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Central Intelligence Agency

Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

International Financial Situation Report #44
19 September 1985

Summary

Renewed LDC dissatisfaction with current international monetary arrangements has bolstered Third World resolve to urge reform during the IMF/World Bank Annual meetings next month in Seoul. For the first time, LDCs have submitted proposed modifications for formal consideration at the meetings, forcing industrial countries to address their criticisms of the international monetary system. Other developments in recent weeks include:

- President de la Madrid is demonstrating his commitment to austerity by recent deficit-reducing moves, realignment of his economic policy-making team, and cuts embodied in the 1986 budget. However, de la Madrid faces increasing pressure to find alternatives to Mexico's current debt arrangements.

- The US Embassy maintains that Sarney's naming of Dilson Funaro as Finance Minister makes it clear that the Brazilian government intends to stress its commitments to economic growth and social spending and to soft-pedal orthodox inflation-fighting policies. Bankers reportedly believe that negotiations with the IMF will drag on with little resolution, and that the Brazilians will reopen the entire rescheduling agreement to renegotiation.

- Favorable economic trends continue to buoy the Argentine government and reinforce its determination to maintain austerity measures. The US Embassy reports some backsliding on the financial reforms introduced this spring, however, causing a resurgence of the intracorporate lending market and reduced Central Bank control of the money supply.

- An IMF team spent two weeks in August reviewing the Philippines' adjustment efforts. The size of the Philippines' 1985 budget deficit is now estimated to be well above targeted levels.

- A mediator for negotiations to reschedule South Africa's short-term debt reportedly has been chosen, and talks are tentatively scheduled to begin next week. Pretoria's four-month moratorium on principal repayments, however, is likely to be extended. [redacted] 25X1

NOTE: THE NEXT REPORT WILL BE PUBLISHED ON 24 OCTOBER 1985. 25X1

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

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UPCOMING IMPORTANT DATES

Date	Event/Country	Comment	
19 September	Paris Club-Panama	Meeting to discuss rescheduling of debt owed to official bilateral creditors. [redacted]	25X1
27 September	IMF Executive Board Meeting	Article IV review on the Philippines. [redacted]	25X1
September-October	40th UN General Assembly	The debt issue will be raised by Latin leaders. Also, Latin American and Caribbean Heads of State may meet informally to discuss debt. [redacted]	25X1
October	Fourth Cartagena Ministerial Meeting (Montevideo)	The economic and foreign ministers of the Cartagena Group have reportedly scheduled a meeting to discuss their current financial situations. [redacted]	25X1
6-11 October	IMF/IBRD Annual Meetings (Seoul)	Discussions will include international monetary reform and the overall debt situation. [redacted]	25X1
10-13 October	Latin American Parliament Meeting (Montevideo)	Latin American political figures will discuss the regional economic situation; a special debt conference will be included. [redacted]	25X1
23 October	"Trade Union Day of Continental Action Against Foreign Debt"	[redacted] demonstrations and work stoppages are planned in a number of Latin American countries. [redacted]	25X1 25X1
25 October	IMF Executive Board Meeting	Arrears owed to the Fund by Sudan will be considered. [redacted]	25X1
14-16 November	University of South Carolina Debt Conference (Colombia, SC)	The University has invited Latin American and Caribbean countries, and major creditors including the IMF and World Bank, to a discussion of the debt issue. [redacted]	25X1

[redacted] 25X1

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KEY ISSUE

G-24 Proposals for Improving the International Monetary System

Renewed LDC dissatisfaction with current international monetary arrangements has bolstered Third World resolve to urge reform during the IMF/World Bank Annual meetings next month in Seoul. For the first time, LDCs have submitted proposed modifications for formal consideration by the IMF Interim Committee in response to the recommendation proposed by the G-10 countries in June.

