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Central Intelligence Agency

Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

International Financial Situation Report #58
20 November 1986

Summary

Venezuelan President Lusinchi plans to announce new stabilization measures soon to deal with the nation's deteriorating financial situation, according to the US Embassy. Already the anticipated $5.5 billion shortfall in oil revenues this year has caused the Central Bank's foreign reserves to decline by almost $3 billion from the $13.7 billion on hand last December. The government fears that continued weakness in oil export earnings in 1987 could exhaust the Central Bank's liquid reserves —about $5.5 billion— before yearend 1987. In other developments:

- Mexico has obtained commitments for 78 percent of its $7.7 billion commercial loan package and [redacted] bankers expect to obtain the 90 percent required for triggering disbursement of the banks' $500 million bridging loan and IMF and World Bank loans no later than early December. Bankers indicate that the loan signing and disbursement of the new financial package is likely to take place in early 1987. 25X1

- After holding the IMF at arms length for nearly two years, Brazil will likely seek to reconcile with the Fund early next year — perhaps agreeing to an enhanced surveillance program. Brasilia's altered attitude partly reflects a rapidly deterioriating external payments situation that could force the government to seek new loans in 1987 to cover a growing current account deficit.

- After securing IMF assistance, the Philippines opened talks with its bank advisory committee on 27 October only to have the talks collapse on 7 November. [redacted] 25X1 Philippine officials feel that the Philippines deserves favorable treatment in light of the concessions Mexico received in its rescheduling package. 25X1 One press report quotes Finance Minister Ongpin as saying the Philippines could declare a unilateral standstill on debt payments if the current impasse is not resolved by 1 January. [redacted] 25X1

- The IMF team has finished gathering data on Argentina and is now discussing policy issues with government officials, according to the US Embassy. Current points of contention include the continuing increase in real government expenditures, as well as Buenos Aires's failure to liberalize foreign exchange payment procedures. [redacted] 25X1

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

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KEY ISSUE

Venezuela: Mounting Financial Difficulties Dictate Additional Stabilization Measures

President Jaime Lusinchi plans to announce new stabilization measures soon to deal with the nation's deteriorating financial situation, according to the US Embassy. Already the anticipated $5.5 billion shortfall in oil revenues this year has caused the Central Bank's international reserves to decline by almost $3 billion from the $13.7 billion on hand last December, feeding speculation of an impending devaluation. Reserves are likely to fall even further before the end of the year, as Venezuela makes $750 million in principal payments to foreign bank creditors on the external public debt. According to the Embassy, the government fears that continued weakness in oil export earnings in 1987 could exhaust the Central Bank's liquid reserves —about $5.5 billion— before yearend 1987, although some bankers believe this is highly unlikely. The oil revenue shortfall has also caused the public-sector fiscal accounts to swing sharply into deficit. The Embassy believes that unless the deficit is reduced, inflationary pressures will escalate, further depressing investment incentives and augmenting incentives for capital flight. [redacted] 25X1

Caracas' financial problems have been compounded by its dual exchange rate system and by its price control strategy. The widening gap between the Bs 7.5/dollar official rate available for authorized imports and the floating market rate—currently Bs 26/dollar—has encouraged over- and under-invoicing and has induced importing at the controlled rate for subsequent reexporting at the floating rate. Meanwhile, government-mandated low prices for consumer basics have encouraged illegal exports to neighboring Colombia, resulting in domestic shortages and exacerbating Caracas' economic troubles. At the same time, the huge subsidies implicit in the low prices for gasoline and electricity have contributed to the widening deficit in the public sector's fiscal accounts. [redacted] 25X1

According to the Embassy, measures under government consideration include a sharp devaluation and price increases for many items. But because such steps would sharply increase the consumer price index, their promulgation has been delayed while the administration and the leadership of the ruling Democratic Action (AD) Party package the measures in a form acceptable to labor, AD's key constituency. If, as seems probable from Embassy reporting, Lusinchi goes ahead with the advice of his principal economic adviser, Minister of the Presidency Carmelo Lauria, and sharply devalues the bolivar, he probably will cushion devaluation's inflationary impact by allowing limited increases in the prices of gasoline, electricity, and other consumer basics. Although labor is also angling for government-mandated across-the-board wage increases as compensation for increases in the prices of consumer basics, Lusinchi's concern that such a move would trigger a wage-price spiral probably means that labor will have to settle, instead, for limited increases in fringe benefits. [redacted] 25X1

