Page Denied

Next 1 Page(s) In Document Denied

 25X1

[redacted]

Central Intelligence Agency

Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

International Financial Situation Report #59
18 December 1986

Summary

25X1

Brazil is encountering serious financial difficulties. Soaring domestic demand for goods has lowered exports, foreign investment is at a 15-year low, and capital flight has accelerated, according to US Embassy. The Sarney administration has expressed deep concern about this situation particularly about Brazil's dwindling cash reserves — [redacted] down from $7.8 billion early in the year to as low as $3-4 billion at the beginning of December. Brazil is working toward overcoming its difficulties by seeking improved relations with Paris Club official creditors. Even after obtaining a Paris Club rescheduling, we believe Brazil's financial squeeze will not ease appreciably for several months. [redacted] In other developments: 25X1

25X1

- Mexico's commercial bankers have received commitments totaling 93 percent of the $7.7 billion new money package. [redacted]

25X1

- Argentina is continuing negotiations with the IMF for a $1.55 billion combined standby arrangement/compensatory financing facility. We expect them to reach an agreement by early next year.

- Market response to the Soviet Vneshtorgbank's latest $300 million syndicated loan is sluggish, possibly resulting in embarrassment for the Soviets and indicating tha 25X1 future loans will have to be priced more attractively.

- Indonesia may be forced to "readjust" its debt payments early next year [redacted] Foreign bankers are concerned by Jakarta's 25X1 unwillingness to begin negotiations for a $3-4 billion IMF standby program.

25X1

- While Egypt continues informal talks with the Paris Club and the IMF, commercial credit continues to contract and the Central Bank is low on cash reserves. [redacted] 25X1

25X1

NOTE: REPORT #60 WILL BE PUBLISHED ON 15 JANUARY 1987

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

GI M 86-20287C

25X1

[redacted]

25X1

Copy 74 of 75

[redacted]

KEY ISSUE

Brazil: Deteriorating Financial Position

A sharp decline in Brazil's trade surplus from a monthly average of $1 billion during January-September to only slightly over $200 million in October and November threatens to draw the country into its first foreign exchange crisis since 1983. Exports receipts have slumped badly because, according to the US Embassy, soaring domestic demand has been diverting consumer goods from export markets and rumors of a major devaluation also have caused exporters to withhold sales. Moreover, foreign investment is at a 15-year low, new borrowing has virtually stopped, and capital flight has accelerated, according to the US Embassy in Brasilia. The Sarney administration has expressed deep concern about Brazil's dwindling cash reserves — [redacted] 25X1 down from $7.8 billion early in the year to as low as $3-4 billion at the beginning of December. [redacted] 25X1 25X1

So far, the government has taken only limited steps to shore up its payments position. It implemented substantial price adjustments on 21 November to dampen domestic demand but strong public protests, notably the 12 December general strike, make important follow-up measures unlikely within the next several weeks. Although Brasilia has instituted daily mini-devaluations of the Cruzado to boost exports, the US Embassy reports that the private sector is not satisfied and continues to wait for a much larger devaluation. The government has temporarily suspended import licenses through administrative delays and government foreign exchange transactions under the Central Bank [redacted] Brasilia expects to continue these practices until exports rebound. [redacted] 25X1

Brazil also is working toward overcoming its debt difficulties by seeking improved relations with Paris Club official creditors. [redacted] 25X1 A successful resolution of the Paris Club issue would pave the way for a reopening of OECD government export credits necessary to ease cash stringencies. It would also pave the way for resumption of negotiations with commercial bank creditors. [redacted] 25X1

Despite reconciliation with official creditors, we believe that Brazil's financial squeeze will not ease appreciably for several months. [redacted] 25X1

 [redacted] 25X1

[redacted] 25X1

Brazil's financial problems and the prospect of possible arrearages almost certainly will make negotiations early next year with creditor banks for a multiyear debt rescheduling agreement more difficult and contentious. [redacted] 25X1 [redacted] 25X1 the Sarney administration probably will feel compelled by domestic political pressures to demand lower interest spreads and better repayment terms than those recently won by Mexico because Brazil has a better economic performance and debt repayment record. Indeed, the press reported that Finance Minister Funaro stressed in a recent address in New York that Brazil henceforth will have to service its debt at much lower cost, signaling a tougher Brazilian negotiating stand. [redacted] 25X1 We believe that an unyielding hardline stance by bankers has the potential to erupt into outright confrontation, leading the Brazilians to opt for a moratorium on debt repayments next year. [redacted] 25X1

