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Treasury Chambers, Parliament Street, SW1P 3AG
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9 April 1985

MF

Andrew Turnbull Esq
10 Downing Street
LONDON SW1

Prime Minister

The summary in the first 9 pages of this report are worth glancing at

AT 12/4

Dear Andrew,

... I enclose the latest assessment of developments on the international financial scene which has been discussed in the Treasury's International Debt Group.

The report will provide useful background briefing for the forthcoming series of international economic meetings. The overall picture is slightly more pessimistic than in previous reports. This reflects the continuing uncertainty and fragility of the present position, both in relation to the domestic economic problems of the major debtors and to the US economy and the threat of protectionism there. However, current policies, and in particular the case by case approach, should be sustained in the forthcoming meetings eg the Interim/Development Committee meetings in Washington. There may be problems thereafter and we shall be looking further at these.

Our main worry is the major debtors, notably Brazil and Argentina, whose IMF programmes have broken down. Despite the uncertainties created by Neves' serious illness, the economic team in Brazil seem intent on pressing ahead with discussions with the IMF and the commercial banks with the aim of an early reinstatement of the programme. The timetable on Argentina may be slower. The Argentine Government has told the French Tresor that it will not be ready for bilateral Paris Club negotiations with them or the UK which had been suggested for later this week.

Elsewhere the prospect is mixed, with some encouraging developments. But in two countries there is a risk of default. One is Poland, which probably cannot service its debt to Western Governments without substantial new credits. These seem unlikely to be available and would only compound the problem. We are assessing the risk and possible consequences; but it is of course relevant to the Foreign Secretary's forthcoming visit to Poland (and reflected in his briefing). The other is Peru, where a change of government later this year seems likely to bring to power an opposition committed to seek a reduction of the debt burden with or without the agreement of creditors. In this case the UK's exposure - banking and ECGD - is fairly small; but the possible implications for Latin American debt generally will need careful watching.

I am copying this letter to Len Appleyard (FCO), John Mogg (DTI) and John Bartlett (BOE).

Yours ever
Rachel.

MRS R LOMAX
Principal Private Secretary

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INTERNATIONAL FINANCIAL SCENE

General perceptions of the debt situation seem to have become somewhat more gloomy since the last report, with a number of developments in both creditor and debtor countries serving to underline the fragility of the success that has so far been achieved. Attention will now shift to the Interim/Development Committee meetings in Washington on April 17/19. The risk is that, whatever expectations debtors may have formed about these meetings, they may use what they would claim as inadequate results to justify their adopting a less moderate stance than they have done so far. In addition, Latin American debtors may decide to issue their invitation to the Summit 7 to participate in a "political dialogue" on debt.

Developments in the United States over much of the recent period have in general not been encouraging for LDC debtor countries. Growth in the US seems to have, at least temporarily, slowed significantly: the 'flash' estimate for GNP growth in the first quarter of 1985 was only 0.5% (2.1% at an annual rate), half the rate of the previous quarter. Over the past few weeks US interest rates have edged upwards; the three-month eurodollar rate has moved from 9% to 9 1/4%. Despite the temporary success of the concerted intervention of non-US central banks and the statements by Volcker and others that the currency was overvalued, the dollar continued to rise for much of the period. With the current account deficit exceeding $100 bn in 1984 (the principal counterpart to the substantial improvement in the external postion of many debtor countries over the past year) and expected to rise further this year, fears have grown that if the dollar does not fall substantially the US may introduce major new protectionist measures as a response to a general feeling that their external sector is out of control. In the last two weeks the partial reversal of the dollar's earlier appreciation will have brought some relief to the debtors as some two-thirds of developing countries' external debt is denominated in dollars (although the total benefit to debtors of the dollar's fall will be reduced because of its effect on trade). The immediate impetus to the dollar decline - ie, the run on a number of savings institutions in Ohio - will have done nothing to reassure market sentiment about the condition of US financial institutions more generally. And, with inflation edging up in the United States and elsewhere, earlier limited terms of trade gains for the debtors could well be reversed.

At the same time, with greater attention being paid to internal developments in the debtors, more sombre appraisals have been made of the adequacy of the adjustment they have undertaken so far. Whilst debtors' external performance over the last couple of years has in a number of cases been spectacular, success in meeting internal targets has in general been much less. All the major Latin American countries have, for instance, consistently overshot their inflation targets. Concerns over these failures were highlighted dramatically in February when the IMF suspended new lending to Brazil because of Brazil's excessive monetary growth. Although the Fund had until then repeatedly accepted reformulations of its programmes as internal targets failed to be achieved, on this occasion they were firm that there could be no waiver.

Negotiations over reschedulings seem to be progressing slowly, perhaps partly because of the tendency recently for debtor countries to seek some form of banks' MYRA, with all the additional complications - over eligibility, comparability, conditionality and general technical difficulty - that these entail. The signing of the banks' MYRA for Mexico at the end of March, almost eight months after the initial agreement with the Advisory Group, will have been the first for a major debtor. No further signings of banks' MYRAs for major debtors can now be expected before mid-year. And no discussions on official MYRAs are at present in progress for any debtor.

On the positive side, a number of countries have reached agreement with the Fund, and a number of conventional rescheduling packages have been put in place. Technical questions, such as the mechanics of currency conversion, seem to have found a solution. A number of governments have recently introduced additional fiscal measures in order to bring their countries' economic performance closer to their internal targets, and have accepted further real currency depreciation in order to improve their external positions. The continuing weakness of the oil price (whilst having an adverse effect on Mexico, Venezuela, and a few others - who perhaps are in general better able than others to withstand some reduction in their export revenues) will have benefitted the majority of debtors.

Little has been heard recently of the "Cartagena Consensus" or other regional groupings of debtors. As noted in the last report, the meeting of the Cartagena Consensus countries in Santo Domingo in February drew lower levels of representation than earlier meetings of the Group, and a generally moderate stance was endorsed. The Interim/Development Committees meetings on 17-19 April will be crucial for assessing whether this present moderate stance will persist.