DEVELOPMENTS IN MAJOR COUNTRIES

Mexico

Mexico has obtained commitments for 78 percent of its $7.7 billion commercial loan package and [redacted] bankers expect to obtain the 90 percent required for triggering disbursement of the commercial banks' $500 million 25X1

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bridging loan and the IMF loan no later than early December. The World Bank has already disbursed $300 million out of the $500 million trade policy loan. The release of these funds should shore up Mexico's foreign exchange reserves—equal to about four months of imports at the end of October—until the commercial loan is completed. Bankers indicate that the loan signing and disbursement of the new financial package is likely to take place in early 1987. [redacted] a number of European 25X1 and US regional banks are continuing to resist participation in the loan for a variety of reasons. Some of the banks object to having their share of the loan based on their 1982 exposure to Mexico—particularly if they have sold off or written down their portfolios—while others are opposed to the package's contingency financing. The bank advisory committee reportedly believes some banks will have to shoulder more of the burden to make up for the banks that resist participation. [redacted] 25X1

Brazil

After holding the IMF at arms length for nearly two years, Brazil will likely seek to reconcile with the Fund early next year. [redacted] 25X1 President Sarney decided this month that Brazil must reach an agreement with the Fund to reschedule its Paris Club debt, restore official export credit, and obtain a multiyear debt rescheduling agreement with its commercial creditors. To avoid a domestic political backlash, Sarney remains opposed to a formal IMF program, [redacted] We believe, however, he will eventually agree to an enhanced surveillance 25X1 program like Colombia's. [redacted] 25X1

Brasilia's altered attitude toward the IMF may also reflect a rapidly deteriorating 25X1 external payments situation that could force the government to seek new loans in 1987. US Embassy reporting indicates that booming domestic demand and an overvalued exchange rate already have dampened exports and raised non-oil imports sharply. According to our projections, the trade surplus is likely to drop by at least 8 percent this year to $11.5 billion, causing the current account to post a $1.5 billion deficit, despite savings from lower oil prices and interest rates. With foreign investment at a 15-year low and new borrowing extremely limited, Brasilia will be forced to draw down reserves to meet its current debt servicing obligations. [redacted] 25X1

[redacted] the Sarney government is expected to announce 25X1 measures to curb domestic demand and encourage foreign investment, and to resume frequent minidevaluations soon. Nevertheless, most observers expect that these measures will have only limited impact on the erosion in the external payments accounts in the short run. Rather than cut imports or deplete its reserve cushion, Brasilia probably believes that its willingness to implement its own economic reforms and reconcile with the IMF would pave the way for a resumption of new lending by its commercial creditors after a formal rescheduling agreement is reached. [redacted] 25X1

Philippines

On 24 October, the IMF Executive Board approved a $519.4 million assistance package for the Philippines—$240.4 million in a standby arrangement and $279 million in a compensatory financing facility. After securing IMF assistance, the Philippines opened talks with its bank advisory committee (BAC) on 27 October only to have the talks collapse on 7 November. [redacted] 25X1 25X1 while the interest rate is the 25X1 most visible issue, there are several other sticking points as well. [redacted] 25X1

[redacted] 25X1

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Philippine officials feel that the Philippines deserves favorable treatment from banks in light of the concessions Mexico received in its rescheduling talks. While not asking for new money or contingency funds, Manila has stood firm in its demand for low interest rates—0.8125 percentage point above LIBOR—and the length of the payback period—20 years. The BAC's rescheduling proposal carried an interest rate of 1.375 percentage points above LIBOR and a 16-year repayment period. 25X1 BAC members were willing to continue negotiations, but as Philippine officials stated, "a single bank's intransigence" caused the talks to collapse. According to press reports, the BAC is scheduled to meet later this year but without Philippine representation. One press report quotes Finance Minister Ongpin as saying the Philppines could declare a unilateral standstill on debt payments if the current impasse is not resolved by 1 January. 25X1

