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Central Intelligence Agency

Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

International Financial Situation Report #39
18 April 1985

Summary

The Cartagena Group is about to press participants in the Bonn summit to enter into a political dialogue on debt. The group has decided [redacted] to advise those attending the summit of the group's political and economic concerns, extend an invitation to each country to join in a dialogue, and request the G-7 countries to set a time and place for the initiation of talks. Other developments in recent weeks include: 25X1

- o The IMF approved on 24 March Mexico's program for the last phase of its three-year extended fund facility. We believe Mexico will be unable to meet most of its targets. [redacted] 25X1

- o Brazil hopes to conclude debt talks by 31 May when bank loans that were rolled over during earlier debt negotiations mature. [redacted] 25X1 25X1

- o The IMF declared Argentina out of compliance on 29 March and withheld disbursement of standby funds. An IMF team is now in Buenos Aires to scrutinize performance data and Argentine policy actions.

- o Unofficial results from last Sunday's elections indicate center-left candidate Alan Garcia of the APRA party probably will be inaugurated as Peru's next President. Garcia has said that he would reject the intermediary role of the IMF in debt negotiations and hold annual debt servicing to 20 percent of Peru's export earnings.

- o The IMF has found Manila out of compliance on several targets of its standby arrangement. [redacted] 25X1 25X1

- o South Korea recently obtained a $600 million syndication, but Korean bankers were disappointed with the low number of participants. Meanwhile, some commercial banks are becoming concerned about Korea's creditworthiness. [redacted] 25X1

NOTE: THE NEXT REPORT WILL BE PUBLISHED ON 23 MAY 1985

This situation report was prepared by analysts of the Intelligence Directorate. Comments are welcome and may be addressed to the Situation Report Coordinator, on [redacted] or secure telephone [redacted] 25X1 25X1

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KEY ISSUE

LDC Debt and the Bonn Summit

The Cartagena Group of 11 Latin American debtors is about to press participants in the Bonn summit meeting of industrial countries to enter into a political dialogue on debt. The group has decided, [redacted] to advise those attending the summit of the group's political and economic concerns, extend an invitation to each country to join in a dialogue, and request the G-7 countries to set a time and place for the initiation of talks. [redacted] 25X1

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[redacted] 25X1

DEVELOPMENTS IN MAJOR COUNTRIES

Mexico

On 24 March, after nearly six months of tough negotiations, the IMF approved Mexico's program for the last phase of its three-year extended fund facility. Approval came only after Mexico promised to make additional budget cuts and to introduce other anti-inflationary measures such as import liberalization. Under the program, the budget deficit is to be cut to 4.9 percent of GDP, several percentage points below last year's level. Tight restrictions also were placed on domestic credit, accrual of government interest arrearages to the Central Bank, net external borrowing, and drawdowns in international reserves. [redacted]

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We believe Mexico will be unable to meet most of the targets in the program. [redacted] Moreover, opposition from Mexico's long-protected private business sector caused Mexico City last week to withdraw the portion of the export promotion plan that would allow companies unrestricted use of 40 percent of their export earnings for imports. [redacted]

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Brazil

After taking office in mid-March, the new civilian administration quickly announced austerity measures and reestablished contact with foreign creditors to restart debt talks, which were suspended in February when Brazil fell out of compliance with its IMF-supported program. According to Embassy reporting, Brasilia ordered a 10-percent cut in public spending, halted new federal lending for two months, and froze government hiring. Moreover, the government tightened price controls, lowered inflation adjustments for government bonds and the exchange rate, and liquidated a bankrupt financial institution — Brasilinvest — rather than rescue it. 25X1

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25X1 Brasilia hopes to conclude debt talks by 31 May when bank loans that were temporarily rolled over during earlier debt negotiations mature. 25X1

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Argentina

On 29 March the IMF declared Argentina out of compliance and withheld disbursement of standby funds, putting on hold attempts to complete a $4.2 billion commercial bank new money package. The IMF decision was based on Argentine failure to slow inflation, which reached an annualized rate of 850 percent in March. According to the terms of the standby arrangement, inflation was targeted to fall to 300 percent, or 12 percent per month, with a 15-percent monthly maximum. 25X1

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[redacted]

