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Central Intelligence Agency



Washington, D. C. 20505

DIRECTORATE OF INTELLIGENCE

International Financial Situation Report #46
21 November 1985

Summary

International bankers—led by the Group of 14—are inching toward a collective reponse to the Baker initiative. Meanwhile, according to Foreign Minister Caputo, Argentina, one of the 15 countries that could qualify for new money under the initiative, views the plan positively and is willing to discuss structural reforms with the international financial community "to adapt them to Argentine needs." However, Adolfo Canitrot, the Argentine Economy Ministry's Secretary for Economic Coordination, says that the real test for the Baker plan is Mexico, and "Argentina will not define its position until the Mexican issue is resolved." Other developments in recent weeks include:

- o Mexico's economic program, outlined last week, seeks to halve the deficit and cut inflation from 60 to 45 percent. While de la Madrid appears to recognize the policies needed to avert an economic crisis, he probably lacks the political mettle to implement them.
- o Next month, Brazil plans to present the IMF with its stabilization program for 1986 which, according to Embassy reporting, Brazil views as nonnegotiable. Brazil's economic team believes it can negotiate a multiyear debt rescheduling with foreign banks even if a formal agreement with the IMF is not reached.
- o Argentina's failure to comply with IMF targets will delay the disbursement scheduled for this month. According to Embassy reporting, Argentina has raised its projection for 1986 new money requirements by \$1 billion to \$3 billion.
- o Philippine officials announced an agreement with the IMF staff mission has been reached on Manila's performance under its standby arrangement. [redacted] 25X1
[redacted] IMF Executive Board may meet on 11 December to review the staff report; 25X1
their approval would trigger the release of a \$212 million disbursement.
- o One of South Africa's major creditors has proposed a debt repayment scheme to be enacted if the South Africans do not make major political changes by the end of the year. [redacted] 25X1

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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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KEY ISSUE

US Initiative on Debt: An Update

International banks are inching toward a collective response to Secretary of Treasury Baker's proposal that they provide \$20 billion in new money to 15 debt-troubled LDCs over the next three years.

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[redacted] the Group of 14--an informal group of bankers--to meet in New York on 7-8 November to further discuss the Baker proposal. According to Embassy reporting, members of the Group of 14 are generally positive toward the initiative, but want answers to questions such as:

- o Will there be changes in US and European bank supervisory provisions?
- o Will the World Bank support the plan with increased lending?
- o Will the debt-troubled countries adopt structural reform programs?
- o Will industrial-country governments make additional financial commitments to debtor countries?

An Embassy source in a major European bank states bankers will not make a public commitment until these questions are answered; the source believes the process could take months.

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According to Embassy reporting, bankers are thinking of using the Group of 14 as an advisory body that would work with the World Bank and the IMF. This Group also would work with the individual bank advisory committees that handle reschedulings and new money requests. A meeting of the Group of 14 has been scheduled for this week in Toronto to discuss technical organizational matters. The next substantive meeting probably will be held in early December.

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Recent public statements by Foreign Minister Caputo indicate that Argentina views the Baker plan positively, and is willing to discuss structural reforms with the international financial community "to adapt them to the Argentine needs." However, Adolfo Canitrot, the Argentine Economy Ministry's Secretary for Economic Coordination, says that the real test for the Baker plan is Mexico, and "Argentina will not define its position until the Mexican issue is resolved."

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[redacted] Canitrot also indicated that Argentine and Mexican economy officials talk almost daily to discuss solutions to their foreign problems.

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DEVELOPMENTS IN MAJOR COUNTRIES

Mexico

Next year's ambitious economic program, outlined last week in the President's annual budget message, seeks to halve the government's budget deficit and cut inflation from 60 to 45 percent. President de la Madrid also promised economic readjustment and reaffirmed the country's intention to honor debt obligations. Nevertheless, although the President again appears to recognize the proper policies needed to avert an economic crisis, he probably lacks the political mettle necessary to fully implement them. As a result, a growing sense of desperation in Mexico City may lead him to agree to a strict IMF-supported program that he knows the country will not meet. [redacted]

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De la Madrid's credibility has been weakened by his handling of last September's earthquakes, and he faces an uphill battle in his efforts to convince Mexicans of the need for renewed economic adjustment. Political infighting within de la Madrid's economic cabinet threatens to undermine the confidence he needs to gain popular approval, stem capital flight, and temper inflationary expectations. Moreover, pressures to abandon the adjustment are sure to increase the months ahead. For example, labor probably hopes to recoup some of the losses in real wages experienced over the last three years and businessmen are sure to demand compensation if increased competition from abroad cuts into their profits. [redacted]

