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Perspective

LDC Debt Problems

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Mexico's severe financial crisis is dramatic evidence of the mounting financial problems of the less developed countries. We expect the LDCs' medium- and long-term external debt to approach $550 billion by yearend, up from $150 billion only seven years ago. Although an increasing number of countries have been in arrears on their debt payments, and many of these have required debt relief, until this year all were small with an aggregate debt of only $10 billion, or some 2 percent of the total debt of non-OPEC LDCs. Now, including Mexico and Argentina, countries in evident financial trouble have nearly 25 percent of total LDC debt.

Mexico's pursuit of overambitious development goals, past heavy borrowing, and the Mexicans' sudden loss of confidence in their own government's economic management underlie the current severe liquidity crisis. Mexico is essentially out of foreign reserves yet faces the need to repay more than $30 billion in short- and long-term loans over the next 12 months. In what looms as the world's largest debt rescheduling, Mexico City will probably seek to roll over more than $20 billion in short-term bank debt and to stretch repayment terms on maturing long-term credit. If strong Mexican leadership proves lacking, the process of building a consesus for an austerity program will be slow, leaving creditors nervous and the Mexican financial situation unstable for at least several months.

Argentina—the third-largest LDC debtor—faces serious debt repayment problems in the wake of economic disruptions triggered by the Falklands conflict. The resignation this week of the Economy Minister and the Central Bank president in a dispute over economic policy can only reinforce bankers' fears about Argentina. We expect that Argentina will be forced to seek a formal rescheduling of the $15 billion in debt obligations coming due in the second half of 1982.

Other LDCs are also encountering financial difficulties because of depressed export earnings and rising debt servicing burdens. Many of them are increasingly vulnerable to loss of banker confidence, especially since more and more of their debt is short term. Candidates for debt problems include Chile and Peru and, particularly if oil prices remain soft, Venezuela and Nigeria.

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Like Mexico and Argentina, Brazil is spending well over half of its export earnings just to pay interest on debt. So far, however, Brazil continues to obtain new credits, albeit at a high cost. Growing numbers of Brazilians are publicly discussing the voluntary renegotiation of all or part of Brazil's $80 billion debt as a way of alleviating external constraints on domestic growth. Some Brazilian economists have called for the major Latin debtors to seek a collective renegotiation. Despite the debate, we believe that there is no support for voluntary debt renegotiations in Brazilian Government circles or indeed in other Latin capitals.

The Mexican and Argentine crises are bound to stimulate a great deal of concern about the stability of the international financial system. Although reschedulings by Mexico and Argentina will not of themselves impair the profitability or solvency of the creditor banks as long as full interest payments are made, they are likely to make bankers and regulatory authorities a great deal more nervous about financial exposure not only to those countries but to other LDCs.

While LDC financial problems are not limited to Latin America, its debt management difficulties have the most serious implications for the United States. Any visible role the US Government and US banks take in resolving Latin economic problems by encouraging austerity measures will leave Washington vulnerable to charges of meddling in these countries' internal affairs. The Federal Reserve reports that US banks—excluding foreign subsidiaries—had some $70 billion in credits extended to Latin borrowers at the end of first-quarter 1982. With such a large exposure, US financial institutions could be whipsawed by rumors, unanticipated shocks, and the failure to arrange orderly debt reschedulings. In the event of a banking crisis massive Central Bank intervention would be required, and LDC access to private credit would suffer.

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