- "Volatile exchange rates have discouraged world trade and investment in developing countries needed to service foreign debt." Although LDCs favor eventually establishing target zones for exchange rates, they intend, in the meantime, to press major industrial countries to coordinate macroeconomic policies by submitting to an explicit, two-stage consultation process with the IMF.

- "Increased economic interdependence has placed the burden of international adjustment on developing countries." The Third World believes that the Fund should tighten surveillance over the monetary and fiscal policies of industrial countries and promote economic growth as an integral part of LDC adjustment, partly by easing conditionality of international lending.

- "International liquidity is insufficient." LDCs favor augmenting the loan base of the IMF and the World Bank. 25X1

Although the industrial countries share LDCs' concern about key features of the monetary system—especially exchange rate volatility—most remain unwilling to support extensive reform. The majority of G-10 countries oppose the adoption of target zones at this time and have reached no consensus on an additional SDR allocation. Instead, they hope to reduce exchange rate fluctuations by improving the effectiveness of existing, informal arrangements to coordinate macroeconomic policies—a strategy they jointly approved this summer. Consistent and sound macroeconomic policies in industrial countries also would foster greater private lending to LDCs, argue the United States, West Germany, and the United Kingdom, easing pressure to increase international liquidity with official funds. 25X1

LDCs, however, may try to exploit differences of opinion existing among individual industrial countries to garner international support for monetary reform. France and Italy, in particular, have supported the concept of target zones. The October meeting is expected to only have a brief discussion of the G-10 and G-24 reports, with further in-depth discussion to be held at the spring Interim Committee meeting. 25X1

Mexico

President de la Madrid is demonstrating his commitment to austerity by recent deficit-reducing moves, realignment of his economic policy-making team, and cuts embodied in the 1986 budget. On the basis of these initiatives, the President appears ready to sacrifice short-term popularity to accomplish long-term economic adjustment. His mettle will be tested by the need to balance the requirement for continued austerity 25X1
with competing demands, particularly from business and labor. In addition, de la Madrid

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[redacted] 25X1

is facing increasing pressure to find alternate solutions to Mexico's current debt arrangements. [redacted] 25X1

[redacted] 25X1
[redacted] The budget for next year calls for further cuts in 25X1
spending and manpower, as well as reductions in politically sensitive food, gasoline, and transportation subsidies. The government realizes that future economic growth, however, depends on the availability of new loans from abroad. The economic program for 1986, for example, assumes a $3 billion increase in net foreign borrowing. To secure these funds, Mexican officials almost certainly will be pushed to agree to another IMF-supported program. They hope the latest austerity measures and cuts outlined in next year's budget will impress the Fund and foreign bankers. Officials also will continue to lobby Washington to press the IMF and international bankers for more concessions. [redacted] 25X1
[redacted] 25X1

Brazil

President Sarney's naming of Dilson Funaro to replace Finance Minister Dornelles probably will prove popular at home, but is likely to heighten difficulties with creditors abroad. The US Embassy maintains that the move makes it clear that the Sarney administration intends to stress its commitments to economic growth and social spending and to soft-pedal orthodox inflation-fighting policies. In a conversation with the US Ambassador, Brazil's new Finance Minister said he believes that negotiations with the IMF and creditor banks will be difficult, and that a number of contentious issues must be resolved. [redacted] Funaro has indicated that in future 25X1
negotiations with the Fund and the banks, Brazil will try to establish a fixed level of interest and debt amortization to be paid each year so that the remainder of its trade surplus can be used to support higher domestic economic growth. [redacted] 25X1

[redacted] 25X1

Argentina

Favorable economic trends continue to buoy the Alfonsin government and reinforce its determination to maintain austerity measures. Last month, inflation fell further to 3.1 percent, Argentina inked its $4.2 billion bank loan package, and a major union protest strike met with only modest success. The US Embassy reports some backsliding on the financial reforms introduced this spring, however, causing a resurgence of the intracorporate lending market and reduced Central Bank control of the money supply. Meanwhile, the Central Bank is trying to boost the earnings of the ailing banking system by selling a new series of high interest rate bonds to commercial banks that will place a greater burden on the public sector deficit. [redacted] 25X1