POSITION IN THE MAJOR DEBTOR COUNTRIES

(i) Latin America

804% inflation

Following Argentina's apparent failure to satisfy several of the performance criteria of its IMF programme during the final quarter of 1984, and de Larosiere's refusal to grant a waiver to allow the first additional tranche of the Standby to be drawn down, the new Argentine Economy and Finance Minister, Juan Sourrouille, has committed himself to bringing the programme back on course. He has already begun discussions with the IMF on ways of doing so, but has stated that the inflation targets in the programme are unattainable: indeed, with prices having risen by 804% in the twelve months to end-February, the aim of reducing the annual inflation rate to 150% in the final quarter of 1985 appears quite unrealistic, and the higher level of inflation will itself prevent achievement of other targets expressed in terms of Argentine pesos. Given the difficulties with the IMF programme, signature of the commercial banks' $4.2 bn loan agreement, scheduled for 29 March, has been postponed. The banks' Working Committee has sent a telex to the banking community informing them of recent developments, included in which was a supportive message from de Larosiere asking the banks to maintain their commitments to the package. Commitments had reached a total of $4.15 bn. Meanwhile, a Fund team has returned to Argentina. The UK's bilateral negotiations with Argentina under the Paris Club agreement were expected to begin on 11-12 April. The Argentines have not yet confirmed these dates to the French Trésor, who are to provide the venue for the meeting. In view of Argentina's difficulties with the IMF it is our intention to proceed with the bilateral discussions but to hold up completion and signature until a revised Argentine IMF programme has been approved by the Fund Board. The breakdown of the IMF programme and the resultant delays in finalising agreements with the banks and official creditors have led to demands by Argentina for bridging finance from the US Treasury and friendly governments, notably Mexico. So far, these requests have not produced results. However, it is possible that the most exposed US banks might be receptive if a request were made for commercial bank bridge finance to prevent interest arrears going beyond 180 days (in which case the US regulators might require them to make some provisions against Argentine exposure).

In Brazil, the new civilian government of Tancredo Neves (inaugurated on 15 March) inherits a difficult situation, not least because Tancredo himself has been unable to assume office owing to a serious illness which has necessitated three major operations. Vice President Sarney is temporarily in charge. As regards economic policy, early indications are that the new economic team are aware of the need for a major tightening of policy; they have already announced a three-month freeze on spending on new projects and a 10% reduction in expenditure by ministries and Federal institutions. Discussions will take place shortly between the new government and the IMF on reinstating the EFF programme, but the IMF Board will probably not see the results of these discussions until May. In the meantime, the Advisory Committee of banks has suspended discussions over Brazil's MYRA and has recommended to the banks an extension of trade credits ($10 bn) and interbank lines ($6 bn) to 31 May. The extension was supported by de Larosiere and has been accepted by the banks with a few minor exceptions. If the programme is not re-instated by the end of May, banks will have to decide whether to extend these deadlines.

There was somewhat better news in Mexico. After seven months of negotiations, the first phase of the banks' MYRA for Mexico - covering $23.6 bn of previously rescheduled debt and $5 bn of 1983 new money - was signed in New York on 29 March. Mexico has agreed in principle a Letter of Intent with the IMF covering the third year of its adjustment programme.

In the case of the other major Latin American debtor, Venezuela, an agreement with the Advisory Committee on the terms of a MYRA is expected in the near future. However, some banks are known to be unwilling to finalise terms until the whole of Venezuela's private sector debt has been registered; Venezuela and the Advisory Committee will discuss progress on this later this month. The 'roadshow' scheduled for April is now unlikely to take place before mid-year.

Chile has reached a provisional agreement with the IMF on a three-year EFF for around $750 mn. In view of the extensive damage caused by a major earthquake early in March, IMF officials are reported to have agreed to a public sector deficit target of 3.5% of GDP compared with an original target of 3%. Negotiations with the banks begin this week on the rescheduling of 1985 maturities and on Chile's request for some $1.1 bn of new money for 1985. Colombia is still holding out against an IMF programme. The IMF has agreed to give the commercial banks an account of the findings of its recent Article IV consultation, and the Colombian authorities hope that when these are made known, the banks will be prepared to put up $550 mn of new money in 1985 without an IMF programme. It is noteworthy that banks have responded well to an $80 mn IADB complementary credit (ie co-financing) for a Colombian power project. A one-year SDR 105.5 mn Standby programme for Ecuador was agreed by the IMF

Board on 13 March. This followed commitment of a critical mass by commercial banks to the $200 mn new money element of Ecuador's debt package. Having already reached agreement with the banks' Steering Committee on the broad outline of a 5-year MYRA, Ecuador has asked the banks for a 90-day extension of the moratorium on debt principal repayments to permit breathing space for further negotiations. The Paris Club is to discuss at the end of April Ecuador's request for a 5-year official MYRA covering 85% of interest and principal. Although there is official reluctance to agreeing a MYRA of this length, it should be possible to agree on something shorter. No significant progress with the IMF or commercial banks is likely in Peru until after the April/May elections; the banks will probably continue to roll over maturities on condition that further efforts are made by Peru to bring interest arrears below 180 days.

(ii) Far East

The signing of the rescheduling/new money package agreed by the Advisory Committee of banks for the Philippines has been delayed following the decision of one of the more sizeable creditors not to participate in the agreement. The package (together with those reached with official creditors) may also be jeopardised by a failure to observe performance criteria set as a condition of the SDRs 615 mn Standby Arrangement; an IMF team is currently in the Philippines for the programme's first review.

Elsewhere in the region, Korea's export performance so far this year has been disappointing. As a result, the country's current account deficit for the first two months of 1985 amounted to almost $600 mn, compared with $400 mn for the same period last year and an official target for 1985 as a whole of $500-700 mn. Although timely action has been taken to curb imports, the official target now looks unattainable. Despite this, and the recent failure of the Kukje Corporation (the country's sixth largest conglomerate), syndication of a $600 mn eurocredit for Korea Exchange Bank on similar terms to those achieved last year has proceeded smoothly.

(iii) Eastern Europe

Because of the failure of some creditors to receive the full 30% downpayment of arrears arising under the 1981 Agreement, the Paris Club did not discuss rescheduling Poland's 1985 maturities and interest payments during its meeting of 5 and 6 March. The agreement in principle to reschedule 1982-84 indebtedness may be in difficulty: official creditors now want it to be signed and operating before they offer any new credit (which is likely to be minimal), while the Poles want to be assured of new credit before they sign. A further meeting is scheduled for 26 April. Yugoslavia has agreed the Letter of Intent for a new IMF Standby programme, which will be submitted to the Board on 26 April. The official creditors initialled a debt-restructuring agreement in Paris on 26 March covering the period 1 January 1985 to 15 May 1986. A further meeting with the commercial banks is scheduled for 11 April in New York when it is hoped that a compromise agreement rescheduling 1985-88 maturities can be reached.

Commercial banks continue to show renewed interest in lending elsewhere in Eastern Europe. The $150 mn credit for the GDR was heavily oversubscribed and finally increased to $500 mn. The Soviet Foreign Trade Bank is currently raising through LBI a £75 mn seven-year credit, believed to be its first syndicated sterling credit, at Libor + 1/4% for three years rising to 3/8% for the balance. These are the same terms as for the recent operation which was finally doubled to Ecu 100 mn. Hungary is expected to approach the banks for a $400 mn co-financing loan in April and will reportedly be seeking better terms than for its borrowings last year (Libor + 1%). This loan may be the last co-financing for Hungary to be considered by the IBRD.