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Brazil

President Sarney's government intends next month to present the IMF with its stabilization program for 1986 which, according to the US Embassy, Brasilia will view as nonnegotiable. The same reporting indicates that the government believes that its policy differences with the Fund are slight and that the major dispute is over the speed of adjustment. Accordingly, Brasilia's program reportedly will spread adjustments over three years and allow 5 to 6 percent annual growth. In our judgment, the Sarney Administration may expect the Fund to agree to its terms because it is willing to forego the small amount of new IMF money associated with a conventional Fund program, and because creditor countries recently acknowledged that debtor economies need to grow. [redacted]

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Brasilia's economic team believes it can negotiate a multiyear debt rescheduling with foreign banks even if a formal agreement with the IMF is not reached [redacted]

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[redacted] The US Embassy reports that if bankers balk at a multiyear rescheduling under that sort of enhanced IMF surveillance arrangement, the Brazilians may seek a formal 1985-1986 rescheduling with Fund monitoring for now, while deferring a longer-term debt accord. [redacted]

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Argentina

Despite well-publicized success in fighting inflation--prices rose only 1.9 percent in October--Buenos Aires' failure to comply with IMF targets will delay disbursement from the IMF scheduled for this month. While the \$800 million in commercial bank money scheduled for disbursement on 26 November will not be affected, the \$600 million

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tranche planned for late December may be delayed. The Fund has suspended this disbursement for two months because of Argentina's large Central Bank deficit, slippage in other fiscal targets, and failure to ease import restrictions. [REDACTED]

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Other economic developments bode ill for Argentina's long-term growth prospects. Opposition from the bureaucracy and infighting among economic ministers have hampered Alfonsin's plans to increase private-sector participation in the oil and telecommunications industries. Also, his economic team's resistance to a currency devaluation is harming export competitiveness. The Embassy reports, moreover, that Argentina has raised its 1986 projections for new money requirements by \$1 billion to \$3 billion and is aiming for a GDP growth rate of 6 percent next year. This, in our view, may indicate that Alfonsin plans to fuel a rapid expansion through borrowing instead of relying on slow, steady growth based on consistent economic policies and major structural reforms. We believe his apparent emphasis on quick growth probably will force his economic team to focus on politically expedient, short-term measures. [REDACTED]

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REGIONAL SITUATIONS

Latin America

In Latin America, Chile's debt package could be delayed as two Italian banks refuse to sign, an IMF team arrived in Bolivia to discuss a new standby, and Panama signed its commercial bank refinancing agreements. [REDACTED]

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Chile

The refusal of two government-owned Italian banks to fully commit funds and sign a new commercial lending agreement is threatening to delay Chile's debt package. The World Bank in late October approved Santiago's request for a \$250 million structural adjustment loan and a \$300 million co-financing agreement with commercial banks, which along with IMF disbursements, already have provided Santiago with \$370 million to shore up its diminishing net foreign exchange reserves, now estimated to be below \$300 million. The completion of the commercial loan agreement would make Chile eligible to draw more funds—\$194 million of its World Bank co-financing loan—and help Santiago meet its IMF end-December program reserve target. [REDACTED]

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[REDACTED] Although the signing is progressing as planned, some banks have made disbursement contingent on 100 percent participation. We believe that the loan agreement will be completed even if the Italian banks continue to demur, but that disbursement could be held up until January, raising the prospect of a temporary suspension of Chile's IMF program and foreign exchange troubles unless the Fund grants a waiver. [REDACTED]

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Bolivia

An IMF negotiating team arrived in Bolivia on 14 November to discuss a new standby agreement to help cover next year's projected financing gap of \$200 million. Fund representatives, according to State reporting, are impressed with La Paz's new economic program thus far, but believe that additional fiscal reforms are necessary to continue Bolivia's success in stabilizing inflation, which the U.S. Embassy reports was 2 percent in October. La Paz also has formally requested a compensatory credit facility of \$50 million because of falling tin prices, which the Fund is likely to provide once an

[redacted]

IMF-supported program is in place, according to the U.S. Embassy. Current IMF calculations, however, do not take into account the recent tin crisis, which threatens to reduce La Paz's foreign exchange earnings by \$50-70 million. Fund officials do not believe the crisis will threaten the economic recovery, an opinion that Bolivian officials and the U.S. Embassy do not share. Meanwhile, press reporting indicates that Venezuela, Colombia, Brazil, and the Andean Development Fund have contributed over \$55 million to the proposed \$150 million United Nations stabilization loan for Bolivia. [redacted]