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REGIONAL SITUATIONS

Latin America

Elsewhere in Latin America, Uruguay reached an agreement with its bank advisory committee on a multiyear rescheduling, Panama probably will not soon receive the structural adjustment loan it had expected, and Bolivia announced an austerity program to break its hyperinflation. [redacted] 25X1

Uruguay

Uruguay reached an agreement in principle with its bank advisory committee on 6 September, providing for a multiyear rescheduling of its external debt and $150 million in new funds. [redacted] 25X1 the banks will provide nearly two-thirds of the total in the form of trade credits and World Bank co-financing, and the remainder will come from government or government-financed sources. [redacted] 25X1 with the financing package arranged, Uruguay's letter of intent will be approved at the IMF Board meeting of 27 September. The package's outline remains to be filled in: repayment terms, interest rates, payment schedules, and the World Bank's guarantee percentage have not yet been determined. We estimate that the financing package will cover Uruguay's financing gap through mid-1986, but Montevideo will need to keep a tight lid on imports to remain current on its debt obligations. [redacted] 25X1

Panama

Panama probably will not receive a $60 million World Bank structural adjustment loan (SAL) this year because of insufficient progress on required labor and industrial reforms, according to US Embassy reporting. Drawings on Panama's $60 million commercial bank new money facility are contingent upon the SAL. Without disbursements from these two loans, Panama in turn will be hard pressed to comply with financial targets required for drawing on its $88 million IMF standby arrangement. Panama likely will try to obtain disbursements from the commercial banks even without the SAL, and probably will seek a revision of the standby arrangement from the Fund. If the intricate financial program unravels, however, Panama will face further cuts in imports, a deepening recession, and higher unemployment. In the meantime, President Barletta is certain to press his appeal to the US for emergency aid to ward off a crisis. His failure to secure the necessary funds—either through reforms or aid—will make him more vulnerable to removal by the military, which looked to him to bring the economy under control. [redacted] 25X1

Bolivia

On 29 August, President Paz Estenssoro announced a rigorous austerity program in a major effort to break Bolivia's hyperinflation and shore up its balance of payments. The US Embassy reports that the IMF has reacted favorably to the reforms. However, the IMF believes that La Paz is not capable of implementing these reforms. Key technical personnel have not been appointed, and the impact of the measures has not been quantified. The major components of the program are:

— A four-month freeze on public-sector wages and the curtailment of subsidies to unprofitable state enterprises. 25X1

— A 93-percent devaluation of the peso. [redacted]

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- A removal of price controls.

- The decontrol of interest rates and reestablishment of dollar-denominated bank accounts to attract investment capital to the banking system. 25X1

There are several shortcomings, however, including the absence of any currency reform or new legislation to prevent the government from overprinting money. Moreover, the US Embassy estimates that it will take at least a year of strict implementation before private businesses are in sound enough financial condition to absorb significant numbers of former public-sector employees. 25X1

Eastern Europe

In Eastern Europe, Yugoslavia formally accepted the terms of its commercial bank rescheduling, Poland's Paris Club meeting was abruptly cancelled due to unsettled arrears, and Hungary is seeking a $400 million loan. 25X1

Yugoslavia

Yugoslavia formally accepted on 9 September the terms proposed by commercial bank creditors to reschedule $3.5 billion in debt falling due in 1985-88. The banks agreed to reschedule 100 percent of the debt over 12 years with a five-and-a-half-year grace period, at an interest rate of 1.125 percentage pionts over LIBOR. The spread in interest rates for 1983 and 1984 reschedulings are to be reduced by one-quarter and one-eighth percentage points, respectively. According to press reporting, the proposal also calls for early repayment of $261 million from the $600 million loan package approved in 1983. It is expected to take about two months to obtain the required approval of 95 percent of the banks, which participated in the 1983 and 1984 reschedulings and 100 percent of the banks participating in the 1985-88 reschedulings, according to a State Department source. A date will then be set for consolidating the 1985 and 1986 maturities into one repayment schedule. Because of progress toward final agreement, the IMF allowed Yugoslavia in late August to draw the second $80 million tranche of its 1985-86 standby credit. 25X1