(iv) Southern Europe

Although Portugal is not to seek a new IMF Standby Agreement, a staff paper on the experience of the last Standby, which expired in February, as well as on recent developments, will give an opportunity of assessing the situation in advance of the routine consultations later in the year.

(v) Africa

The terms of the $1.5 bn commercial bank rescheduling package for Morocco, outlined in the last Report, have been accepted by two thirds of the 200 banks involved. The Nigerian government shows no sign of rapprochement with the IMF on the key elements of a Fund programme. A further small issue of notes to uninsured creditors has, however, taken place, and back interest to 1 January 1984 paid. But no interest payments appear to have been made yet on insured arrears, though this may merely reflect an administrative muddle.

A further IMF mission has been despatched to Sudan to encourage the government to clear up arrears so as to move towards the eventual normalisation of relations with the Fund. The steering committee of the commercial banks has endorsed further rescheduling proposals.

Heavy current account deficits in the early 1980s led to a sharp rise in the level of South Africa's external debt - almost all of it short-term. The continuing need to roll over this debt is a focus of attention. Following the sharp depreciation in the rand last summer the authorities introduced an austerity package. Initially the burden of adjustment fell almost entirely on monetary policy, but fiscal policy has now been tightened following the recent budget measures.

(vi) Other

The IMF have so far failed to reach agreement with Turkey on terms for a new Standby programme. Although the Turks are expected to revise the presentation of their current-account data in a way that is likely to show the deficit in 1984 at around $1.5 bn, the outturn on the old basis is unlikely to show any improvement on the 1983 deficit level of $2.2 bn.

While the Israeli budget for 1985/86 has passed its first hurdle in the Knesset, the price, wage and tax agreement reached in February is in danger, with both trade unions and manufacturers threatening to withdraw. The US State Department have made clear their wish to see more determined action by the Israeli Government (particularly over budget cuts), but pressure from Congress may well lead to the Israelis' request for supplementary economic aid being granted.

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INDEBTEDNESS AND BRITISH EXPOSURE $ billion

	Total external debt	British-owned banks' exposure[1]	ECGD amounts at risk	
	End-Dec 1984	End-June 1984	End-Dec 1984 [2]	End-Dec 1984 [3]
Latin America				
Argentina	48	2.5	0.2	0.3
Brazil	100	6.6 (0.5)	0.7	1.7
Chile	19	1.3	-	0.1
Colombia	12	0.7	-	0.2
Ecuador	7	0.6	0.1	0.1
Mexico	95	6.2 (0.6)	0.5	1.2
Peru	14	0.4	0.1	0.1
Venezuela	35	2.3	-	-
Eastern Europe (convertible currency)				
East Germany	13	0.6	0.1	0.1
Hungary	8.5	0.5	-	0.1
Poland	27	0.5	1.0	1.1
Romania	8	0.3	0.2	0.4
Yugoslavia	19	0.9	0.7	1.1
Southern Europe				
Greece	12	1.5	0.2	0.4
Portugal	15	1.3	0.2	0.3
Spain	41**	2.8 (1.0)	0.1	0.1
Far East				
Indonesia	35	0.9	0.7	1.4
Philippines	26	1.3	0.2	0.2
South Korea	43	2.7 (0.7)	0.4	0.7
Africa				
Morocco	13*	0.1	0.1	0.2
Nigeria	21*	1.2	1.5	3.0
South Africa	24	4.9	0.8	2.9
Sudan	8*	-	0.1	0.2
Other				
Israel	30**	0.6	0.1	0.1
Turkey	20	0.3	0.2	0.3

[1] This column now shows exposure defined as consolidated external claims, adjusted for certain inward and outward risk transfers in respect of guaranteed loans, plus any net claims on local residents in local currency.

[2] Defined as unrescheduled principal disbursed, plus political claims paid and claims under examination.

[3] Defined as guaranteed principal and contractual interest, plus political claims paid and claims under examination.

* Estimates for end-December 1984 ** End-June 1984

Amounts in brackets represent undisbursed commitments where these exceed $1/2 bn.

Throughout the following notes on individual countries, "exposure" is defined as consolidated gross external claims, adjusted for certain inward and outward risk transfers in respect of guaranteed loans, plus any net claims on local residents in local currency. ECGD amounts at risk exclude claims paid (net of recoveries).

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ARGENTINA

Total external indebtedness was estimated at $48 bn at end-1984.

Although details are not yet available, it is now apparent that Argentina breached several of the performance criteria of its IMF programme during the final quarter of 1984. Both its fiscal and monetary targets were probably exceeded, and the Managing Director of the IMF was not prepared to grant a waiver to permit the first conditional drawing on the Standby to be made. The new Economy and Finance Minister, Juan Sourrouille, whilst confirming his commitment to restrictive demand policies, has stated that the inflation targets enshrined in the programme are unattainable. The programme envisages a reduction in the annual inflation rate to 150% in the final quarter of 1985, but, as prices rose by 25% in January and 21% in February (bringing the inflation rate in the twelve months to end-February to 804%), that aim looks scarcely realistic. Talks between Sourrouille and the IMF to consider ways of getting the programme back on course took place in Washington in the third and fourth week in March. Sourrouille also met the banks' Working Committee in New York. President Alfonsin too has visited the US, where he sought greater understanding of Argentina's difficulties and support for his administration's policies.

The talks between the Fund and the Argentines will aim to set new targets for the coming year, but de Larosiere will wish to see two months' good performance by Argentina before being willing to recommend a revised programme to the Executive Board. Before these latest developments, and in spite of the initial apprehension felt by the banks with the sudden ministerial changes, the pace of commitments to the $4.2 bn of new money had quickened somewhat. Commitments are now about $4.13 bn; but given the problems with the IMF programme, signature of the loan agreement has been put back from the scheduled date of 29 March. The Working Committee has sent out a telex to the banks detailing the latest developments. Included in it was a supportive message from de Larosiere asking the banks to maintain their commitments to the refinancing package. The Working Committee had told the IMF that the banks would need such a message if they were to stay in line, and that Argentina would also have to reduce arrears on interest payments on public sector debt which are now over four months overdue.