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Panama

After months of delay, Panama and its commercial bank creditors signed an \$850 million refinancing agreement on 31 October. The deal provides a \$60 million new long-term loan and about \$80 million in trade credits, and refinances some \$580 million in 1985-86 debt obligations. In addition, bank creditors promise to maintain \$130 million in deposits with local subsidiaries. The first \$20 million tranche of the new loan is scheduled for disbursement by yearend but continued drawings are tied to economic policy changes the Delvalle government appears unlikely to implement. Even though Panamanian financial authorities are telling bankers that labor, industrial, and agricultural reforms required for a World Bank structural adjustment loan will be made soon, Delvalle—according to US Embassy reporting—has not formulated an economic program and, like his predecessor, almost certainly lacks the political muscle to push through the reforms. [redacted]

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Eastern Europe

Among the East European countries, Poland says it will not be able to make all of the payments due to commercial banks and governments over the next two months. Yugoslavia is nearing completion of its 1985-88 commercial bank rescheduling agreement. [redacted]

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Poland

Warsaw, for the first time, formally admitted to its government creditors this month that it cannot cover all payments due to banks and governments in the next two months. According to Embassy reporting, the Poles are deciding whether to pay the \$220 million in interest due to its official creditors in November or the \$240 million in principal owed to banks in December. Warsaw also claims it cannot cover the \$550 million in interest due at the end of the year on its rescheduled 1982-84 official debt. According to the same Embassy report, Poland was scheduled to meet with the Paris Club this week to sign a rescheduling agreement for debt due in 1985, and it is requesting another meeting next month to discuss payment problems anticipated for 1986. The decision to approach the Paris Club for relief suggests Poland will continue giving preferential treatment to the banks. The Paris Club may demand equal treatment, but the Poles know the governments have little leverage because they tolerated more than \$10 billion in arrears in 1982-84. We believe Poland faces even greater difficulty allocating payments next year, when the gap between resources and debts due is expected to widen to about \$2 billion. [redacted]

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Yugoslavia

The 1985-88 rescheduling agreement with commercial banks approved by Yugoslavia in mid-September is nearing final completion. The chairman of the International Coordinating Committee (ICC) was expected to send the formal loan

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documentation to Yugoslav officials by 5 November, [redacted]

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[redacted] Assuming Belgrade's approval, the chairman did not expect major problems when he submitted the agreement to Yugoslavia's numerous commercial bank creditors represented by the ICC during the week of 11 November. However, one issue yet to resolved involves demands of some banks for an alternative interest rate to LIBOR, with some West German banks wanting an adjusted LIBOR rate and other US banks preferring an adjusted certificate-of-deposit rate. The numerous revisions made in the proposal originally approved by Belgrade in mid-September will require reapproval by higher Yugoslav political authorities than the Ministry of Finance, [redacted]

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[redacted] Thus, signing will probably be delayed until after the first of the year.

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Western Europe

Greece

EC Finance Ministers approved a \$1.5 billion loan package to help Greece through its current balance of payments crisis, but linked the loan to the implementation of strict economic adjustment measures. The six-year loan is divided into two tranches; one to be drawn immediately and one in 12 months. The finance ministers insisted that they take part in reviewing the Greek economic package before the second tranche is disbursed. Without the funds from the EC, the Greeks would have faced serious difficulties meeting their debt payments next year. One US moneycenter bank estimates that Greece's total debt will reach \$16.4 billion by yearend 1985 and \$18.2 billion by yearend 1986. Most of this debt is in the form of long-term loans whose grace periods have begun to expire. Amortization payments on public-sector long-term debt, which accounts for 80 percent of total debt, will average more than \$1 billion a year during the second half of the decade, up from less than \$580 million paid in 1980-84. [redacted]

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In hopes of rectifying their economic ills, Prime Minister Papandreou announced a series of austerity measures last October. The international banking community, however, is expected to defer any new money loans for at least six to nine months until Athens shows the political will to implement the austerity program. [redacted]

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[redacted] Until recently, as US and European banks pulled back, Japanese lenders had taken their place. [redacted]

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Asia

Philippines

Philippine officials announced that an agreement with the IMF staff mission has been reached on Manila's performance under its \$615 million IMF standby arrangement. US Government sources indicate that the IMF Executive Board may meet on 11 December to review the staff report. Their approval would trigger the release of \$212 million in IMF balance of payments assistance. Any further delay in IMF disbursements, however, could endanger the Philippines' commercial bank new money

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[redacted]
package. Under this agreement, an "event of default" occurs if the Philippines fails to draw an IMF tranche 45 days after the negotiated schedule. Since the third tranche was scheduled to be disbursed by October 1985, the release of the remaining \$525 million in the Philippines would technically be in default after 15 December. [redacted]