An IMF team is now in Buenos Aires to scrutinize performance data and Argentine policy actions. In an effort to reconcile with the Fund, Argentina has already announced some financial adjustment measures, including the prohibition of bank acceptances and of bank intermediation of company-to-company loans, according to Embassy reporting. These transactions will be replaced by short-term bank loans at market-determined interest rates, giving the Central Bank greater control over the money supply. Buenos Aires also reduced guarantees on deposits and subsidies to member banks and announced its intention to boost tax revenue through tougher enforcement, but it sharply lowered reserve requirements on term and savings deposits to a range of 4.5-14 percent. According to press and Embassy reports, the implementation of inflation-fighting controls and wage restraints is expected soon. [redacted] 25X1

If all goes smoothly and promised adjustments are implemented quickly, the earliest that Argentina could draw the new monies would be July. [redacted] 25X1

[redacted] 25X1

REGIONAL SITUATIONS

Latin America

[redacted] 25X1

Venezuela

Through 8 March, the Central Bank reports making nearly $800 million in 1985 public-sector debt payments — including $611 million in interest — to prevent accumulation of arrearages, according to Embassy reporting. [redacted] 25X1
25X1 [redacted] private-sector debtors are falling further behind; only

[redacted] 25X1

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[redacted]

$400 million in private-sector interest has been paid through February, against approximately $1.0 billion in obligations. Venezuela continues to resist the linkage of a public-sector rescheduling to private-sector debt repayments. With no real leverage on the government to settle these past due payments, we expect bankers to use minor issues, such as the terms for the relending facility, to delay a rescheduling agreement until private-sector interest arrearages are brought more current. [redacted] 25X1

Chile

[redacted] 25X1

Santiago now is scrambling to find additional financial resources, but negotiations for new lending from official sources are unlikely to result in immediate relief. Chile's $750 million extended fund facility — scheduled for IMF Executive Board consideration on 17 May — likely will provide less than $175 million this calendar year, and the World Bank structural adjustment loan may not be concluded until next year [redacted] 25X1 25X1 [redacted] Despite the tightening financial squeeze, Santiago is steadfastly refusing a Paris Club rescheduling, asserting that $226 million in new disbursements could be threatened while only $132 million in relief would be gained. To obtain some relief, the Chileans have asked the United States to reschedule CCC credits, according to Embassy and State Department reporting. Meanwhile, press reports indicate Chile has managed to avoid serious financial strains by drawing down $380 million in reserves to cover debt servicing. Although we believe Chile could persuade bankers to increase their lending offer to $700-800 million by giving guarantees to private-sector debt, this would still leave a financing gap that probably would compel Chile to implement severe austerity measures. [redacted] 25X1

Peru

Unofficial results from last Sunday's presidential elections indicate that center-left candidate Alan Garcia of the APRA party probably will be inaugurated as Peru's next President in July. Based on Garcia's speeches, interviews and speeches of other APRA candidates, and documents published by the party, we speculate that the economic policy of an APRA administration likely will be highly nationalistic and will put heavy emphasis on economic planning. We believe it will be more difficult for creditors to negotiate with the new APRA government than with the outgoing Belaunde administration. Garcia has said that, if elected, he would reject the intermediary role of the IMF in debt negotiations and hold annual debt servicing to 20 percent of Peru's export earnings. [redacted] 25X1 25X1 [redacted]

The Belaunde administration continues to adjust policies in a manner consistent with Fund recommendations, although Lima has no formal IMF-supported program in place. [redacted] 25X1

[redacted] 25X1

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[redacted]

[redacted] 25X1

[redacted] Finance Minister Garrido Lecca approached Paris Club and Socialist bloc creditors with new plans to meet obligations but on easier terms. In an attempt to improve its standing with official creditors, the US Embassy reports the Peruvians intend to make monthly partial payments to Paris Club countries. In addition, Lima has renegotiated $170 million in debt owed to the Soviets by promising payment with minerals and other exports. The Soviets agreed to this commercial concession to win political gains, [redacted] 25X1

25X1 [redacted]

Lima made a $16 million good faith payment to commercial banks last month to keep overdue interest below 180 days and prevent loans from being downgraded by US regulators, according to press reports. The move probably was aimed also at getting banks to keep trade credit lines at the current $300 million level, but we believe Lima's cash shortages will continue to complicate relations with bankers. Finance Ministry and Central Bank officials contend that the Peruvian Treasury has currency to pay only $400 million to Peru's creditors this year, but owes $3.6 billion in principal and interest. [redacted] 25X1

