 | 1 | 3 |
| Inflation (*percent*) | 45 | 25 | 80 | 100 |
| Public-sector deficit (*percent of GDP*) | 5.5 | 3.5 | 12.0 | 15.0 |
| Current account balance (*billion US $*) | 2.5 | 1.8 | −1.6 | −3.7 |
| External debt [c] (*billion US $*) | 83.6 | 82.8 | 86.5 | 91.2 |

[a] Assumes Mexico City keeps imports and public spending depressed.
[b] Assumes Mexican policymakers relax austerity by increasing imports and public spending.
[c] Yearend.

### Continued Tough Austerity

As revealed by the late November presentation of the 1984 budget and by other recent public and private statements, austerity is Mexico City's planned policy course next year. De la Madrid intends to further reduce the public deficit as a share of GDP from 8.5 percent in 1983 to 5.5 percent next year. The government plans to hold growth in spending even with inflation, while revenues are expected to increase faster because of more efficient tax collection and higher prices for public-sector goods. At the same time, net foreign borrowing is projected to fall by $1 billion to $4 billion for all of 1984.

Our analysis indicates that because of depressed private-sector demand and stagnant government spending, there would be no change in economic activity next year; current government projections call for at most economic growth of 1 percent. On the other hand, inflation would fall to 45 percent next year—close to Mexico City's 1984 target of 40 percent. Nevertheless, the economic and political costs of continued austerity would be substantial:

- Per capita consumption would decline for the third straight year.
- Unemployment would gradually increase to the 25-percent range.

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### Stimulating the Economy

We believe poor economic performance could lead to political pressure to adopt expansionary policies. According to recent US Embassy reporting, the de la Madrid administration has been negotiating for additional flexibility under the IMF program if economic expansion is not under way by the second half of 1984. If Mexico relaxes austerity in 1984, we project the economy could grow as much as 4 percent. The costs would be substantial, however, including:

- Greatly increased government deficits and near triple-digit inflation.
- Sharply higher foreign borrowing requirements.
- A faster plunge in the exchange rate.

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Mexico could sustain such policies only if the economy were opened to foreign investment and foreign bankers were provided with guarantees that encouraged them to renew and increase loan and trade credit lines. Unemployment and underemployment, however, would not improve much from current levels because of the large numbers of new labor force entrants.

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Should de la Madrid pursue this course, Mexico's economic stabilization program would be endangered, probably postponing self-sustaining economic recovery. If higher spending causes Mexico to miss IMF performance targets by a wide margin, we believe de la Madrid would find it necessary to clamp down on the economy again in late 1984 to ensure continued access to essential foreign funding. Such a start-stop course could drag out economic recovery and undercut the government's longer term objective of creating enough jobs for a rapidly growing labor force.

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**Impact of External Factors**

Despite the broad array of choices that are open to de la Madrid, the course of the economy during the next two years also will depend on factors outside of Mexico City's control. Either a setback in the current world economic recovery or a deterioration in the international lending climate—perhaps brought on by a debt default in another country—could preclude Mexico City's current option of relaxing austerity. A drop in demand for Mexican oil or a reduced availability of credit would severely circumscribe Mexico City's options. For example, each dollar change in oil prices—Mexico currently gets an average $27 per barrel—would cost Mexico about $500 million in annual oil revenues, and each one-percentage-point increase in world interest rates boosts debt service obligations roughly $800 million each year.

On the other hand, a major disruption in world oil supplies—perhaps brought on by trouble in the Middle East—could boost oil revenues and allow Mexico City to spur a noninflationary economic recovery. In these circumstances, as oil revenues increased, Mexico's import capacity would be increased markedly. The government could prepay principal obligations and, at the same time, reopen factories and rapidly boost industrial capacity utilization. Higher imports and lower domestically financed public deficits could reinforce anti-inflationary policies.

**Implications for Longer Term Policy Options**

The measurable consequences for the balance of the de la Madrid administration (1985-88) are clear. Under any policy option—barring a dramatic rise in world oil prices—Mexicans face continuing economic adjustments and depressed levels of personal consumption. We believe that economic management problems will mount once the clear justification for austerity fades, political pressures for noticeable improvement intensify, and the private sector continues to experience financial difficulties. Moreover, distortions, inefficiences, and waste are likely to grow and encroach further on private decisionmaking. In this setting, nonoil export expansion necessary to increase import capacity and revitalize economic activity is unlikely.

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Because well-organized interest groups have a hearing at the highest level in Mexico's political system, the government will face intense pressures for high subsidies, generous wage increases, and a return to an overvalued exchange rate during the remaining de la Madrid years. Social problems papered over by the oil boom and now festering under the constraints imposed by the economic crisis, will increasingly demand the government's attention.

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# Brazil: Medium-Term Financial Outlook Under Alternative Economic Scenarios [1]

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Although creditor concerns over Brazil's international financial situation recently eased when the IMF resumed disbursements following approval of Brasilia's stabilization program, many bankers are skeptical that Brazil can secure sufficient funds from private and official sources to cover its longer term financing needs. Our projections suggest that under favorable global economic conditions the country's credit needs could decline considerably over the decade to levels that can be financed. In the event of global economic shocks, however, Brazil's financial requirement could grow to an amount that would keep the country in financial crisis. Recognizing that the world economy is unlikely to follow our favorable assumptions and, instead, that economic shocks will occur in the next several years, we believe Brazil probably will face serious financial difficulties through the rest of the decade.