The switching of Economy and Planning portfolios in Alfonsin's government between Bernardo Grinspun and Sourrouille, and the replacement of Enrique Garcia Vazquez by Alfredo Concepcion as President of the Central Bank, were not intended to signal a shift in the direction of economic policy, but rather to improve the style and cohesion of the government economic team. However, it is thought that Sourrouille will prove more resourceful than Grinspun in applying the government's counter-inflation strategy: in particular, he hopes to win greater support for wage and price restraint from the trade unions and industry. On external policy, Sourrouille will probably continue the practice of daily exchange rate adjustments, with additional intermittent mini-devaluations. In January and February, Grinspun had allowed the rate of depreciation to fall behind the Argentine inflation rate. Sourouille has already increased the pace of depreciation, but the gap between the official and black market rates has so far not closed.

At end-December 1984, ECGD had an estimated $261 mn at risk. At end-June 1984, British-owned banks' exposure to Argentina totalled $2,469 mn and consolidated external claims $2,568 mn, whilst UK-registered banks' exposure was $3,422 mn and consolidated external claims were $3,441 mn.

BRAZIL

Total external debt at end-1984 was estimated at $100 bn.

Following twenty years of military rule, a new civilian government under President Tancredo Neves took office on Friday 15 March. However, Tancredo (who is 75) was taken ill with a serious intestinal complaint the day before he was due to be inaugurated, and has subsequently had three major operations following the emergence of complications. Brazil has consequently been thrown into political turmoil. Vice President Jóse Sarney is temporarily in charge of the government and has received pledges of loyalty from Tancredo's ministerial team. The military are thought unlikely to intervene, but at best Tancredo may be incapacitated for the foreseeable future; at worst, Sarney (who is generally considered a lightweight political figure) may have to assume office in place of Tancredo.

The main figures nominated to Tancredo's economic team are pragmatic and moderate. The Minister of Finance is Tancredo's nephew, Francisco Dornelles, under whom the Ministry will have its former position of pre-eminence; the Planning Minister is Joao Sayad, who had a sound and responsible record as Financial Secretary in the Sao Paulo state government for the last two years; and the new President of the Central Bank, Carlos Lemgruber, is a respected middle-of-the road economist.

The administration inherits a difficult economic and financial situation. It became clear in the week ended 8 February that final agreement between the outgoing Brazilian government and its Advisory Committee of banks on a MYRA would have to be postponed because of difficulties with the IMF programme. These resulted from an excessive rise in the monetary base in December, and therefore for 1984 as a whole, the rise being caused mainly by budgetary expansion in excess of Fund targets rather than, as earlier in the year, by an unexpectedly rapid growth of reserves. Moreover, inflation (year-on-year) was almost as high at end-1984 as it had been a year earlier, at 224% against an original IMF target of 95%; there was no improvement in January-February, and the 1985 target of 120% is probably now unattainable. The worse than expected performance on inflation means that Brazil almost certainly exceeded by a substantial margin the end-1984 performance target for the overall PSBR. It also seems clear that, without a major tightening of policy, Brazil is unlikely to succeed in restricting the growth of the monetary base and the money supply to a targeted 60% in 1985; following December's large increase, further expansion in the first two months of the year brought the year-on-year increase in the monetary base to 269% in February (compared with an end-1984 target of 95% and an outturn of 244%). Because of these developments, the IMF's Managing Director rejected the possibility of a further waiver, and the scheduled March purchase (SDR 374 mn) under the EFF was therefore postponed.

The Fund has already begun preliminary discussions with the authorities on the 1985 programme, but the results are unlikely to come before the Board until April or May. The Fund will doubtless be seeking firm assurances from the new economic team that strong remedial action will be taken, particularly in the area of fiscal policy, to correct the major deviations that have occurred so far in 1985. The early signs are that the new team are aware of the need for strong action. Dornelles has already introduced a number of measures, including an immediate 3-month freeze on spending on new projects and a 10% reduction in expenditure by ministries and Federal institutions. Until the IMF has obtained adequate assurances, and worked out appropriate new performance criteria, it is unlikely that any further progress will be made on the commercial bank MYRA, or on the Paris Club negotiations for a similar deal (although, encouragingly, Dornelles and Lemgruber agreed to meet the Advisory Committee in New York on 1 April).

Because of these setbacks, the Advisory Committee agreed to a Brazilian request to recommend to the banks that they extend the maintenance of trade credits ($10 bn) and interbank lines ($6 bn) to 31 May. On 14 February, the Committee sent out to the banks a telex which was accompanied by a letter from de Larosiere supporting the extension and outlining the position of the Fund.

Doubts about Brazil's prospects for 1985 have been reinforced by the trade figures for the first two months of the year which showed a trade surplus of $1.1 bn, compared with $1.4 bn in the corresponding period last year. These results raise some doubts whether Brazil will be able to achieve the current target of a $12.9 bn trade surplus in 1985, particularly as export subsidies are to be phased out by May.

At end-December 1984, ECGD had an estimated $1,687 mn at risk. At end-June 1984, British-owned banks' exposure to Brazil totalled $6,550 mn and consolidated external claims $5,885 mn, whilst UK-registered banks' exposure was $9,658 mn and consolidated external claims $8,998 mn.

CHILE

Total external indebtedness at end-1984 was an estimated $18.6 bn.

Provisional agreement with the IMF on a three-year EFF for around $750 mn was reached in mid-February. The economic programme envisages a reduction in the public sector deficit from 4.7% in 1984 to 3.0% in 1985, a reduction in inflation from 26% to 23%, and a cut in the current account deficit from $1.8 bn to $1.4 bn. Overall, GDP growth is set at 4%, compared with 5.9% last year. However, after a major earthquake shook the country in early March, causing some $1 bn of damage, including loss of copper production, the new Finance Minister, Sr Buchi, and IMF officials met to consider a relaxation of some of the targets, notably those for the public sector and current account deficits. It now seems that a public sector deficit in 1985 equivalent to 3.5% of GDP has been accepted by the IMF, allowing extra government spending equivalent to $100 mn, which has to be linked to the accelerated drawing of funds from the IBRD and IADB which are to be redirected to earthquake relief and reconstruction work. The Chilean authorities still do not contemplate requesting a rescheduling from the Paris Club.

On 14 March, Buchi presented a request to the commercial banks in New York for a rescheduling of 1985 maturities and a new money loan of $1,050 mn. Their response is not yet known, but in previous discussions they showed considerable reluctance to respond fully to a request for $875 mn of new money. They have, however, agreed to an extension, to 1 July, of the moratorium on maturities falling due, to allow time for Chile to conclude negotiations with the Fund.

In late February, the new Finance Minister announced a package of economic measures and proposals as a prelude to the new IMF programme: they included a devaluation of the peso by 7.7%, the immediate reduction of import tariffs from 35% to 30% (originally planned for July), reductions in government expenditure, and an assurance that the authorities are determined to tighten monetary policy and raise interest rates so that they become positive in real terms. One reassuring development for Chile has been the increase that has occurred in the copper price on world markets, and some observers are forecasting a price of $0.70 per lb by the end of June (from $0.55 at the end of 1984). Without this price increase, Chile's current account target for 1985 would have been virtually unattainable. Government policies, as reflected in the EFF and also in a request for an IBRD SAL, are designed to stimulate exports in the medium-term. In the meantime, the country's payments position continues to be very serious, given the need to raise substantial amounts of new money over the next three years.