The Philippines has received a substantial amount of new money from official sources. During President Aquino's recent trip to Japan, Tokyo pledged over $600 million in new financial assistance. According to US Embassy reporting, the funds include $249 million to be used for the Calaca II coal-fired thermal power plant, $62 million in grant aid, and $308 million in assistance under the 14th yen loan package. Manila is also expecting to receive a $300 million structural adjustment loan from the World Bank to be used to minimize strains caused by the denationalization and breakup of the corporations that previously monopolized the cocoa, sugar and other commodity sectors. 25X1

REGIONAL SITUATIONS

Latin America

In Latin America, Argentina continues to negotiate a standby arrangement with the IMF, Chile reached a preliminary agreement with the IMF on the second stage of its extended fund facility, Costa Rica's negotiations with its commercial bank creditors remain on hold, and Panama is still trying to obtain a World Bank structural adjustment loan. 25X1

Argentina

An IMF team has finished gathering data and is now discussing policy issues with government officials, according to the US Embassy. Current points of contention include the continuing increase in real government expenditures, as well as Buenos Aires' failure to liberalize foreign exchange payment procedures. Moreover, the IMF is concerned that fiscal objectives will be overridden by increasing pressure on Buenos Aires to grant salary increases and boost pension payments. We believe such doubts could delay approval of a $1.55 billion combined standby agreement/compensatory financing facility until early next year. We do not expect Argentina to approach commercial banks for an estimated $1.0-1.5 billion in new lending until after it successfully concludes the IMF discussions. 25X1

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Chile 25X1

Chile has reached preliminary agreement with a visiting IMF team on its 1987 macroeconomic targets under the second stage of its three-year extended fund facility, according to US Embassy reporting. The targets closely parallel this year's performance and include a 4- to 5-percent GDP growth rate, a 15-percent inflation rate, and a nonfinancial public-sector deficit equaling 1.7-percent of GDP. Santiago anticipates achieving these goals by incurring another billion dollar current account deficit in 1987. The economic team plans to finance most of the gap with a $250 million World Bank Structural Adjustment Loan (SAL)—expected to be approved in late November—$400 million in World Bank and IDB project loans, and part of a $650 million 1987-88 commercial loan/interest concession package yet to be negotiated. [redacted] 25X1

Costa Rica

San Jose and its creditor banks averted for the moment a confrontation last month that could have led to a seizure of Costa Rican assets by banks, but negotiations likely will remain slow as differences on key issues remain. Costa Rica made a token $5 million payment of overdue interest to creditor banks 23 October—backtracking on its earlier threat of withholding all payments until it was granted a multiyear rescheduling agreement—in order to resume negotiations with its bank advisory committee (BAC). 25X1 San Jose announced it will also seek a new IMF standby agreement; a Fund mission will travel to Costa Rica on 24 November. Despite a resumption of negotiations, San Jose and the BAC remain far apart on terms of a debt rescheduling. [redacted] 25X1 [redacted] 25X1 the banks seem willing to settle for less than complete payment of overdue interest prior to reaching an agreement. The BAC is now waiting for the IMF mission report—expected in late December—before making its next move. For its part, Costa Rica is confident that it can use the letter of intent, which may be agreed to by 1 January 1987, to complete talks with the banks, according to the US Embassy. [redacted] 25X1

Panama

Despite the rapidly approaching World Bank deadlines, Panama has yet to send to the national assembly the social security reform package necessary to finalize the second structural adjustment loan (SAL-II) for $100 million. President Delvalle is aware that prompt action is necessary to give the World Bank enough time to approve the SAL-II this year—the final loan committee meeting is scheduled for 25 November—but he has yet been unable to forge the political consensus required to get the legislation passed. 25X1 Because of strong public opposition to the reform proposals, Panama is trying to scale down the World Bank program to what it considers to be domestically acceptable at this time. 25X1 Panamanian ministries are preparing a detailed study of the social security system to find alternatives to World Bank proposals, [redacted] 25X1 Successful implementation this year is vital for the government's effort to maintain financial stability. In addition to missing the disbursements of SAL-II funds, Panama's failure to gain approval for the SAL would jeopardize disbursement of the final three tranches—totaling $39 million—of commercial bank financing. Without this new financing the government may miss the IMF public-sector deficit target contained in the