[redacted] 25X1

DEVELOPMENTS IN MAJOR COUNTRIES

Mexico

Commitments from international bankers so far represent 93 percent of the $7.7 billion commercial loan package and Mexico City expects it will take until January to complete the deal. [redacted] 25X1

Mexican negotiators expect to reach a preliminary agreement soon with international bankers on terms for restructuring $11.7 billion in private-sector debt covered by the government foreign exchange risk program (FICORCA). Without the rescheduling, a number of firms included in the plan probably could not continue making principal repayments presently set to rise from $200 million this year to $3 billion in 1987. [redacted] 25X1 Most of the major banks probably will agree to rescheduling payments, but smaller banks may decide to write off loans or swap debt for equity. Bankers are likely to resist Mexican proposals requiring them to lend repayments to private enterprises or deposit the funds in an account at the Bank of Mexico given their gloomy assessment of Mexico's economic prospects. [redacted] 25X1

Argentina

Negotiations continue between Argentina and the IMF for a $1.55 billion combined standby arrangement/compensatory financing facility. [redacted] 25X1 IMF officials are concerned about a large public-sector wage hike, the declining trade balance, and Buenos Aires' insistence on increased public investment and continued GDP growth to boost the ruling Radical party's prospects for winning the November 1987 gubernatorial and congressional elections. The gap between the parallel and official exchange rates widened 5.6 percent one day last week to more than 30 percent, in part

[redacted] 25X1

 [redacted] 25X1

because of market anxiety over the discussions, according to the US Embassy. Negotiators are in frequent contact, however, and we expect them to reach an agreement by early next year. President Alfonsin's recently unveiled public-sector reform initiatives almost surely were designed to demonstrate to the IMF that Argentina is ready to address some of the underlying causes of its fiscal deficit. The reform includes the creation of a holding company for major state-owned enterprises—headed by a senior private-sector executive—to speed the introduction of efficiency-enhancing measures, and a cutback in executive-branch employment through a voluntary retirement program. [redacted] 25X1

Argentine and Dutch negotiators have reached a preliminary agreement on resolving a bilateral debt associated with a Dutch-built pipeline, according to the US Embassy. Under the agreement, the Dutch company Cogasco will transfer ownership of the pipeline to the Argentine state gas company. In return, Buenos Aires will cancel Cogasco's debt and compensate the company for future earnings through the balance of the original contract period. The Dutch will finance the bulk of the $1.1 billion package deal, the US Embassy reports. An agreement would clear a longstanding stumbingblock to Paris Club rescheduling of Argentine 1986-87 bilateral debt. [redacted] 25X1

Latin America

In Latin America, Venezuela and its creditor banks are grappling with how to reschedule the debtor's private-sector debts, while Ecuador's IMF disbursement has been delayed, but Panama and the World Bank have reached a compromise, making a $50 million disbursement possible this year. [redacted] 25X1

Venezuela

President Lusinchi's efforts to achieve consensus before making difficult economic policy decisions helped delay his promised "turn of the rudder" by one month. When he announced his economic adjustments on 6 December, he tacitly admitted that his government still had not arrived at a comprehensive set of measures. The adjustments so far, including a major devaluation, pave the way for tighter foreign exchange controls. Lusinchi also announced minor financial incentives for certain sectors of basic industry. To make the economic package palatable, he retained price controls on basic consumer goods and granted a 25-percent increase in the minimum wage to organized labor. [redacted] 25X1
[redacted] 25X1

The new plan to handle the private-sector debt calls for $5.5 billion of the $7.8 billion private-sector debt to be repaid within eight and a half years. [redacted] 25X1