## Setting the Stage

During the past few years, steadily rising debt service obligations and depressed foreign exchange earnings have caused Brazil's foreign borrowing to surge. Since 1979, debt service payments have grown by an average of $4.5 billion a year while foreign exchange earnings have grown only one-third as fast. As a result, debt service payments in the past five years exceeded foreign exchange earnings by $17 billion. To finance this shortfall and imports, Brazil's gross borrowing rose steadily over the period, reaching $31 billion in 1983—$12 billion more than in 1979. This borrowing increase pushed the country's outstanding debt to its present level of slightly more than $90 billion.

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To examine whether Brazil's demand for credit will continue to grow in the next several years, we constructed a balance-of-payments simulation model. Given assumptions about future global economic conditions—such as economic growth, interest rates, inflation, and oil prices—and the future course of the Brazilian economy, the simulation model projects trade trends, debt service payments, gross borrowing, outstanding debt, and other variables required to determine financing needs. We then used the model to examine Brazil's financial requirement under four sets of assumptions. One scenario assumed favorable global economic conditions through 1990, while each of the others assumed that the world economy would be buffeted by a different economic shock.

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## Favorable Economic Conditions: Dwindling Credit Needs

We first projected Brazil's financial requirements through the rest of the decade assuming favorable global economic trends. We assumed that during the next seven years:

- Brazilian and world real GDP grows at an average annual rate of about 3 percent.
- Interest rates decline by 2 percentage points.
- Oil prices rise by $2.00 per barrel each year.
- World export prices grow, on average, at about 6 percent each year.

In addition, we assume in this, and the other scenarios, that prices and volumes of Brazilian exports and imports will respond to changing conditions as they have done in the past two decades.

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[1] This article is the first in a planned series that assesses the longer term financial outlook for key debt-troubled LDCs based on simulation model results.





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Under these favorable global economic assumptions, Brazil's projected financing needs would lessen considerably in the 1984-90 period. Net borrowing—the amount of new money borrowed—could drop off to about $7 billion in the next two years, down one-third from 1981-82. During the rest of the decade, net borrowing should steadily decline, turning negative in 1988 when principal payments exceed gross borrowing. Gross borrowing would still remain in the $28 billion range through 1987—down $3 billion from 1983—before falling by about $1 billion each year through 1990. Based on these projections, outstanding debt would peak in 1987 at $110 billion before returning to the $90 billion level by the end of the decade.

Growing trade surpluses would be responsible for the bulk of this projected reduction in Brazil's longer term financing needs. We project that Brazil's exports and imports in real terms would grow at average annual rates of 8.0 and 4.5 percent, respectively, through 1990. As a result, the trade surplus would rise to $23 billion in 1990, up from its current level of $4 billion. The growing trade surplus would outstrip increases in principal and interest payments and would allow Brazil to reduce its level of annual foreign borrowing throughout the decade.

### Global Economic Shocks: Multiplying Credit Needs

In contrast to the relatively optimistic assessment of Brazil's future financial situation under favorable global economic conditions, our projections for scenarios incorporating economic shocks indicate that credit needs could grow rapidly—and in some cases rise to record levels. While the timing and magnitudes of the three shocks—a classical recession, a tight money recession, and an oil supply disruption—differ, the severe damage inflicted on Brazil's financial position in the long run would be similar. In the three years after the shock, however, the degree of damage done would be different.

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***Classical Recession: Credit Needs Rise Moderately.*** As one alternative to the favorable economic conditions case, Brazil's financial requirement was projected assuming the occurrence of a classical recession. Specifically, we assumed in this scenario that in 1985 a worldwide recession hits due to sagging demand. In this case:

- World real GDP growth and world export price inflation decline because of reduced demand.
- Oil prices hold steady in the face of lower industrial production.
- Interest rates fall in response to lower inflation and slack credit demand.

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Of the global economic shocks examined, a classical recession should do the least immediate damage to Brazil's financial position. Under these assumptions, Brazil would have to borrow about $32 billion annually during the 1985-87 period—$8 billion of which is new money. This $8 billion of net borrowing compares to the $11 billion of net borrowing during 1981-82. Compared with the favorable economic condition case, the additional amount of borrowing generated in this period by the recession would be about $10 billion. The bulk of the additional $10 billion increase in borrowing would result from sharply lower exports. Slower world economic growth and reduced export price inflation would cause this to occur. Based on higher borrowing levels, Brazil's outstanding debt would rise steadily from its current level of $90 billion to about $130 billion at the end of the decade under this scenario.

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***Tight Money Recession: Credit Needs Boosted Significantly.*** As another alternative to the favorable economic conditions case, Brazil's longer term credit needs were projected under the assumption



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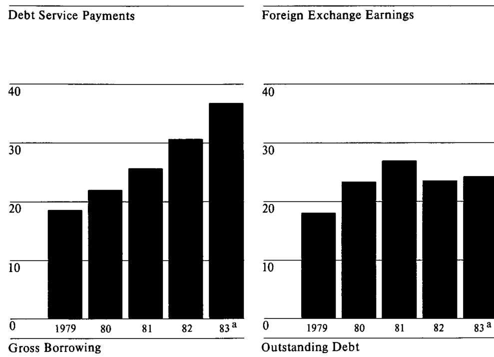
## Brazil: International Financial Trends