25X1 [redacted]

Colombia

Bogota is hoping the favorable IMF Article IV mission report will support its position in ongoing negotiations with foreign creditors. Although US Embassy reports indicate the document gives an encouraging appraisal of Bogota's recent economic policy adjustments, observers close to the talks say the IMF mission still is not entirely satisfied with exchange rate policy, trade liberalization efforts, and reserves available to cover debt payments. [redacted] 25X1

[redacted] We believe that international bankers are unlikely to provide new money without some form of IMF monitoring. [redacted] 25X1

President Betancur continues to resist a formal agreement with the Fund, [redacted] Upon his return from the United States, Betancur publicly placed his prestige behind the conclusion of a commercial bank financing arrangement without a standby arrangement, and we believe that backing away from this position would in his view be politically difficult. [redacted] 25X1

25X1 [redacted] some government officials consider Betancur's attitude unrealistic. With Colombia's financial needs still pressing, Betancur's uncompromising stance and a lack of agreement with commercial banks on new money could lead to further erosion of reserves as the seasonal trade surplus dwindles, and at worst, a foreign exchange crisis in coming months. [redacted] 25X1

Eastern Europe

Among East European countries, Yugoslavia reached agreement with Western government creditors on a rescheduling of official debt, Poland has had difficulty lining up new credits from Western governments, and East Germany has built up its reserves in an effort to cushion itself against unfavorable international financial conditions. [redacted] 25X1

25X1 [redacted]

[redacted] 25X1

 [redacted] 25X1

Yugoslavia

Yugoslavia and Western creditor governments agreed in late March to reschedule roughly $800 million in official debt falling due between January 1985 and 15 May 1986, according to Embassy reporting. The agreement reschedules 90 percent of principal over nine years, including a four-year grace period. Final signature of the agreement depends on approval of the IMF standby arrangement by the Fund's Executive Board, which will meet at the end of April. The rescheduling agreement contains a goodwill clause promising continued involvement by government creditors in Yugoslavia's adjustment program, provided that Belgrade maintains an appropriate relationship with the IMF following expiration of the 1985 standby program. Creditors indicated a willingness to consider less stringent Fund monitoring in the future if Yugoslav economic performance continues to improve. [redacted] 25X1

[redacted] 25X1

Poland

Poland has had little success in its effort to obtain pledges of new credits from Western governments. [redacted] 25X1 Bonn indicated that it will not provide guarantees and new credits until Warsaw's arrearages on the 1981 debt rescheduling agreement are paid off, the 1982-84 Paris Club debt rescheduling agreement is officially signed, and the 1985 multilateral and bilateral FRG-Polish debt rescheduling pacts are concluded. While turning aside the request for credits, West German Economics Minister Bangemann agreed to strongly support Poland's application for IMF membership and to encourage US support for Polish membership in the Fund. British Foreign Secretary Howe, during an official visit to Poland in mid-April, also responded unfavorably to Polish requests for credits. According to Polish press reports, the British official stressed that the restoration of credits was conditional on Poland's signing of the Paris Club rescheduling agreement. [redacted] 25X1

The Poles are off to a poor start in fulfilling their hard-currency export plans this year. [redacted] exports to non-socialist countries fell by 14.9 percent and imports rose 1.1 percent in the first two months of 1985 compared to the 25X1

[redacted] 25X1

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previous year. The hard currency surplus was only $62 million, compared to $190 million in the January-February period in 1984. The decline was mainly due to extremely cold weather which contributed to breakdowns in the transportation system, decreased production time, and diverted coal from exports to domestic use. Although the Poles may make up some of the decrease in exports during the rest of the year, it will be difficult to meet the 7-percent increase planned for 1985. According to Embassy reporting, the Poles are revising downward their import plans in order to meet this year's planned $1.5 billion hard currency trade surplus. 25X1

Meanwhile, the Polish banking system received at least $250 million of new hard currency deposits from Polish citizens who took advantage of a grace period before tougher requirements were imposed on documenting sources of hard currency offered for deposit in interest-bearing accounts. According to the Polish press, the new deposits brought the total amount of hard currency in the Polish banking system at the end of March to more than $1.1 billion. The newly deposited funds could prove useful to Warsaw in reducing the financing gap looming this year. Poland 25X1 used private hard currency deposits for external payments in the late 1970s and early 1980s. 25X1