Although the new private-sector debt scheme has been imposed rather than negotiated with foreign creditors, the US Embassy reports representatives of US banks in Caracas think the scheme will be acceptable to most foreign creditors. Local businessmen, however, have reacted negatively to the scheme. According to press and Embassy reports, they fear that the increased costs will bankrupt some companies. In addition, they anticipate debt servicing disruptions and uncertainty in the short term. [redacted] 25X1
[redacted] 25X1

[redacted] 25X1

[redacted] 25X1

Ecuador

The IMF has delayed disbursement of an $18 million tranche to Ecuador, thus adding to current economic concerns caused by low oil revenues. According to US Embassy reporting, Ecuador has failed to meet its standby targets on international reserves and domestic credit, and has increased government spending to twice the level specified in the August agreement. The increase in government expenditures will raise the public-sector deficit to 5 percent of the GDP this year, according to IMF estimates, substantially over the target of 2.5 percent. Government officials have been meeting this month with IMF representatives to discuss target revisions that will allow disbursement of funds under the accord, but a rescheduling is unlikely before the end of 1986, according to the US Embassy. [redacted] 25X1

Meanwhile, Ecuador has announced plans to seek a rescheduling of $5 billion in foreign commercial bank debt early next year, in response to growing external obligations. [redacted] In addition, the 25X1 Central Bank has approved debt-equity swaps as a mechanism to reduce as much as $1.3 billion in private-sector foreign debt assumed by the government in 1983. According to US Embassy reporting, the debt-equity swaps have the advantage of reducing Ecuador's debt service at no cost to the government and may facilitate privatization of state enterprises. [redacted] 25X1

Panama

The World Bank and Panama have reached a compromise that allows a disbursement of half of the $100 million second structural adjustment loan (SAL), even though the reform of the politically sensitive social security reform system will not be passed this year. According to the US Embassy, the World Bank is pleased with the progress Panama made earlier this year on economic adjustments, and has agreed to disburse the $50 million first tranche based largely on Panama's demonstration of "good will" to move ahead on social security reforms. But the expected prompt cabinet approval of the legislation, unveiled 25 November, was delayed when the major political parties and the social security board of directors rejected the package outright. These groups — as well as Defense Chief Noriega — apparently have become concerned the prospect of heavy criticism from business, professional, and labor groups. [redacted] 25X1

USSR

USSR

Following its October market entry, final syndication of Vneshtorgbank's $300 million loan was announced, with almost exclusively European banks participating. [redacted] 25X1 According to US Embassy reporting, Western bankers have indicated that Banque Nationale de Paris is having trouble selling down the loan reflecting extremely low interest rate spread of 0.125 of a percentage point above LIBOR and the current saturation of the secondary market. Although these problems are of a technical

[redacted] 25X1

 [redacted] 25X1

nature, the reluctance of banks to participate could be embarassing for the Soviets and may mean that future loans will have to be priced more attractively. [redacted] 25X1

In the future, the Soviet Union can be expected to broaden the scope of financial instruments it employs. By diversifying its sources and methods of borrowing, Moscow can expect to gain flexibility and leverage in international markets and reduce the costs of borrowing. [redacted] 25X1 To venture into the bond or instrument market, however, Moscow must be willing to forego control over ownership of its obligations — something it has not been willing to do in the past. Moreover, the Soviets will need to develop the market sophistication necessary to trade successfully in these instruments. [redacted] 25X1

Asia

Among Asian countries, Indonesia may be forced to "readjust" its debt payments early next year, Malaysia's banking system is feared to be moving toward insolvency, and the Philippines is scheduled to resume negotiations with commercial banks in January. [redacted] 25X1 25X1

Indonesia

While the government publicly denys rumors that Jakarta will reschedule its external debt [redacted] Indonesia may be forced to "readjust" its debt after the first quarter 1987 [redacted] 25X1 Meanwhile, Indonesia will draw down another $1 billion on existing commercial lines of credit, dip into its $10 billion in foreign reserves, and seek $2 billion or more from the World Bank and the Japanese Exim Bank to meet its 1987 net financing requirements — estimated at $4 billion by one international bank. The Indonesians may also seek a compensatory financing facility from the IMF [redacted] 25X1