ECGD had an estimated $50 mn at risk at end-December 1984. At end-June 1984, British-owned banks' exposure to Chile totalled $1,303 mn, and consolidated external claims $1,295 mn. At the same date, UK-registered banks' exposure amounted to $1,934 mn and consolidated external claims $1,926 mn.

COLOMBIA

Total external indebtedness at end-1984 was an estimated $11.5 bn.

There have been no major developments since the last report in the debt negotiations between Colombia and the banks' Consultative Committee. Discussion of the Colombians' request for $550 mn of new money from the banks in 1985 (revised from an original request for $875 mn) will resume towards the end of March. An IMF Article IV mission, which was brought forward by four months in response to the banks' desire for up-to-date information in the current negotiations, was in Colombia from 11 February to 7 March, and will give the Committee an account of its findings at the beginning of April in advance of the written report (due in May). The Colombian authorities hope that the Fund's report will be favourable enough to persuade the banks to drop their demand that Colombia should apply for a Standby Arrangement. In the meantime, a proposed IADB complementary credit of $80 mn for the Jaguas Hydroelectric development has received a very positive response from European and Japanese banks. The loan, which is being managed by Samuel Montagu and Kleinwort Benson, requires $52 mn from the banks and has been oversubscribed by 70%. The last commercial banks' syndication for Colombia was in the form of $175 mn of a $370 mn IBRD co-financing to the state electricity company, the banks' money being disbursed in December.

The authorities have recently published economic plans for 1985-86, which project a current account deficit of $1.2 bn (cf $1.75 bn in 1984), resulting from a move into small surplus in the trade account (from a deficit of $340 mn in 1984). The improvement is expected to result in part from exports of coal from the El Cerrejon development, which began last month, a year ahead of schedule, and are expected to bring in $500 mn this year. Colombia expects further improvement in its trade account next year as its next oil fields begin production.

At end-December 1984, ECGD had an estimated $184 mn at risk. At end-June 1984, British-owned banks' exposure to Colombia totalled $707 mn and consolidated external claims $671 mn. UK-registered banks' exposure was $882 mn and consolidated external claims amounted to $827 mn.

ECUADOR

Total external indebtedness at end-1984 was an estimated $7.2 bn.

A one year Standby programme for SDR 105.5 mn was agreed by the IMF Board on 13 March. Discussion of the SBA by the Board had been delayed because of the slow progress of subscriptions to the $200 mn new money element of Ecuador's commercial bank debt package, which the Fund stated must exceed a 'critical mass' of 92% before the SBA would be considered. The sluggishness of the commercial banks' subscriptions seems to have derived largely from the reluctance of some smaller (mainly US) banks to increase their exposure to Latin America in general, rather than a lack of confidence in the economic prospects of Ecuador in particular.

Delays with the Fund agreement also led to the postponement of the Paris Club's consideration of Ecuador's request for a five year MYRA covering 85% of interest and principal for maturities of $300 mn. This will now be considered in late April. The Paris Club is unlikely to accede to Ecuador's request in full but seems prepared to grant a two year MYRA, with a trigger for a third year, dependent upon Fund surveillance.

The government's stated economic policy of continued retrenchment and a tightened fiscal and monetary stance, in line with IMF targets, has been threatened by a conflict between the President and the Congress on the question of minimum wages. President Febres Cordero had been anxious to keep any increase in minimum wages to 35% and had recommended to Congress a bill to that effect. (Inflation in the year to February 1985 was 30%.) However, Congress has rejected the President's bill, arguing instead for a 50% increase. A one-day general strike has been called by the unions, in support of the Congressional stance. Another threat to the economic programme for 1985 is the recent cut in the export price of oil (which accounts for 75% of total exports). To countervail the price cut, the state oil company has announced an increase in production, distancing Ecuador still further from OPEC. In an attempt to increase the rate of exploitation over the medium term, the Ecuadoreans intend to sign 20 oil exploration contracts with foreign companies over the next two years, and have already signed one with the US Occidental Exploration Company.

ECGD had an estimated $64 mn at risk at end-December 1984. At end-June 1984, British owned banks' exposure to Ecuador totalled $571 mn and consolidated external claims $583 mn. UK-registered banks' exposure was $726 mn and consolidated external claims were $737 mn.

MEXICO

Total external indebtedness at end-December 1984 was estimated at $94.9 bn.

The legal documentation covering both the $23.6 bn of debt previously rescheduled and the $5 bn of 1983 new money was despatched to all banks, and signing will have taken place in New York on 29 March. A Letter of Intent, covering the third year of Mexico's Fund programme, has been agreed.

The Mexicans have now agreed with the clearing banks on the precise mechanism to be used for the currency switching option. One bank (LBI) will sell sterling and buy dollars on the appropriate dates on behalf of all UK banks. Two reference banks - to be nominated by Mexico - will endorse the rate as truly representative. To eliminate exchange risk, UK banks can then deal with LBI at this rate, though it is not obligatory to take cover in this way: a bank can choose to do its own dealing if it wishes, but the rate at which the dollar loan is re-denominated into sterling must be the endorsed LBI rate.

On preliminary figures, a trade surplus of $12.3 bn was achieved last year ($13.7 bn in 1983), with exports amounting to $24.1 bn ($22.2 bn) and imports $11.8 bn ($8.5 bn). The current account is likely to record a surplus of around $4 bn ($5 1/2 bn in 1983) and reserves will again have risen much more than the IMF's target of $2 bn.

For 1985, the official forecast is for a trade surplus of $10.3 bn and, with interest payments benefitting from the new spreads under the MYRA, a current account surplus of $1.5 bn. With gross reserves expected to rise still further this year, an increase in external debt of $1 bn is projected, mainly to be financed from non-commercial bank sources.

On the domestic front, recent measures to cut expenditure are expected to reduce the public sector deficit this year from the original Budget estimate of 5.1% of GDP to 4.3%; a Letter of Intent will shortly be agreed with the Fund. Inflation is forecast at 35% (year-on-year) at end-December, although private sources are already suggesting that 50% may be more realistic.

At end-June 1984, British-owned banks' exposure to Mexico totalled $6,225 mn and consolidated external claims $6,367 mn. At the same date, UK-registered banks' exposure was $8,520 mn and consolidated external claims $8,736 mn. ECGD had an estimated total amount at risk of $1,213 mn at end-December 1984.