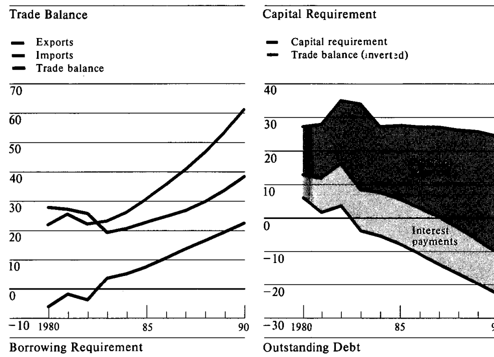
Note scale change

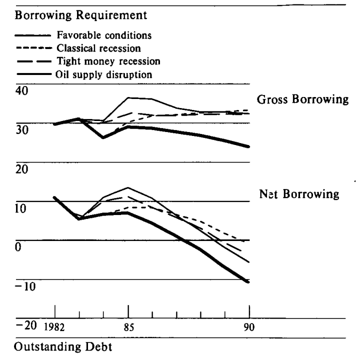
**Recent Trends**

**Future Trends Under Favorable Economic Conditions**

**Future Trends Under Alternative Economic Conditions**




Gross Borrowing

Outstanding Debt

Borrowing Requirement

- Principal payments
- Gross borrowing
- Net borrowing

Outstanding Debt

Outstanding Debt

Favorable conditions
Classical recession
Tight money recession
Oil supply disruption

[a] Projected.

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that a tight money recession occurs. This recession, assumed to occur in 1984, could evolve if the central banks of industrial countries adopt restrictive monetary policies. In particular we assumed:
- Tight monetary policy drives up interest rates.
- Higher interest rates stifle spending, leading to a slowdown in GDP growth.
- Lower demand for imports results in lower world export price inflation.
- Lower demand for energy, by increasing the oil glut, keeps oil prices from rising.

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In terms of its effect on Brazil's medium-term financing needs, our projections indicate that a tight money recession would be worse than a classical recession. If such a recession were to occur in 1984, the model projects that in the following three years Brazil would be required to borrow $32 billion annually, including $10 billion of new money. The additional borrowing that would be required if the global economy is struck by a tight money recession can be traced to lower exports and higher interest payments compared with the favorable economic conditions case. As a result of increased borrowing, outstanding debt would peak at about $130 billion in 1988 before declining slightly through 1990.

***Another Oil Shock: Credit Needs Jump Dramatically.*** We assess the impact of an oil shock on Brazil's financial requirements by assuming an oil supply disruption in 1984 similar in magnitude to what would occur if Persian Gulf oil shipments were disrupted. Specifically, we assumed an oil shock would set off the following chain of events:
- The oil supply shortfall would cause a rapid runup of oil prices to the $60 per barrel level.
- Higher oil prices would stunt world GDP growth and cause export price inflation to accelerate.
- Increased inflation would drive up nominal interest rates despite slackening credit demand.

Our projections indicate that an oil supply disruption of this magnitude would increase Brazil's credit needs more rapidly than the other cases. In the three years after the oil shock, the country's gross borrowing requirements could average $35 billion annually—$12 billion of which would represent infusions of new money. Moreover, net borrowing in 1985 could reach the unprecedented level of $14 billion—$3 billion higher than the 1982 level that precipitated financial crisis. In terms of cumulative damage, the shock could raise borrowing in the 1984-86 period by almost $20 billion above the level projected under favorable economic conditions. This dramatic increase in borrowing would push outstanding debt to $136 billion in 1988—a five-year increase of over $45 billion.

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We estimate that significant increases in Brazil's imports and interest payments, in comparison with the favorable economic conditions case, would be responsible for most of the additional borrowing that the oil shock would generate. In this scenario, Brazil's average annual imports and interest payments in the 1984-86 period would be $27 billion and $15 billion, respectively, compared with $23 billion and $12 billion under the favorable economic conditions case. Rising oil prices and interest rates would be responsible for these increases.

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### Can Projected Credit Needs Be Satisfied?

While it is difficult to predict the future behavior of international lenders, we believe that Brazil's credit needs under the favorable economic conditions case—an annual average of $6 billion of new money in the next three years—probably could be satisfied. Lenders—both official and private—could be willing to loan this amount of new money in the future for the same reasons they did in the past two years; they may continue to believe that Brazil's problem is one of illiquidity rather than insolvency, especially when they see the country's trade surplus beginning to grow. Lenders could

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***Brazil: Key Assumptions for Alternative Scenarios***

***Favorable Economic Conditions***

*Brazilian real GDP growth:*
- *Negative in 1983 and 1984*
- *Accelerates from 2.0 percent in 1985*
- *Reaches 5.0 percent in 1989*

*World real GDP growth:*
- *Developed countries—averages 3.0 percent over the period*
- *Developing countries—rises steadily after no growth in 1983*

*Interest rates:*
- *Hold steady in 1983 and 1984*
- *Fall slowly over the next six years*

*Oil prices:*
- *Hold steady in 1983 and 1984*
- *Rise slowly through 1990*

*World export price inflation:*
- *Negative in 1983*
- *Accelerates peaking in 1985*
- *Declines over the rest of the decade*

*Brazilian inflation and exchange rate:*
- *Close parity between inflation and devaluation rates*
- *Both fall sharply from their 1983 level*

***Classical Recession*** [a]

*Brazilian real GDP growth:*
- *Same*

*World real GDP growth:*
- *2.5 percentage points lower in 1985*
- *1 percentage point lower in 1986*