Nevertheless, foreign creditors are concerned by Jakarta's reluctance to begin negotiations for a $3-4 billion IMF standby program. [redacted] 25X1 The market for Indonesian debt is growing rapidly as Western banks become increasingly concerned about Jakarta's financial outlook. Loans currently being swapped for 83-85 cents on the dollar, for example, could soon be trading at 70-75 cents per dollar according to a reliable source. [redacted] 25X1

Malaysia

Malaysia's foreign bank creditors believe that without swift government intervention, a number of major Malaysian banks could become insolvent by mid-1987. By the end of the first quarter 1987, for example, [redacted] 25X1 25X1 no principal or interest will have been paid in 18 months on over 25 percent of Malaysian bank loans. These loans were made primarily to exporting companies, which have been hard hit by low oil and other commodity prices. [redacted] 25X1

[redacted] 25X1

[redacted] 25X1 the government does not appear serious in its efforts to reduce the government budget deficit and to devalue the ringgit. Instead, Mahathir's financial advisors appear to be hoping for a rebound in commodity prices to bolster the economy in 1987. For their part, many international banks — which expect export revenues to decline 5 to 10 percent in 1987 — may consider decreasing their loan exposure next year. On the other hand, Japanese banks probably will remain involved in Malaysia as part of their loan efforts in the Pacific rim, despite their concern over the financial outlook. [redacted] 25X1

Philippines

The Philippines' bank advisory committee (BAC) met on 11 December to hammer out an agreed position. The BAC members now believe they have narrowed their differences on a negotiating stance sufficiently to resume talks with Philippine officials. According to press reports, the BAC members have granted Manila a three-month moratorium on debts that mature starting 1 January, and agreed to extend the $3 billion revolving trade facility — originally due to expire at the end of the year — for six months. In what Philippine officials view as a significant step, the moratorium contains a clause stipulating that the final terms will be retroactive to 1 January 1987. Formal negotiations with Philippine officials could begin in early January. The Philippines is also scheduled to begin negotiations with its Paris Club creditors in January. [redacted] 25X1

Middle East

In the Middle East, Egypt continues informal talks with the Paris Club and the IMF and Morocco's $1.5 billion rescheduling package is nearly complete. [redacted] 25X1

Egypt

Egyptian officials appear satisfied with the support they received from key IMF executive directors at a 4 December Fund discussion of the country's economic reform program, according to [redacted] US Embassy reports. 25X1 Cairo may be underestimating the distance that remains before Fund approval of a standby arrangement, however. Cairo believes that the support voiced at the meeting indicated IMF acceptance of its reform measures as the most that is politically possible for Egypt, setting the stage for speedy Fund agreement on a standby arrangement. Critical elements of the standby negotiations — including agreement on economic performance criteria — are still ahead, however, and the details of exchange rate unification and interest rate hikes, each a potential sticking point, remain to be worked out. Meanwhile, informal talks on Cairo's problems continue with a Paris Club discussion with IMF officials tomorrow of Egypt's financial situation, and a meeting of key IMF Executive Directors will take up the subject next week. [redacted] 25X1

Meanwhile, [redacted] US Embassy contacts report the Egyptian central 25X1 bank is essentially broke, and the Fund believes that Cairo — prior to the Kuwaiti aid — had only enough cash available to fund critical imports and debt payments through March. Commercial credit is continuing to contract, according to the US Embassy [redacted] 25X1 At the same time,

[redacted] 25X1

although European countries' export credit agencies officially remain on cover for Egypt, our Embassy reports almost all of them have gone off cover unofficially. [redacted] 25X1

Morocco

Morocco and its commercial bank advisory committee reached agreement in principle last week on a $1.5 billion debt rescheduling package. [redacted] both sides settled on a rate of 1.19 points above LIBOR, for most of the debts, but Rabat will pay 1.63 points above LIBOR on debts that had been rescheduled once before. The rescheduling terms will now be telexed to all of Morocco's bank creditors for approval. With agreement in principle reached on the bank rescheduling, the IMF this week approved a $275 million standby arrangement for Morocco. [redacted] 25X1