Belgrade undoubtedly views the agreement as a victory. After months of protracted negotiations, the banks made several concessions, including lowering interest rates and renegotiating the 1983 and 1984 agreements. Belgrade probably believes the agreement will improve its chances of securing a multiyear rescheduling from official creditors early next year. But Belgrade's hard dealing with the banks may make bankers less willing to normalize commercial relations and extend new credits. 25X1

Poland

Talks scheduled for 16 September between Poland and the Paris Club of Western official creditors were called off abruptly, because Warsaw did not make full payment of arrears due at the end of August, a precondition to negotiating terms for 1985 maturities. Warsaw was to pay $200 million of overdue interest from the 1981 rescheduling. According to the US Embassy, Polish negotiator Karcz said the arrears were too great to be paid in one month's time, but that payment would be made over the next few weeks. No further date has been set for a Paris Club meeting to discuss rescheduling of 1985 maturities. 25X1

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[redacted] 25X1

Warsaw's request for $600-800 million in new credits from Western governments seems to have fallen on deaf ears; most creditors continue to wait for payments of all amounts due on the 1981 and 1982-84 rescheduling agreements and the signature of a 1985 accord before committing any new loans. Progress on bilateral talks—begun with all OECD creditors except the US—has been slow because of Polans'd failure to pay arrears and disagreement over interest rates, according to the US Embassy in Warsaw. So far, only the Austrians have pledged $40 million, less than Poland had requested. The Austrians claim that only half of the credit is actually a new commitment. The new credits—guaranteed by the Austrian Kontrollbank at an 8.5 percent interest rate—are to support export of Austrian industrial equipment to Poland. The other half is an extension of ongoing official trade financing for grain sales to Poland. [redacted] 25X1

In a press interview, Karcz reiterated that without new funds, Poland could not meet its 1985 repayment commitments. During January-July, hard currency exports did not reach planned levels, and Warsaw does not expect to meet its target for a $1.5 billion trade surplus this year. Even with the rescheduling of 1982-84 debt and assuming the rescheduling of all 1985 maturities, we estimate that Warsaw faces a financial gap of $500-700 million. Poland's payment schedule will be particularly difficult over the next few months, when Warsaw must cover large payments on its Paris Club reschedulings as well as the first repayment of principal under the 1981 rescheduling agreement with the banks. [redacted] 25X1

[redacted] 25X1

Asia

Philippines

An IMF team spent two weeks in August reviewing the Philippines' adjustment efforts. [redacted] 25X1 25X1 the immediate area of concern is the size of the Philippines' 1985 budget deficit now estimated to be well above targeted levels. Philippine officials attribute the overrun to a shortfall in trade revenues, repayment of officially guaranteed loans of troubled domestic banks, and unanticipated financing gaps of various government agencies. [redacted] 25X1

According to US Embassy reporting, it appears that the Philippine plan for reforming the coconut and sugar sectors may not satisfy the IMF as they do not open up the industries to competition and actually protect the status quo. However, the World Bank—which is to make the technical determination on the adequacy of the policy 25X1

[redacted] 25X1

[redacted] 25X1

reforms—appears to be prepared to accept Manila's proposed measures, according to State Department reporting. [redacted] 25X1 [redacted] 25X1 The plan calls for merging the PNB and the Development Bank of the Philippines into a much smaller unit dealing principally with agricultural financing. The IMF Executive Board will conduct an Article IV review of Philippines on 27 September. Manila had hoped to reach agreement with the Fund on a revised letter of intent to allow a review its standby performance at the same meeting. Information available at this time, indicates that negotiations on the revised letter of intent will delay a formal review of the program until November, thus postponing the next scheduled tranche disbursement. [redacted] 25X1