*Interest rates:*
- *1.5 percentage points lower in 1985*
- *1 percentage point lower in 1986*
- *0.5 percentage point lower in 1987*

*Oil prices:*
- *$3 lower 1985 through 1990*

*World export price inflation:*
- *6 percentage points lower in 1985*
- *4 percentage points lower in 1986*

*Brazilian inflation and exchange rate:*
- *Same*

***Oil Supply Disruption*** [a]

*Brazilian real GDP growth:*
- *Same*

*World real GDP growth:*
- *3 percentage points lower in 1984*
- *2 percentage points lower in 1985*
- *1 percentage point lower in 1986*

*Interest rates:*
- *2.5 percentage points higher in 1984*
- *3 percentage points higher in 1985*
- *2 percentage points higher in 1986*
- *1 percentage points higher in 1987*

*Oil prices:*
- *$50 per barrel vs. $29 in 1984*
- *$60 per barrel vs.$32 in 1985*
- *$55 per barrel vs. $34 in 1986*
- *$50 per barrel vs $36, $38, $40, and $42 in 1987 through 1990*

*World export price Inflation:*
- *4 percentage points higher in 1984*
- *3 percentage points higher in 1985*
- *2 percentage points higher in 1986*
- *2 percentage points higher in 1987*

*Brazilian inflation and exchange rate:*
- *Same*

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***Tight Money Recession*** [a]

*Brazilian real GDP growth:*
- *Same*

*World real GDP growth:*
- *2 percentage points lower in 1984*
- *1 percentage point lower in 1985*

*Interest rates:*
- *3 percentage points higher in 1984*
- *1.5 percentage points higher in 1985*

*Oil prices:*
- *Same*

*World export price inflation:*
- *2 percentage points lower in 1984 and 1985*

*Brazilian inflation and exchange rate:*
- *Same*

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[a] *Compared with the favorable economic conditions case.*

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make new loans that would bridge this period of illiquidity and keep old loans current if they believe a turnaround is possible. Writing off nonperforming loans would damage short-term earnings, while making new loans to keep old loans current would not.

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We believe, however, that Brazil's annual new money requirements of $8 billion to $12 billion following a global economic shock could approach amounts that lenders would be unwilling to finance. Although lenders financed similar large amounts during 1981-82, they may balk next time. If lenders begin to question Brazil's longer term ability to repay loans, they may decide to cut their losses. Under these conditions, Brazil and its creditors would be forced to reach some comprehensive agreement rescheduling the terms of outstanding debts.

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Based on our estimate of the size of future credit needs, there is a high probability that Brazil will be haunted by financial difficulties throughout this decade. The determining factor would be whether the global economy in the next several years is hit with adverse shocks. If the past 10 years are any guide, we would expect at least one major economic shock to the global economy in the next few years. In that case, Brazil's financial problems would linger through 1990.

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# Argentina: Economic Prospects in 1984

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Raul Alfonsin, who assumed the Argentine presidency on 10 December, faces a stagnant economy, 400-percent inflation, and a de facto foreign payments moratorium. According to his initial statements, he is determined to use his electoral mandate, the rebound in public confidence, and improved economic expectations to support plans to stimulate the economy and at the same time slow price increases. Moreover, his economic team has indicated to world bankers its willingness to facilitate the refinancing of some $18 billion in foreign debt in 1984 and to enter into a new IMF agreement provided it allows for some stimulation of the economy.

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We expect improvement in the economy during the first half of 1984. Inflation should drop sharply, both because of increased confidence and expected policies under the new Radical Civic Union government. This may enable the new President to conclude wage and price settlements that will further lower inflation to a monthly rate of about 5 percent. At the same time, his plans to stimulate growth by increasing government spending for housing and welfare programs should generate a modest economic recovery during the first six months. Foreign exchange problems are expected to ease early next year as a result of the seasonal resumption of foreign grain sales.

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Beyond mid-1984, however, economic and political pressures will build. We expect that inflationary pressures will increase and that Alfonsin will discover that his tax restructuring and collection efforts have not generated sufficient funds to cover increased public spending. If the IMF and international bankers later next year react to a growing budget deficit by halting disbursements and restricting new lending, Alfonsin's economic team will have little choice but to rely on monetary expansion, leading to a resurgence of inflation.

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**Argentina: Balance of Payments** *Billion US $*

| | 1979 | 1980 | 1981 | 1982 | 1983[a] |
|---|---|---|---|---|---|
| Current account balance | −0.5 | −4.8 | −4.7 | −2.5 | −2.0 |
| Trade balance | 0.3 | −2.4 | −0.3 | 2.3 | 3.5 |
| Exports, f.o.b. | 9.6 | 8.0 | 9.1 | 7.6 | 7.7 |
| Imports, c.i.f. | 9.3 | 10.4 | 9.4 | 5.3 | 4.2 |
| Net invisibles (noninterest) | −0.3 | 0.3 | 0.2 | 0.5 | 0 |
| Interest payments | −0.5 | −2.7 | −4.6 | −5.3 | −5.5 |
| Capital account balance | 4.6 | 2.4 | 1.4 | −2.9 | 0.5 |
| Direct investment | 0.3 | 0.7 | 0.9 | 0.3 | NA |
| Short-term nonbank borrowing | 1.6 | −1.6 | −8.2 | −5.3 | NA |
| Other, including errors and omissions | 2.7 | 3.3 | 8.7 | 2.1 | NA |
| Financing | −4.1 | 2.5 | 3.3 | 5.4 | 2.5 |
| Reduction in reserves | −4.4 | 2.8 | 3.8 | 0.7 | −0.2 |
| Other, including accumulation of arrears | 0.3 | −0.3 | −0.5 | 4.7 | 2.7 |

[a] Estimated.