Africa

Nigeria

The IMF last week approved in principle for 30 days a $790 million standby agreement for Nigeria, according to US officials. President Babangida has claimed, however, that Lagos will not actually draw the money available under the standby because of domestic opposition. Final approval remains pending until a "critical mass" of Nigeria's commercial lenders — probably 90 percent — agree to participate in the $4 billion debt rescheduling and $320 million new money package approved to by the London Club steering committee last month. More than half of the banks reportedly have signed on already, but the process may not conclude before yearend. The US Embassy reports that the Paris Club of official creditors concluded a debt rescheduling this week, which will become effective upon final approval of the IMF accord. Meanwhile, the World Bank last month provided its first disbursement from a $450 million loan to help fund Nigeria's second-tier foreign exchange market. [redacted] 25X1

[redacted] 25X1

 [redacted] 25X1

FINANCIAL BRIEFS

International

An **African Development Bank** (AFDB) committee reached agreement on terms and conditions for a 200 percent ($9 billion) fourth general capital increase (GCI) covering the period 1987-91. . . to deal with the chronic problem of subscription arrears, voting power will now be tied to paid-in capital. . . AFDB executive board will consider the GCI proposal 18 December. [redacted] 25X1

Thirty-one donor countries agreed to a $12.4 billion replenishment of the **International Development Association.** . . Japan's shareholding in World Bank will increase by 1.5 percent; Italy and the Netherlands by 0.32 percent as part of the agreement. . . sub-Saharan Africa slated to receive 45 to 50 percent of future IDA loans. [redacted] 25X1

[redacted] 25X1

Paris Club official creditors scheduled to meet during week of 19 January. . . countries tentatively on agenda include Zambia, Morocco, Gabon, the Philippines, and possibly Brazil and Poland. [redacted] 25X1

Americas

Bolivia has fully complied with the targets of its IMF standby agreement. . . its fiscal deficit this year will probably be 3.7 percent of GDP, compared with 14 percent in 1985. . . Fund officials predict that Bolivia will qualify for a $60 million compensatory financing facility in 1987 in addition to the $40 million it is already scheduled to receive later this year. [redacted] 25X1

Colombia seeking $400 million in rural development loans from World Bank to undercut insurgency. . . recently received $171 million from World Bank for electric power system, wants additional $800 million from Inter-American Development Bank and commercial banks for same project. [redacted] 25X1

Cuba missed 30 November deadline for payments due under 1986 Paris Club agreement. . . not likely to pay soon. . . banks again refused Havana's request for $350 million to settle overdue short-term commercial debts, countering with an offer of about $65 million to cover interest due in 1986. [redacted] 25X1

World Bank and IMF Boards agreed that **Dominica** would be the test case for the new joint Structural Adjustment Facility. . . approved the first year of the three-year program in late November. . . makes nearly $1 million of a total $2.25 million loan available for immediate disbursement. [redacted] 25X1

[redacted] 25X1

[redacted] 25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/06/22 : CIA-RDP86T01017R000808260001-6

 25X1

Jamaican Prime Minister Seaga and IMF Managing Director de Larosiere reportedly have reached an agreement in principle on standby program. . . Fund staff currently trying to negotiate exact program details. . . stumbling blocks remain arrears, calls for devaluation, government spending. 25X1

Nicaragua establishing a national foreign trade bank. . . responding to complaints of trading partners that Central Bank actions make it difficult to conduct normal trading relations. . . hope to increase exports to Western Europe by streamlining financial bureaucracy. 25X1

Peru has tinkered with exchange rates to counter falling reserves and weak exports . . . more export and import transactions shifted from official rate to a 25 percent higher financial rate. . . both exchange rates will be devalued 2.2 percent monthly beginning in January, not fast enough to compensate for inflation. 25X1

25X1

Europe

The Paris Club may meet with Polish officials this week if **Poland** comes up with about $300 million in payment arrears. . . Warsaw claims payment difficulties because of expected 1986 trade surplus of only about $1 billion—$500 million less than planned. . . banks unlikely to offer new money due to poor economic prospects. 25X1