Africa/Middle East

In South Africa, bankers seem resigned to reschedule short-term debt, and Morocco received a $318 million standby arrangement. [redacted] 25X1

South Africa

Commercial banks seem resigned to negotiating a rescheduling of South Africa's short-term debt, but Pretoria's four-month moratorium on principal repayments is likely to be extended. [redacted] 25X1 Pretoria and creditor banks are moving toward rescheduling negotiations. [redacted] 25X1 25X1 South Africa's promise to maintain full interest payments probably inclined bankers to be patient because their banks can avert loan loss provisions as long as interest payments continue. Bankers may also find reassurance in Reserve Bank Governor de Kock's continued assertions that South Africa will not ask for new money at rescheduling negotiations. Bankers are leery of appearing to help South Africa, however, and probably welcome the appointment of a mediator to conduct negotiations. [redacted] 25X1 25X1

[redacted] 25X1

Morocco

According to press reports, the IMF approved an 18 month $200 million standby arrangement and $115 million in compensatory financing for Morocco on 13 September. According to IMF documents, the program—originally requested in April—is designed to strengthen government revenues, and increase the price of subsidized products and certain public tariffs. Rabat increased prices in early September for most basic foodstuffs by 5 to 10 percent. [redacted] 25X1

Morocco's Paris Club creditors met and rescheduled its debt on 17 September. According to US Embassy reporting, Morocco had hoped to get 90 percent of their official debt rescheduled—versus 85 percent in 1983-84—and to get more generous terms. According to the same Embassy report, Morocco's London Club steering committee informed commercial bankers that formal agreement had been reached on the documentation package with the final signing expected in early October. [redacted] 25X1 25X1

[redacted] 25X1

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FINANCIAL BRIEFS

Americas

- Financial experts of the **Cartagena Group** met 11-13 September in Montevideo...meeting held under great secrecy...recommends further dialogue with EC and will submit technical solutions to Latin debt problem at the October Ministerial meeting. 25X1

- Subscriptions to **Chile**'s loan syndication reached 99 percent of the requested $1.085 billion...almost 20 percent of banks still holding out...we believe package will be concluded in October and first disbursement will be made by November. 25X1 25X1

- **Colombia**'s $1 billion new money package delayed...60 of 280 banks reluctant to subscribe to syndication...some oppose recapitalization of Banco de Colombia, while other reluctant to increase their exposure. 25X1

Europe/USSR

- **Bulgaria** is arranging its second loan syndication in three months...Japanese-led loan is for $100 million for eight years at three-eights percentage point over LIBOR...observers believe that lenders' enthusiasm will increase the total to more than $200 million. 25X1

- Premier Ozal disclosed **Turkey** will not seek an IMF agreement...declaration is in contrast to other recent official statements...consultations with Fund continue...bankers appear not to be concerned. 25X1

Asia

25X1

- Pressures to restrict **Japan's** net long-term outflow of funds being stepped up...net long-term outflow topped $37 billion for first seven months of 1985, versus $50 billion in 1984...Ministry of Finance has expressed opposition to capital controls. 25X1

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[redacted]

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Africa/Middle East

- **Iraq** likely to seek $500 million club loan.. [redacted] ...first medium 25X1 activity since 1983. [redacted] 25X1

- IMF has delayed decision on disciplinary action against **Liberia** until late November...issue is some $39 million arrears to Fund...current standby arrangement remains suspended. [redacted] 25X1

- **Nigeria** to send delegation to Western nations to discuss economic assistance and cooperation with IMF...Babangida to hold national debate on IMF issue to test support...Western receptiveness likely to influence regime's willingness to implement reforms. [redacted] 25X1

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