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## The Economy in 1983

After the economic chaos triggered by the Falklands conflict, Argentina began 1983 on a hopeful note. A default had been staved off by a $1.1 billion

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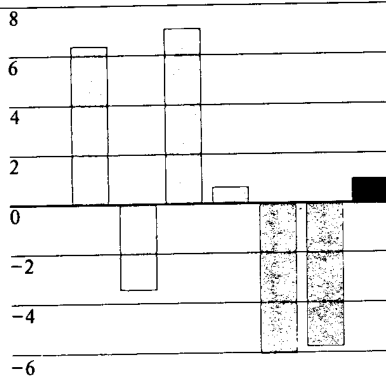
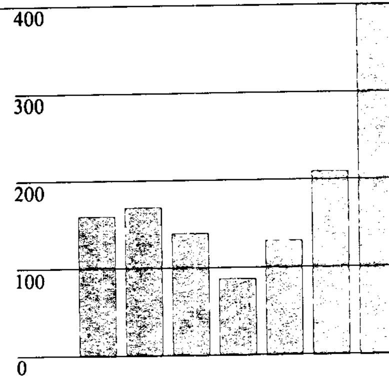
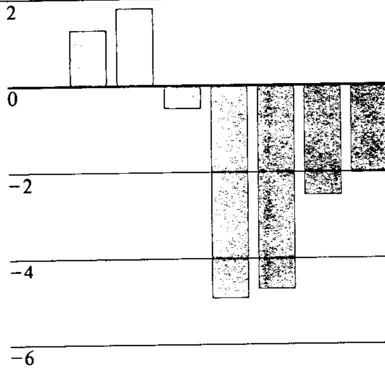
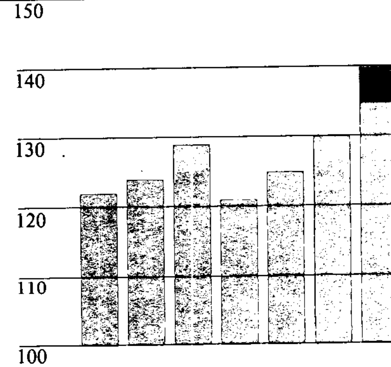
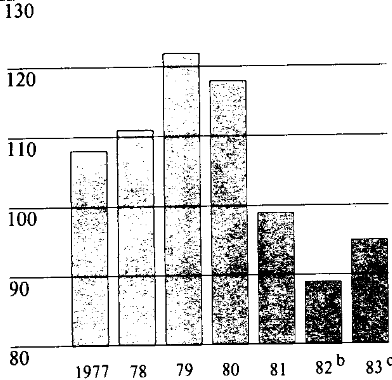
## Argentina: Economic Indicators

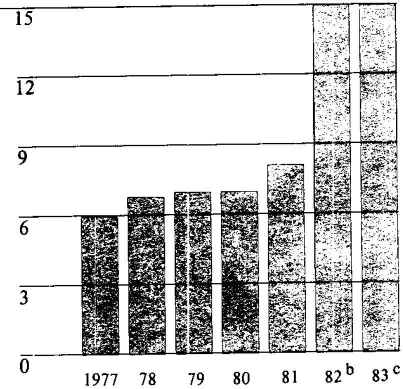



[a] December over December.
[b] Estimated.
[c] Projected.

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commercial bank bridge loan and a $2.2 billion IMF rescue program. Moreover, a projected rebound in export earnings after a 16-percent decline in 1982 and a $1.5 billion loan scheduled for disbursement in the second half of 1983 were expected to cover foreign financing requirements.

This year did not turn out as well as expected, however, and the Alfonsin government inherited rampant inflation and a stagnant economy. Inflation was never brought under control; consumer prices will probably reach 400 percent for 1983, discouraging production and new investment while encouraging speculation. The military government's inability to deny high wage demands eroded fiscal discipline. Despite some initial improvements in industrial capacity utilization, economic growth will probably be no more than 1 percent for the year.

The foreign financial rescue program ran into difficulties as a result of a dispute with bankers over domestic legal issues affecting the debt. Because Buenos Aires was unable to access promised loans, it failed to eliminate interest arrears by the end of June as agreed upon with the Fund, thus stalling bank and IMF loan drawings. Despite having drawn foreign reserves down to precariously low levels in September to make external payments, Argentina still had substantial interest arrears. These past-due payments and meddling in debt negotiations by Air Force officers and a maverick judge in October triggered another series of delays in the disbursement of loans, forcing Argentina into a de facto payments moratorium. Noncompliance with IMF targets halted drawings against some $950 million in Fund credit and $1 billion remaining in a medium-term loan arranged earlier in 1983.

## Alfonsin's Ambitious Program for 1984

Press statements indicate that the Radical Party wants to promote growth, mainly through demand-stimulation policies. They are expected to follow through on their party platform pledge for housing and antipoverty programs that Alfonsin expects to fund, according to the US Embassy, by cutbacks in military spending and badly needed tax reform and collection efforts. Private industrial activity will be stimulated by subsidized interest rates.