PERU

Total external indebtedness at end-1984 was an estimated $13.5 bn.

After running up more than six months' interest arrears, totalling over $200 mn, on debt to commercial banks, Peru paid $52 mn in early January, and the authorities promised to make further periodic payments in order to keep arrears at, or below, the 180 day threshold. Although Peru has not managed to bring arrears below the threshold, the payment of $52 mn persuaded the banks to agree to a rollover of maturities due on 14 January to 14 February, and a second payment of $24 mn on 14 February secured a further 30-day rollover. The banks seem willing to continue granting moratoria until the new government takes office in July - on the condition that efforts continue to be made to bring interest arrears within the 180 days margin - and they have agreed to a Peruvian request for a 60-day rollover to mid-May. Citibank has estimated that $40 mn a month will be needed to keep arrears within the 180 day margin; it is therefore worrying that the Peruvians are reportedly only willing to make a $15 mn payment for March.

Whilst the remedial action taken by the Peruvian authorities has so far obviated the need for US banks to classify their Peruvian exposure as 'bad loans', US accounting practice requires the banks to classify all loans on which interest payments have been more than 90 days overdue at any stage in one quarter as 'non-performing', unless they are well secured and/or negotiations for a settlement - and IMF package - are in progress: Peru's bank loans will continue to be 'non-performing', even if they are brought within 180 days, unless these conditions are met.

In spite of the build-up of arrears and the breakdown of the IMF Standby programme, however, two recent developments have made banks more favourably disposed towards Peru. First, Garrido Lecca's appointment as Economy Minister in December (in place of Jose Benavides) seems to have eased the previously strained relationship between the government and Central Bank. The second, related, development was a package of austerity measures introduced by Lecca early in the New Year: these measures supplemented the 1985 budget approved on 15 December, and are expected to produce extra revenue equal to 1% of GDP over the next six months and to reduce expenditure by 1.6% of GDP. Lecca has also increased the pace of currency depreciation. Despite the encouragement these measures have afforded the banks and the IMF (who currently have a mission in Lima), the Advisory Committee has refused to agree to a Peruvian request that trade lines be increased to $350 mn from their current level of $300 mn.

At end-December 1984, ECGD had an estimated $124 mn at risk. At end-June 1984, British-owned banks' exposure to Peru totalled $357 mn and consolidated external claims $418 mn. At the same date, UK-registered banks' exposure was $643 mn and consolidated external claims were $704 mn.

VENEZUELA

Total external indebtedness at end-1984 was an estimated $35 bn.

Negotiations on the terms of Venezuela's MYRA have continued over the last month, and an agreement between the authorities and the banks' Advisory Committee is expected in the near future. One remaining area of contention, however, is that of private sector debt payments. Under the scheme set up by the previous administration, private sector debts must be rescheduled with creditors on terms specified by the Central Bank, registered with the exchange control agency RECADI, and then approved by the Venezuelan authorities before payments of interest and rescheduled principal can qualify for preferential rates of exchange. So far RECADI has registered some $6 bn of an estimated $8 bn private sector debt: much of the remainder is trade debt. However, while the Venezuelan government is refusing to include in the proposed agreement a commitment to make speedier progress on registration and payment of private sector debt, some banks have made it clear that they are unwilling to finalise the terms of the agreement until all such debt has been registered. As a result, the 'roadshow' hoped for in April is now unlikely to take place before mid-year. Agreement also has still to be reached on the details of the currency switching procedure.

The Paris Club sent a 'task force' to Venezuela last month to discuss procedures for payment of some $800-900 mn of officially-guaranteed trade debt. The Venezuelan authorities confirmed that unrescheduled Paris Club debt would qualify for preferential foreign exchange, but only on the condition that such debts be registered beforehand.

The authorities have cut their planned increase in budget spending (18 bn bolivares in addition to the existing 103 bn bolivares) to some 6 bn bolivares following OPEC price cuts in February which are expected to reduce the average price of Venezuelan oil exports by $0.50 pb.

At end-December 1984 ECGD had an estimated $37 mn at risk. At end-June 1984, British-owned banks' exposure to Venezuela totalled $2,276 mn and consolidated external claims $2,260 mn. UK-registered banks' exposure was $2,789 mn and consolidated external claims were $2,775 mn.

POLAND

Outstanding convertible-currency indebtedness at end-1984 is estimated at $26.8 bn.

When the creditor governments met the Poles in Paris on 4 March, several of them - including the UK - had not received the full 30% arrears under the 1981 Agreement that were to have been paid on initialling of the 1982-84 Agreement; the governments therefore refused to discuss rescheduling of 1985 maturities. The Poles claimed that the shortfall in payments was due to the fact that they had not paid delay interest where not explicitly provided for in bilateral agreements, and were not prepared to pay penalty interest; but this did not appear completely to explain the shortfall, and in any case was felt to be an unacceptable stance. The meeting ended inconclusively, but the prospects of a breakdown seem real. The Poles have continued to insist that substantial new credits - some $1.7 bn in total - be promised before they sign the 1982-84 Agreement, while most governments have indicated that they would promise nothing before signing. The next Paris Club meeting is scheduled for 26 April.

The first IMF technical mission to Warsaw has been concluded, and a second mission may go out in late March. Although it might be possible to bring Poland into membership later this year, it seems unlikely that agreement could be reached on a programme in time for Poland to borrow from the Fund before late 1986. And agreement on projects that would attract IBRD funding seems, for technical reasons, to be unlikely for several years.

At end-June 1984, British-owned banks' exposure to Poland totalled $521 mn and consolidated external claims $1,081 mn (compared with $538 mn and $1,214 mn respectively at end-December 1983). UK-registered banks' exposure at end-June 1984 was $758 mn and consoldiated external claims $1,324 mn ($778 mn and $1,471 mn). At end-December 1984, ECGD had a total commitment of $1,135 mn (including $576 mn already paid).

CONFIDENTIAL

YUGOSLAVIA

At end-1984 convertible currency debt was estimated to be just over $19 bn.

Negotiations with the IMF on the terms of a new SDR 300 mn Standby Agreement are almost complete. A substantially agreed Letter of Intent is now being finalised for discussion in the Board on 26 April. A few minor points remain to be settled, but the acceptance of a compromise formula on the question of real interest rates has removed what seemed the most difficult obstacle to agreement. The Fund is willing to provide the "enhanced" Article IV monitoring on a six-monthly basis, as sought by the banks, but seems less prepared to be put in a position of passing judgement on appropriate remedial action in the event of failure to meet targets written into the restructuring agreement between the Yugoslavs and the banks. The new programme is intended to run from mid-May.