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current standby accord, and create problems for further reschedulings next year. Although we expect the reforms to be enacted some time this year, the delays thus far may require a commercial bank rollover of maturities due after 1 January 1987. [redacted] 25X1 25X1

USSR/Eastern Europe

The Soviet Union is considering a new $200 million Eurodollar facility, and Yugoslavia failed to meet September targets specified in its debt rescheduling agreement with commercial banks. [redacted] 25X1

USSR

In early November, a number of French and West German bankers expressed concern about Soviet pressure on East European countries for repayment of their present debts to the USSR. [redacted] the Europeans' concern— 25X1 expressed on several occasions—centered on their belief that the present level of Soviet pressure would impair scheduled repayments to French and West German banks. In other matters, Vneshtorgbank, the Soviet Foreign Trade Bank, is discussing a $200 million Eurodollar facility proposed by a US moneycenter bank. [redacted] 25X1 the proposal calls for an eight-year facility with an interest rate of .125 25X1 of a percentage point over LIBOR for the first six years and a .250 of a percentage point over LIBOR for the remaining two years. Fifty percent of the principal repayments would be made in semi-annual payments over the last two years of the facility with the remaining 50 percent coming due at the end of the eight year period. [redacted] 25X1 25X1

[redacted] the USSR has sold an estimated 25X1 250 tons of gold through August, earning Moscow nearly $3 billion so far this year. The Soviets are likely to earn an additional $1.5 billion in the remainder of 1986. Thus, total sales in 1986 could reach 400 tons—more than double last year's 190-ton mark. [redacted] traders attribute the recent fall in gold 25X1 prices to heavy Soviet sales in October which has prompted the price-conscious Soviets to retreat to to the sidelines at least temporarily. [redacted] 25X1

Yugoslavia

Yugoslavia failed to meet the September "trigger mechanism" target for export performance specified in its debt rescheduling agreement with commercial banks, [redacted] The level of foreign exchange reserves also fell 25X1 slightly below the target. [redacted] banks would review Prime Minister 25X1 Mikulic's proposed economic reforms before deciding how to proceed with the second phase of the rescheduling in the spring of 1987. [redacted] 25X1

Meanwhile, in late October, Belgrade reduced its projections of the 1986 surplus in its convertible currency current account from $700-800 million to $360 million. Yugoslav officials hope increased exports and tourism revenues in the fourth quarter will fuel the improvement. Achieving even this figure would require a marked turnaround since Yugoslavia registered a hard currency current account deficit of $376 million through August. [redacted] 25X1

[redacted] 25X1

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Asia

Indonesia

[redacted] 25X1

Squeezed by stagnant oil prices, Indonesia is stepping up its foreign borrowing from both official and commercial sources. At Jakarta's request, a consortium of US, Japanese, and Arab banks arranged an eight-year, $350 million loan for Indonesia, with terms comparable to other loans obtained this year. Jakarta also is pressing Japan to agree to two new loans—a loan from the Japanese EXIM Bank sufficient to cover the local costs of all World Bank and Asian Development Bank loans over the next two to three years, and a quick disbursing, commodity assistance loan to purchase foreign goods. The US Embassy believes it highly unlikely the Japanese will agree to the total Indonesian package—estimated at several hundred million dollars. On another note, Jakarta has reduced tariffs and other import barriers and offered new incentives to foreign investors in a bid to stimulate the economy. Furthermore, to put to rest rampant rumors of impending foreign exchange controls and conversion of foreign bank deposits to treasury bonds, Finance Minister Prawiro assured business leaders that the government will continue Indonesia's free currency exchange system. [redacted] 25X1