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According to press reports, Prime Minister Virata said that the monetary and fiscal targets agreed to with the Fund run only through the end of December. This leaves Manila little room for maneuvering as their program runs through June 1986 and additional IMF reviews will be needed for the remaining \$208 million in disbursements. We believe that additional government spending tied to the presidential election, now scheduled for 7 February, will increase the likelihood of compliance difficulties with the end-December targets. Some observers believe Manila will finance a large part of the election by reallocating already budgeted funds, rather than relying on an increase in overall spending. [redacted]

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Africa/Middle East

South Africa

South Africa's first meeting with bank creditors last month was brief and inconclusive, [redacted] Although both sides agreed to meet again on 26 November, recent press reports indicate the debt mediator--Swiss banker Fritz Leutwiler--has postponed the second meeting until early next year. Although Pretoria has not yet made an official announcement, we believe this delay ensures South Africa will extend the current debt repayment moratorium beyond its self-imposed yearend deadline--perhaps by as long as six months, according to [redacted] US Embassy reporting. [redacted]

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[redacted] Leutwiler may have postponed talks in hope that a decline in black unrest or possible progress on reform after the South African parliament convenes in January would improve Pretoria's standing with the international financial community. [redacted]

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Meanwhile, some Western bankers may soon take a much harder line with Pretoria on linking a debt accord to progress on racial reforms. [redacted]

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[redacted] Although the plan probably is intended primarily to jolt South African officials into serious negotiations with creditors, we believe an explicit linkage between a bilateral debt agreement and progress on reform would complicate debt talks by further polarizing Pretoria and bankers and reducing both sides' negotiating flexibility. In our judgment, bank creditors probably are overestimating their leverage with Pretoria if they believe such a move will motivate more rapid racial reform. [redacted]

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FINANCIAL BRIEFS

International

- o **Cartagena Group** tentatively has scheduled a meeting of Latin American foreign and economic ministers for 15 December in Montevideo...will discuss and respond to the Baker initiative on debt. [redacted] 25X1
- o **Tin market crisis** another blow to LDCs...substantial loss of export earnings expected for Indonesia, Malaysia, Thailand...Bolivia hit hardest, facing loss of \$50-70 million in foreign exchange...banks reviewing creditworthiness of affected countries. [redacted] 25X1
- o Panama's Foreign Minister Jorge Abadia has begun to contact Latin American governments to arrange a **summit meeting on debt**...reportedly there is a "positive attitude" regarding the meeting so far. [redacted] 25X1

Americas

- o **Jamaica** unlikely to receive IMF waiver of September performance target failure...Prime Minister Seaga remains reluctant to implement price hikes, other measures deemed essential by Fund...IMF believes if standby is revised Jamaica will require more foreign assistance. [redacted] 25X1
- o **Peru** continues to limit debt service payments...most go to official lenders.. [redacted] 25X1
[redacted] 25X1
- o **Venezuela's** rescheduling remains on hold while banks negotiate over the government's proposed "contingency" clause...would permit revisions in the agreement if there are significant changes in oil revenues or interest rates... [redacted] 25X1

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Europe

- o **East Germany** does not plan to seek new syndicated loans in the near future... \$1 billion in undrawn credits remain from previous syndications... Bank for International Settlements figures show foreign exchange reserves of \$5.26 billion at mid-year, up \$771 million from three months earlier. [redacted] 25X1
- o **Portugal** negotiating with banks for reduced spreads on two 1983 loans... trying to send message that Portugal is in strong financial position with reserves of \$1.7 billion...if successful, negotiations on two more loans are likely. [redacted] 25X1

Asia

- o [redacted] 25X1
[redacted] 25X1
- o The government of **Thailand** approved an emergency law that will allow the Finance Ministry to refinance public-sector debt...put ceiling on FY86 foreign loans at \$1 billion, half the amount of pre-1984 levels.. [redacted] 25X1
[redacted] 25X1

Africa/Middle East

- o [redacted] 25X1
[redacted] ..Egyptians and IMF still at odds...officials recognize they must come to terms with the Fund before a rescheduling can occur. [redacted] 25X1
[redacted] 25X1
- o IMF approved **Mali's** third standby arrangement...provides \$24 million over 17 months...economic program includes price hikes, reform of state enterprises...Bamako likely to use drawings to make payments on previous IMF credits. [redacted] 25X1 25X1
- o [redacted]
- o **Senegal** seeking immediate Western financial assistance to save imperiled IMF program...tax shortfall and low export prices have delayed debt payments violating Fund guidelines...probably can avert immediate suspension, will face problems remaining solvent through 1986. [redacted] 25X1



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