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At the same time, the Alfonsin government believes that the strong mandate from voters and the reestablishment of a constitutional government will brake uncertainty and speculation, reducing price hikes to about 10 percent a month. Economy Minister Grinspun plans to capitalize on the initial reduction in the inflation rate to reach wage and price control agreements with labor and business. He hopes to limit real wage increases to 6 percent annually and reduce monthly price hikes to a 5-percent pace.

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Alfonsin also plans to:

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- Proceed with IMF negotiations. By the time Grinspun develops an economic plan to present to the IMF, however, Argentina probably will be so far out of compliance with its present program that disbursement of IMF money is unlikely before April.

- Discuss rescheduling and new loans with commercial bankers to settle past due payments and to purchase imports needed to activate industry.

- Welcome foreign investment that is beneficial to Argentina but control it closely.

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## Likely Successes—The First Six Months

We agree with Grinspun's assessment that inflation will drop sharply as the civilians come into power. The Embassy points out that high wage demands and sharp price hikes in the immediate preelection period were in anticipation of wage and price controls following the election. The outgoing military regime was particularly receptive to popular wage demands because of its strong desire to maintain domestic tranquility before the elections.

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The civilian administration, in our view, will not feel the need to be as generous. Additionally, the easing of speculation and the impact of price controls will tend to slow price hikes.

The initial easing of prices makes Grinspun's goal of a 5-percent monthly inflation rate a realistic target in our view and will support his demands for union and business cooperation with the new government. Behavior of the free market foreign exchange rate since the election indicates that inflationary expectations have already diminished.

Alfonsin's attempts to stimulate the economy are certain to prove popular and at least create an impression of positive change. Businesses will be pleased initially with subsidized interest rates and reductions in military spending that should make more credit available to the private sector. Similarly, support for more housing, higher real wages, and antipoverty programs should likewise encourage wage earners.

Argentina's external payments difficulties are likely to abate temporarily. Seasonal foreign grain sales are scheduled to resume this month and will generate new flows of foreign exchange. The recent disbursement of $500 million in new loans will relieve some bank pressure to reduce growing interest arrears. We also expect lenders will be willing to allow small reductions of the interest rate spread and extend grace and repayments periods to cooperate with the new government.

**Potential Obstacles**

There is a small risk that the performance criteria in any new IMF program could stall a quick reconciliation with bankers. We judge that there is ample room for reduction of the Argentine budget deficit—likely to be near 15 percent of GDP in 1983—but we expect Grinspun's projection of a deficit totaling 7 percent of GDP in 1984 to be a point of contention with the Fund. Grinspun's plans for import and capital controls and export subsidies are also likely to delay an agreement and could prevent the anticipated cash-flow improvements from materializing.

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We believe Alfonsin ultimately will be forced to establish a new IMF program to gain access to new bank loans. The US Embassy indicates that as much as $4 billion in additional credit will be required by Buenos Aires to clear past-due debts, obtain imports to nourish a recovery, and rebuild foreign exchange reserves in 1984. Any agreement Grinspun brings home, however, has the potential to cause trouble. Unless presented to the public as a growth program with which the banks are assisting, it could trigger a backlash, fueling demands for a long-term moratorium.

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**A Tougher Second Half**

After a good start, we expect economic difficulties to increase substantially around mid-1984. Even if Alfonsin forges an initial consensus to limit price and wage increases, we anticipate a resurgence of inflationary pressures by mid-1984. The sharp increase in the public-sector deficit in late 1983 and the attendant monetary expansion will translate into renewed pressure on prices. Any resurgence of inflation would ultimately undermine labor cooperation on moderating wages. Old-line labor bosses would be quick to exploit any restiveness, and Peronist political chiefs would set aside internal differences to oppose Radical Party economic policies for their own political ends.

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Alfonsin is likely to find that he has been overly optimistic in estimating the fiscal gains from the tax restructuring and new collection efforts. If he nonetheless sticks to an expansionary program—higher public investment, more spending for housing, higher salaries, and social welfare—he could quickly lose control over the size of the government



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deficit. We would then expect the IMF to halt disbursements under any new loan programs. This would rule out foreign borrowing, and the Radicals would have little choice but to resort to domestic monetary expansion, furthering inflationary pressures.

The reductions in industrial costs derived from subsidized interest rates would be quickly overwhelmed by another round of salary increases. With tight price controls, profit margins would then be squeezed and bankruptcies would increase. Resulting rises in unemployment would gut the initial gains in purchasing power by wage earners. Stagflation would then be likely to emerge by late 1984.

**Implications for the United States**

A breakdown in Argentina's debt renegotiations—should it occur—would have serious implications for US banks. Buenos Aires was the fourth-largest debtor to the United States with $8.2 billion outstanding to US lending institutions at the beginning of 1983. A long-term moratorium, or some selected default, would quickly push some Argentine loans into the nonperforming category, seriously eroding the profits of some US banks and perhaps necessitating a US Government bailout or bank mergers.

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We consider a major confrontation with international lenders to be unlikely during the first six months of the administration, but after that the odds will grow if the economy worsens. Grinspun is an unproven debt negotiator, however, and his reputation as aggressive and undiplomatic could lead to an impasse at any time.

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# Colombia: Debt Difficulties Weaken the Economy

The lackluster world economic recovery and banker resistance to new lending so far have blunted President Betancur's ambitious domestic economic policies. As a result, we believe the Colombian economy has grown by only 1 percent this year—the worst performance since 1950—with inflation remaining at about 25 percent. Despite import cuts, declining exports and capital flight continue to drain foreign exchange reserves at a time when foreign bankers are increasingly reluctant to extend substantial new credits to Colombia, thereby heightening the prospect of debt servicing disruptions.