Official creditors resume negotiations in Paris on 25 March, but are clear that they will concede no more than a one-year rescheduling for 1985 plus a goodwill clause for subsequent years.

The Chairman of the commercial banks' ICC had further debt discussions in Belgrade in the week beginning 4 February, but failed to reach agreement on the structure and pricing of the prospective rescheduling. The Yugoslavs continued to insist on a four-year block arrangement with an interest margin of 1%, while the banks stood firm on a 2+1+1 formula at +1 1/4%. It seems likely that the Yugoslavs will in due course relax their demands for a four-year block arrangement and that the banks will be prepared in turn to offer some cosmetic concessions on the interest rate. A further meeting is scheduled for 11 April in New York.

At end-June 1984, British-owned banks' exposure to Yugoslavia totalled $944 mn and consolidated external claims $1,316 mn (compared with $934 mn and $1,300 mn respectively at end-December

1983). UK-registered banks' exposure at end-June 1984 was $1,317 mn and consolidated external claims $1,705 mn ($1365 mn and $1,739 mn). At end-December 1984, ECGD had a total commitment of $1,071 mn.

PORTUGAL

Total external indebtedness is now officially put at $14.9 bn at end-1984, slightly below earlier estimates. This represents an increase of $0.5 bn over the end-1983 level.

The 1984 current account deficit, at $0.5 bn (2.5% of GDP), showed a better outturn than previously estimated, and compares with a deficit of $1.7 bn in 1983. The improvement was reflected in a slower growth in the external debt; the increase of 3% in 1984 compares with 6% in 1983 and 24% in 1982.

Following their decision not to seek a further IMF Standby Agreement - the previous Agreement expired at end-February - the Portuguese authorities discussed with the staff the possibility of continuing the Fund's involvement outside the format of a programme. The Portuguese were unwilling, however, to accept the full requirements of enhanced surveillance, especially the need for quantified objectives. A staff team will, nevertheless, prepare a paper analysing recent economic developments and experience with last year's Standby, and there is a possibility of a Board discussion.

At end-June 1984, British-owned banks' exposure to Portugal totalled $1,321 mn, and consolidated external claims $1,145 mn. UK-registered banks' exposure totalled $1,672 mn and consolidated external claims $1,447 mn. At end-December 1984, ECGD had an estimated $275 mn at risk.

PHILIPPINES

Total external indebtedness (including short-term liabilities of the banking system) amounted to around $26 bn at the end of 1984.

The refusal by the National Commercial Bank of Saudi Arabia to participate in the new money/rescheduling package agreed with the Advisory Committee of banks has led to a further delay in the signing of the agreement. Reportedly expressing a desire to negotiate a bilateral agreement with the Filipinos, the Saudi bank has stated that, as it has a policy of reducing its international exposure, it is not prepared to provide its share (understood to be around $13 mn) towards the $925 mn new money. At a meeting in New York in the third week of March, the Advisory Committee agreed not to proceed with the signing until the Saudi bank agrees to participate: at stake is said to be the long-established and central principle that all creditor banks must shoulder their responsibilities equally when dealing with debt-problem countries. At this stage it is not possible to predict how long the impasse will last.

At the time of writing, an IMF team has gone to Manila for the first mid-term review of the SDRs 615 mn Standby Agreement which was approved by the IMF Board in December. Inter alia, the team will be examining whether the authorities will be able to keep to the reserve money target set for end-March. As indicated in the last report, the reserve money target for end-December was breached following an unexpectedly large inflow of funds (in the main from Filipino workers overseas) as soon as the IMF programme was in place, which had the effect of swelling the money supply. If the IMF are content that the authorities have regained control of monetary growth, a waiver for the end-December reserve money target will probably be granted; if not, the programme will be considered to have broken down, which in turn would jeopardise the agreements reached with official and commercial creditors.

As at end-December 1984 ECGD had an estimated $248 mn at risk. At end-June 1984 British-owned banks' exposure to the Philippines totalled $1,279 mn and consoldiated external claims $1,519 mn. At the same date, UK-registered banks' exposure totalled $1,392 mn and consolidated external claims $1,649 mn.

MOROCCO

Total external indebtedness at end-1983 was around $11.5 bn.

The Moroccans agreed a $1.5 bn rescheduling package with the steering committee of the commercial banks in early February. This was the final element of the three-pronged 1983/84 rescheduling negotiations (comprising an IMF programme, the rescheduling of official and officially-guaranteed debt, and commercial bank rescheduling), started in September 1983. Some two-thirds of the two hundred banks involved have already responded; however, it will be some time (perhaps mid-summer) before the commercial bank package becomes operational. As part of this package, a total of $535 mn of medium and long-term maturities in 1983/84 is to be rescheduled over eight years, with four years' grace, at 1 3/4% above LIBOR as from September 1983, together with $750 mn of rolled-over trade credit and $200 mn of new trade credit.

Failure to reach an accord with the commercial banks by 30 November 1984 led to a further interruption of the $0.3 bn Standby (approved in September 1983). Board discussion of the Review Under Standby, scheduled for 30 November, was accordingly postponed until 4 January. At that meeting, however, it was agreed that Morocco could proceed to make purchases under the Standby, notwithstanding any arrears on debts to commercial banks, as final agreement on their rescheduling seemed in the offing.

The IBRD's Consultative Group for Morocco met in Paris between 9-11 January, its first meeting since 1974; subsequently the IBRD representative gave a presentation to the Paris Club on Morocco's medium term prospects. Morocco informed the Paris Club last December of its intention to seek a restructuring of 1985 maturities from the Paris Club, but no meeting has yet been scheduled. In the meantime the Moroccans have undertaken not to interrupt debt service, and to pay an instalment of 2.5% of sums which have fallen due since 1 January 1985.

At end-June 1984, British-owned banks' exposure to Morocco totalled $144 mn and consolidated claims $191 mn. At the same date, UK registered banks' exposure was $293 mn while consolidated claims amounted to $372 mn. ECGD's total amount at risk to Morocco at end-December 1984 was $211 mn.

NIGERIA

Total external indebtedness at end-1983 was around $20 bn (including an estimated $6 bn of arrears).

There has been no progress since the last report in negotiations with the IMF on a possible three-year EFF (SDR 2.4 bn, if annual access is set at 95% of quota). The authorities remain opposed to the key conditions of an IMF loan - a substantial devaluation, reduction of petroleum subsidies, and liberalisation of import controls. A Fund mission visited Lagos at the end of January to conduct routine Article IV Consultations; the discussions were reportedly amicable but the Nigerians were reluctant to take any measures which would involve price increases. The mission emphasised that, without drastic action on the external side, the benefits of the fiscal adjustment already achieved would be wasted.