East Germany

East Germany's Foreign Trade Bank President Polze told a US Embassy official that East Berlin has built up its large reserve position primarily as a cushion against possible unfavorable international financial developments. Polze indicated that he was particularly concerned with two possiblities: spillover of another East European country's borrowing problems to East Germany, and a generalized international banking crisis. Polze said the bulk of recent medium-term borrowings — which helped push East Germany's foreign exchange holdings in Western banks to $4.6 billion at the end of September — will remain on deposit, while some of the funds will be used for a gradual reduction of short-term debt. Polze claimed that the credits are not linked to imports 25X1 for any specific investment projects, although we believe East Berlin may eventually use some of the money to finance capital goods imports mandated by the 1986-90 economic plan.

Western Europe

Portugal

The Embassy reports that Lisbon is making little headway in negotiations with the World Bank for a loan to restructure public-sector enterprises. Lisbon has not gone far enough to reform government management of the firms nor has it reduced back payments owed to these monopolies. Moreover, the Portuguese have not settled on performance criteria for one of three companies that will given special scrutiny by the World Bank. The World Bank believes an agreement is unlikely this year if Portugal's latest proposal is turned down this month. 25X1

Asia

Among Asian countries, the IMF has found the Philippines out of compliance on several targets under its standby arrangement, and the South Korea recently obtained a $600 million syndicated loan from commercial banks. 25X1

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[redacted]

Philippines

[redacted] IMF has found Manila out of compliance on several of the targets set as conditions of its $615 million standby arrangement, including the credit ceilings to the public and private sectors, the reserve money target, and reforms of the sugar and coconut monopolies. New end-of-May targets are being established in an attempt to salvage the Philippines' economic adjustment program. As a result, we believe that the $160 million in IMF funds originally scheduled to be disbursed in March and May will be delayed at least until July. 25X1

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[redacted]

South Korea

In its first major borrowing of 1985, a $600 million syndicated loan was signed on 29 March for the Korea Exchange Bank (KEB). According to Embassy reporting, the terms are slightly more favorable than a similar borrowing by the KEB last year. The loan consists of two tranches: $362 million with an interest rate of 0.625-0.75 percentage point above LIBOR and $238 million at the US prime rate plus 0.1 percentage point. Both tranches are repayable within eight years, including a four-year grace period, and the US prime tranche carries a cap on interest tied to the US 3-month CD rate. At the time of the KEB's last borrowing in December 1984, bankers believed Korea would have to pay higher rates to attract lending; in light of the terms of the recent syndication, however, many bankers feel Korea likely will avoid higher rates in 1985. [redacted] 25X1

25X1 [redacted]

While this syndication was a success, several factors point to bankers' increasing concern about lending to South Korea. According to Embassy reporting, a KEB official indicated that he was not overly pleased that 40 percent of the participating banks were Japanese, while the Canadian and US regional banks stayed away. He also indicated that the KEB was accustomed to more than the 14 participants that this loan had attracted. In addition, [redacted] many smaller banks are nearing their limits on Korean exposure; they are concerned that Korea may soon become the third largest LDC debtor replacing Argentina; they are reluctant to commit funds for more than five years; and syndications such as this one with narrow spreads and low visibility are no longer attractive lending vehicles. [redacted] 25X1

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[redacted] 25X1

Moreover, [redacted] at least one major US bank with substantial exposure in South Korea is increasingly concerned about Korea's creditworthiness, and while the bank has not officially lowered its credit rating for Korea, it is actively considering it. The primary sources of the banker concerns are the rumoured financial difficulties of Korea's highly leveraged conglomerates, a slowdown in exports which contributed to a $594 million current account deficit in the first two months of 1985, problems arising from the deregulation of the domestic financial center, and Korea's high proportion of short-term debt. [redacted] 25X1

Africa/Middle East

Jordan

According to the US Embassy, Jordan will soon borrow $200 million in the Eurodollar market to help combat falling foreign exchange reserves. The loan will be for eight years, including a four-year grace period, at 0.5 percentage point above LIBOR for the first four years and 0.625 above LIBOR thereafter. Jordan has obtained similar amounts the past two years but is entering the market earlier this year than expected. Reserves have plummeted sharply over the past year — in part because of declining Arab aid — and stood at $448 million in February, or about half the level held at the end of 1983. [redacted] 25X1

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