[redacted] NID 81[redacted]

February 20, 1981

SPECIAL ANALYSIS

POLAND: Hard Currency Default Looms

[redacted]

Poland can cover its hard currency obligations for only another two or three months. At that point, barring massive assistance from Western governments or the USSR, it probably will default. Some payments already are being delayed. [redacted]

Poland's financial crisis reflects hard currency debt service obligations of about $10 billion this year, far exceeding the likely value of exports--$7 billion. In addition, a trade deficit of nearly $2 billion is likely if Warsaw continues on its current course. [redacted]

The Kania regime has not been willing to deal with the problem by further cutting imports because of the impact this would have on labor unrest. Instead, it has sought to obtain government credits, but this approach is breaking down. [redacted]

Western banks are unwilling to allow any increase in their financial exposure. Some have already refused to refinance the debt coming due. [redacted]

The multiplicity of banks holding the Polish debt and the absence of the IMF or any other institution capable of playing a leadership role will make it difficult to arrange an orderly rescheduling. Although rescheduling may ultimately occur, the process will take many months and could be preceded by a moratorium on Polish debt payments. [redacted]

If enough new financing does not become available, Warsaw will have to cut imports by about 20 percent--to a level consistent with export earnings. In addition, default could interfere with Polish exports as creditors attempt to lay claim to Polish export revenues deposited in Western banks. [redacted]

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Avoiding Default

A default could be avoided only if Western governments or the USSR provide large new loans and defer payments on guaranteed debt. Western governments, concerned about the outcome of the labor strife and the Soviet reaction to it, have so far been in no hurry to make large new aid commitments. Moscow might provide large additional sums, but not without political strings. [redacted]

If Western governments decide to support an orderly debt rescheduling so as to avoid economic and political collapse in Poland, the cost to them will be heavy. [redacted]

The process of rescheduling could last well into 1982. In the interim, Western governments will have to underwrite a large portion of Poland's hard currency financing requirements, which now are running at about $1 billion per month. The participation of commercial banks probably will depend on how decisively their governments act and how the Polish internal situation shapes up in the next few months. [redacted]

Broader Implications

Other East European countries would be affected by a Polish default. Western banks have continued to lend money to them on easy terms. [redacted]

Moscow's failure to prevent a Polish default, however, would puncture the widely held confidence in the existence of a Soviet "umbrella" protecting Western lenders, and call into question the creditworthiness of other East European countries. Polish default might hurt some West European banks badly, but Polish debt held by US banks is not especially large and probably represents only a small share of any individual bank's portfolio. [redacted]