Most exporters have agreed to the Nigerian offer, made last April, to reschedule <u>uninsured</u> trade arrears in the form of six-year promissory notes, with 2 1/2 years' grace, at 1% over LIBOR. The issue of notes is to proceed in three stages. The first tranche, valued at $260 mn, was issued on 9 November and covered the dollar-denominated arrears of major companies. The second tranche, worth some $70 mn, was issued on 21 February and covered the same companies' arrears in non-dollar currencies; as with the first tranche, interest back-dated to 1 January 1984 was also paid. The final issue of notes, to all remaining uninsured creditors (some 7,000-9,000 companies), is likely to be delayed until June-July when the process of reconciling exporters' claims is expected to be completed.

Official credit agencies remain insistent that a restructuring of <u>insured</u> trade arrears should be negotiated within a multilateral framework, and be conditional on agreement being reached with the IMF. At a Paris Club meeting on 4 October, it was agreed that, as an interim measure, the Nigerians would make payments equivalent to interest calculable from 1 January 1984, at a rate of 1% above LIBOR, on insured arrears registered at Chase Manhattan and reconciled with importers' submissions to the Central Bank of Nigeria. But it was also agreed that this agreement should in no way prejudice the form of the full settlement which would only follow eventual agreement with the IMF. The first interest payment, due on 5 January, does not appear to have been made.

At end-June 1984, British-owned banks' exposure to Nigeria totalled $1,194 mn and consolidated external claims $2,051 mn. UK-registered banks' exposure at end-June amounted to $1,545 mn and consolidated external claims $2,534 mn. At end-September 1984, ECGD's total amount at risk was $3,037 mn.

SOUTH AFRICA

South Africa's large current account deficits in 1981 and 1982 (which together totalled over $7 bn) resulted in very substantial increases in the volume of external debt, the bulk of it short-term. During these two years total external debt rose by $5.5 bn (32%) to $22.8 bn. Short-term borrowing (particularly through the South African banks' branches abroad) almost doubled to reach $11.5 bn. At the end of 1982, therefore, short-term debt accounted for 50% of the total outstanding compared to 37% two years earlier. External debt increased more modestly during 1983 as the current account recorded a small surplus. At end-December 1983 (the latest date for which comprehensive data are available) total external debt amounted to $24.1 bn and the short-term component $12.6 bn (52% of the total).

The extent to which South Africa has relied on borrowing from the banking system during the latest period of balance of payments difficulties is illustrated by the proportion of total debt represented by claims of BIS area banks; this rose from 42% in 1980 to 71% in 1983. The picuture is even more striking in the case of short-term component: BIS area banks' claims accounted for 90% of the total at end-1983 compared to 39% three years earlier.

Although the South African authorities have a proven track record in dealing with previous external imbalances, the continuing need to roll-over short-term borrowing is a focus of attention, particularly when set against the backdrop of the increasingly vociferous calls for investment sanctions against South Africa. There are currently no indications that institutions are unwilling to roll-over the debt, although clearly attitudes may be influenced by calls for punitive action following the recent brutal events in the Eastern Cape.

Correcting the balance of payments position is seen by the South African Government as the main economic priority, ranking above inflation which currently stands at 16%. The current account is forecast to record a healthy surplus in 1985 even on the assumption that there is no significant recovery in the gold price. Developments elsewhere in the economy are likely to depend heavily on the extent to which the authorities are able to adhere to the tight monetary and fiscal policies that are now in place. Until the recent budget, the burden of adjustment within the economy had fallen almost entirely on monetary policy. On the face of it, the budget measures should ensure that fiscal policy comes to play its part.

At end-June 1984, British-owned banks' exposure to South Africa totalled \$4.9 bn and consolidated claims \$5.3 bn. At the same date, UK registered banks' exposure was \$5.2 bn while consolidated claims amounted to \$5.6 bn. ECGD's total amount at risk to South Africa at end-December 1984 was \$2.9 bn.

SUDAN

Total external indebtedness at end-1983 was around $7.8 bn.

Heavy foreign borrowing undertaken in the mid-1970s has never been fully serviced, and was the subject of Paris Club reschedulings in 1979, 1982, 1983 and 1984 and commercial bank reschedulings in 1981, 1983 and 1984 (with equivalent measures by Arab and other bilateral creditors). Arrears at end-1984 totalled some $260 mn (of which $80 mn was due to the IMF).

Sudan's external public sector debt is divided up as follows: 60% bilateral to foreign governments; 20% to multilateral institutions; 16% to commercial banks. Less than 4% takes the form of supplier credits, and the external debt of the private sector is negligible. The post-rescheduling debt service ratio in 1983-84 was 31%. The latest Fund projections show debt service payments in excess of $1 bn until the end of the decade, with the debt service ratio gradually falling to around 50% from 120% in 1984/85. But it is tacitly acknowledged that Sudan will not be able to meet its commitments.

Bilateral and commercial creditors are pressing Sudan to improve its economic management and debt servicing, but the situation is made particularly difficult by the impasse that has existed between Sudan and the IMF since the breakdown of its current SDR 90 mn Standby Arrangement. This was finalised with great difficulty on 25 June last, but further arrears to the Fund under the Standby began to accrue within two months of its coming into effect and reached some SDR 80 mn by end-December 1984. The IMF and IBRD, and the US government, have sought throughout the last nine months to impress upon the Sudanese the need for economic adjustment. Some adjustment, including devaluation and higher fuel prices, has resulted, and a further IMF mission has just left for Khartoum. The Sudanese hope that this mission will lead to an IMF statement to the effect that the authorities are moving in the right direction and will require further generous support from creditors if they are to succeed. This would not be part of a formal IMF programme, but would be accompanied by a middle to long-term strategy to get arrears paid and the relationship with the Fund back on to a formal footing. (It is generally recognised that the rehabilitation of Sudan will take at least ten years.) But, even if this can be achieved, the prospect of a further substantial external financing gap this year remains.

Meanwhile, the steering committee of the commercial banks (party to the 1981 rescheduling agreement) has endorsed terms suggested by Morgan Grenfell for a further rescheduling. The proposals are that arrears should be treated in two tranches: in both cases there would be no payments until 1988. Arrears of principal as at 1982 would be re-rescheduled, attracting interest at LIBOR + 1 3/4%, up to 1992, while accrued, unpaid and capitalised interest since 1982 would also be re-rescheduled but on an interest-free basis. Some other banks have accepted these terms, but the majority have not yet responded (the deadline is 26 March).

At end-June 1984, British-owned banks'exposure to Sudan totalled $46 mn and consolidated claims $50 mn. At the same date, UK-registered banks' exposure was $127 mn while consolidated claims amounted to $132 mn. ECGD's total amount at risk to Sudan at end-December 1984 was $150 mn.