If Bogota is unable to obtain substantial new international loans—as seems likely—it will be forced next year to join other South American countries in rescheduling its external debt under IMF auspices. At this juncture, we believe Bogota will have to undertake a politically unpopular economic adjustment program to improve its external accounts and reduce inflation. The Colombian economy will probably suffer through yet another year of near-zero growth, high unemployment, double-digit inflation, and falling real wages. Measures to resolve economic problems will continue to adversely affect US interests and, at worst, President Betancur may shift to an even more inward-looking, nationalistic economic strategy.

## A Weakening Economy

During the late 1970s Colombia registered solid economic gains through buoyant external conditions and conservative fiscal policies:

- Real growth averaged 5.5 percent during 1976-80 because of growing exports, industrial development, and new construction.
- Inflation averaged 24 percent annually—not excessive by Latin American standards—reflecting relatively tight fiscal and monetary policies.
- Booming exports of coffee and sugar—and marijuana—combined with small increases in imports to generate an annual average $185 million current account surplus; foreign borrowing requirements were moderate.

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Colombia's economic performance, however, changed markedly after 1980. The overvalued peso and depressed prices for key agricultural exports in the wake of a severe recession in the industrial countries gradually undermined both the domestic economy and Colombia's favorable payments position. By the end of 1981 the current acccount deficit plummeted to $1.9 billion and increased a further 20 percent in 1982.

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## Betancur's Economic Game Plan Goes Awry

Taking office in August 1982 during a period of worsening economic performance placed Betancur, the populist, in a dilemma. Betancur was under heavy political pressure to adopt more expansionary policies and gave highest priority to reviving the economy. He increased public spending and granted new subsidies—tolerating a higher fiscal deficit—to spur growth. Betancur also loosened monetary restraints by lowering interest rates and eased access to credit for financial institutions, importers, and farmers. At the same time he was implementing these stimulative policies, Betancur was also pledging to reduce inflation.

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Betancur counted on a strong world recovery to improve the external accounts this year. Instead, exports headed lower and foreign financing became





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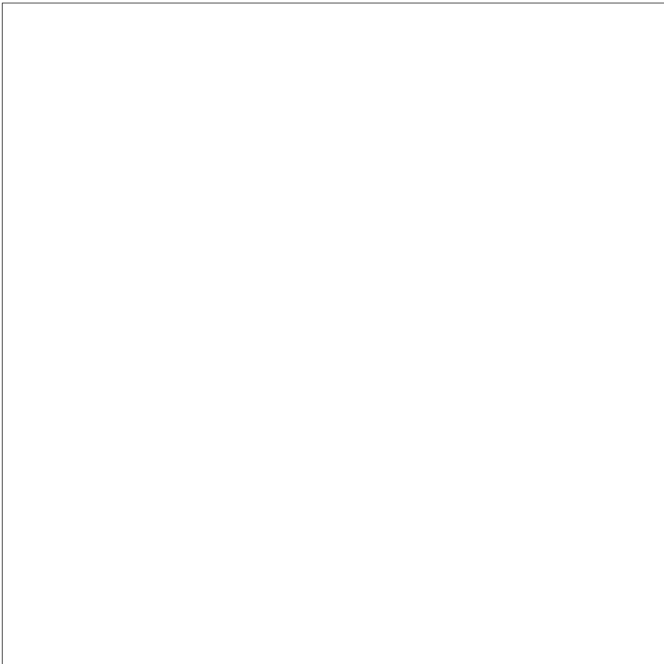
harder to obtain. Coffee revenues—which traditionally account for half of total export earnings—have declined because of lower prices and demand in developed countries. Protectionism and slower growth in Colombia's Andean Pact neighbors—who absorb 30 percent of Colombia's exports—are also adversely affecting sales in the nontraditional export sector. As a result, debt servicing as a percent of total exports rose from 15 percent in 1980 to nearly 40 percent this year.



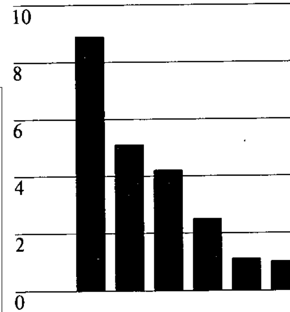
Domestically, Betancur's efforts to curry political favor by relaxing fiscal discipline hindered efforts to reduce inflation. Increased public spending this year is pushing the public deficit beyond the 4.5 percent of GDP recorded in 1982. In order to finance the deficit, Bogota is again increasing the money supply, thereby perpetuating high inflation. In addition, some of Betancur's other ambitious plans are making little headway. Although the President predicted that 70,000 new jobs would be created this year by the housing program, construction has not strengthened, dashing Betancur's plans to reduce unemployment.