Hungary arranging $200 million loan to help cover current account deficit of $1 billion expected for 1986. . . priced at 0.25 of a percentage point over LIBOR for 8 years. . . Japanese appetite for Hungarian paper may have bid down price. . . US banks not likely to show much interest because of Hungary's worsening external payments situation. 25X1

Asia

Government of **Brunei** has closed the National Bank of Brunei and arrested bank chairman Khoo. . . government alleges 90 percent of loans went to Khoo's family interests. 25X1

Africa

25X1

Some **Zambian** politicians blaming IMF for riots last week. . . 15 killed in unrest following doubling of staple food prices recommended by the IMF, IBRD, and AID. . . President Kaunda retracted prices hikes reluctantly, remains in favor of economic reform, according to US Embassy. . . disbursements from Lusaka's $275 million Fund standby have been halted since July because of missed targets and arrears to the Fund. 25X1

25X1

SUBJECT: International Financial Situation Report #59 [redacted] 18 December 1986 25X1

Copy No.
1 Sec. James Baker Treasury
2 R. G. Darman "
3 James W. Conrow "
4 Robert Cornell "
5 Thomas J. Berger "
6 Charles Schotta "
7 James A. Griffin "
8 Doug Mulholland "
9 Robert M. Kimmit "
10 David Mulford "
11 Sec. George Shultz State
12 John C. Whitehead "
13 Morton I. Abramowitz "
14 Jerome H. Kahan "
15 Michael Armacost "
16 Ralph Lindstrom "
17 W. Allen Wallis "
18 Elliot Abrams "
19 Rozanne Ridgway "
20 Douglas McMinn "
21 Chester Crocker "
22 Gaston Sigur "
23 Richard Murphy "
24 Harry Gilmore "
25 Byron Jackson Commerce
26 S. Bruce Smart "
27 [redacted] NSA
28 "
29 Steve Farrar NSC
30 Stephen Danzansky "
31 Randall Fort PFIAB
32 Leo Cherne PFIAB
33 David Tarbell OSD (ISA)
34 DCI
35 ExDir
36 SA/DDCI
37 DDI
38 ADDI
39 Ch/PES/DDI
40 NIO Economics
41 ADD/NIC AG
42 DDO
43 Ch/DDO/EPDS
[redacted]
45 Ch/DDO/AF
46 Ch/DDO/EA
47 Ch/DDO/EUR
48 Ch/DDO/LA
49 Ch/DDO/NE
50 Ch/DDO/SE
51 D/ALA
52 Ch/ALA/SAD
53 D/OEA
54 D/EURA
55 Ch/EURA/EE/EW
56 D/SOVA
57 D/NESA
58 DD/OGI, D/OGI
59 Ch/OGI/SRD
60 Ch/OGI/FSIC
61 Ch/OGI/ECD
62-63 Ch/OGI/ECD/FI
64 [redacted] OGI/CO 25X1
65 CPAS/ISS/SA/DA
66 Ch/OGI/Pub [redacted] 25X1
67-69 OGI/Pub
70-75 CPAS/IMC/CB Destroyed #75 12/18/86

[redacted] 25X1

1 - H. Robert Heller, Federal Reserve Board
1 - Edwin Truman, Federal Reserve Boar 25X1
1 - David Roberts, Federal Reserve, New York
1 - Leo Cherne, PFIAB, New York
1 - E. Gerald Corrigan, President, Federal Reserve Bank, New York
1 - John Bohn, Chairman, ExIm Bank
2 - Doug Mulholland, Treasury
1 - Ambassador Richard McCormack, State
1 - Martin A. Wenick, State
1 - Nicholas Burakow, State
1 - Peter W. Rodman, State
5 - Byron Jackson, Commerce
1 - Warren E. Farb, Commerce
1 - [redacted] DIA 25X1
1 - Ron Silverman, OMB
1 - Beryl Sprinkel, CEA
1 - Eugene McAllister, EPC 25X1
[redacted] 25X1
1 - Ch/ECD
1- Ch/ECD/IF
1 - Ch/ECD/T
1 - Ch/ECD/DI
1 - Ch/ECD/ES
1 - Ch/ISID/FI