In order to deal with the growing external financing problem, Betancur has been forced to move away from his expansionary policies. Earlier this

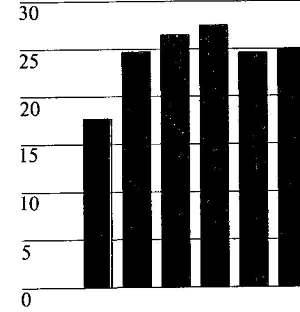
**Colombia: Selected Economic Indicators**

Note scale change

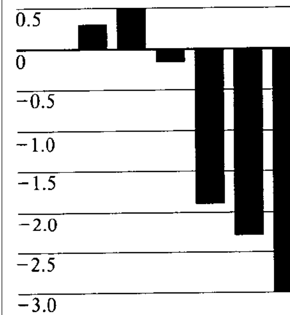
**Real Economic Growth**
Percent



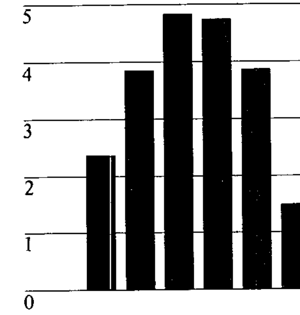

**Consumer Price Inflation**
Percent



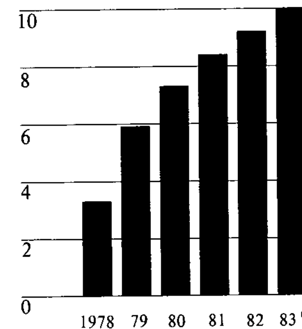

**Current Account Balance**[a]
Billion US $



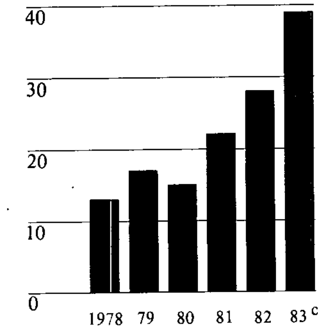

**Foreign Exchange Reserves, End of Year**[b]
Billion US $




**Total Debt**
Billion US $




**Debt Service Ratio**
Percent




[a] Excluding official transfers.
[b] Excluding gold.
[c] Estimated.

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year he declared emergency tax reform measures to bolster the government's coffers. Although legal problems delayed their implementation several months, these measures could limit next year's budget deficit. Bogota has also accelerated peso devaluations, hiked tariffs, tightened import controls, and taken steps to prevent capital flight.

## 1983: A Dreary Year

Economic growth is unlikely to exceed 1 percent—the worst performance in 30 years. Inflation is outpacing wage gains, resulting in reduced demand; a large proportion of merchants report sales below last year's levels. New orders during the second quarter reached the lowest point in years, based on a survey of industrial executives, causing inventories to soar.

The US Embassy reports that the unemployment rate for the four largest cities climbed from 10.8 percent in March to 12 percent at the end of June—the highest rate since 1974. The impact of Betancur's stimulative economic policies will cause the inflation rate to hover near the 25-percent level.

Despite corrective measures already in effect, Bogota's current account deficit rose to an estimated $3 billion. Although import retrenchments offset declining export earnings, Colombia's services deficit increased twofold to $1.2 billion this year because of falling tourism, interest earnings, and remittances and a 10-percent increase in interest payments. Thus far, Bogota has drawn down foreign exchange reserves to cover the payments gap, but its foreign exchange cushion is dwindling. From yearend 1982 through the end of September, foreign exchange reserves fell from $3.9 billion to $1.6 billion.

**Colombia: Current Account** *Million US $*

| | 1980 | 1981 | 1982 | 1983 [a] |
|---|---|---|---|---|
| **Current account balance** | **−159** | **−1,895** | **−2,292** | **−3,000** |
| Trade balance | −238 | −1,544 | −1,946 | −1,805 |
| Exports, f.o.b. | 4,062 | 3,219 | 3,230 | 2,875 |
| Coffee | 2,375 | 1,459 | 1,577 | 1,500 |
| Imports, f.o.b. | 4,300 | 4,763 | 5,176 | 4,680 |
| Net services and transfers | 79 | −351 | −346 | −1,195 |

[a] Estimated.

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## A Look Ahead

Betancur will be unlikely to engineer either economic recovery or lower inflation in 1984. According to our estimates of recovery in the developed countries, Colombian exports will not post the strong rebound needed to spur the economy. We believe international bankers will resist financing a large payments deficit, and Bogota's unwillingness to cut public spending augurs another large budget deficit. Further increases in the money supply and upward pressures on prices appear inevitable.

To regain foreign banker support, Bogota will have to undertake unpopular economic adjustments under IMF guidance next year. This probably will entail further peso devaluations, reining in large budget deficits, and limiting generous wage and salary increases. These moves will conflict, however, with Betancur's personal political convictions.

Development lending will have to be restored before Colombia can exploit untapped energy and mineral resources. More than half of the investment funds needed for these longer term projects are expected to come from international agencies and foreign banks. Ultimately the development of coal and nickel deposits could boost the domestic economy, but there is little hope this will occur in the near term.





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**Implications for the United States**

Colombian measures to deal with its foreign payments problems are adversely affecting US interests. US exports of processed foods, wine, and fresh fruit have been hurt this year, and more cutbacks can be expected. US sales to Colombia declined from $900 million in the first half of 1982 to $425 million during the same period this year. By the end of 1983, Colombian import cuts will probably turn last year's $1 billion trade surplus enjoyed by the United States into a $150 million deficit.

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President Betancur could shift to more inward looking and nationalistic economic policies that would further harm US interests. He could resort to increased tariffs, tougher import quotas, and tighter restrictions on dividend payments or capital repatriation. The Betancur administration also could follow the example of other major Latin American debtor countries by slowing interest and principal repayments to US commercial banks.

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