Africa/Middle East

In the Middle East, Morocco signed a letter of intent with the IMF, and the Fund believes Egypt must undertake further reforms to avoid an impasse. Among the African countries, Nigeria's commercial bankers agreed to a rescheduling, South Africa's economy was reviewed by its bank creditors, and Zaire proposed controversial economic changes. [redacted] 25X1

Morocco

Rabat signed a letter of intent with the IMF late last month for a $275 million, 15-month standby arrangement, according to US Embassy reporting. Economic performance criteria under the arrangement include major cutbacks the budget and modest reductions in government arrearages to both foreign and domestic creditors. In addition, to help achieve these gains Rabat has agreed to phase out consumer subsidies for vegetable oil and sugar next year. [redacted] 25X1

Meanwhile, Moroccan officials are meeting this week with the country's commercial bank advisory committee in London to continue negotiations to reschedule commercial debts. [redacted] 25X1 25X1 bankers agreed to reschedule all principal repayments falling due in 1985-87 — totaling some $1.5 billion. To meet the IMF requirement that commercial banks provide $235 million toward closing the country's $788 million financial gap next year, bankers decided to extend $173 million in fresh loans to Moroccan banks, and to again reschedule $62 million of previously rescheduled debt falling due next year. Under the formula bankers agreed on, only French banks will be required to provide new money. In addition, bank creditors will restructure $450 million in trade-related credits which have been frozen by Rabat since 1983. [redacted] 25X1

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Egypt

The IMF team visiting Cairo has warned Egyptian officials that they must quickly present new and more far-reaching economic reform proposals to avoid an impasse in negotiations over a standby arrangement. Fund representatives reportedly also are insisting that Cairo abandon its gradualist approach and adopt major policy adjustments simultaneously, which the Egyptian government strongly opposes. Egyptian officials have promised a new reform draft by this weekend — before the IMF delegation leaves — to keep standby prospects alive. A satisfactory response by the Egyptians is far from certain, however. Even if Cabinet experts can agree on reform measures, the package will need President Mubarak's approval, and he remains fearful that increased prices will lead to widespread political unrest. Persuading him will require a concerted effort by the Cabinet and Prime Minister Sidqi and time. [redacted] 25X1

Nigeria

Nigeria's commercial bank advisory committee agreed last weekend on terms for a rescheduling of roughly $3.6 billion in debts, according to a US official. The rescheduling package includes $320 million in new money from the banks, and the bank advisory committee's approval of terms will allow the World Bank to begin disbursements from a $450 million loan it approved last month. Nigeria has signed a letter of intent with the IMF, but Fund approval of a standby arrangement will be on hold pending commitment of a critical mass of creditor banks —probably 80-90 percent— to the new money loan. Moreover, the final $100 million disbursement from a $250 million bridge loan approved in October by official bilateral creditors, and negotiations for a Paris Club rescheduling, await IMF approval of a standby arrangement. [redacted] 25X1

South Africa

South Africa's foreign bank creditors view the country's financial position as better than expected, [redacted] 25X1 25X1 Bank creditors believe South Africa is able to make additional repayments against the country's $14 billion in frozen debts above the currently agreed limit of 5 percent of actual maturities. Bankers were unsuccessful in their bid to boost repayments at the September interim review of the moratorium, however, and the limitation is unlikely to be revised until its June 1987 expiration. Indeed, some bank creditors are foregoing repayments eligible under the freeze. The report indicates roughly half the loans owed by the South African private sector are being renewed voluntarily by foreign creditors. [redacted] 25X1

Meanwhile, Pretoria continued to bolster foreign currency reserves last month, and added to gold reserves, according to US Embassy reporting. Hard currency reserves rose sharply to almost $800 million, and the country added about 19 tons of gold to reserves — now officially totaling some 141 tons valued at roughly $1.7 billion. [redacted] 25X1

Zaire

Zaire's ruling political party late last month proposed sweeping economic policy changes that could jeopardize the country's IMF and World Bank programs. Party leaders recommended limiting Zaire's debt service payments to 10 percent of export earnings, returning to a fixed exchange rate, and reimposing trade restrictions, according to US Embassy reports. The IMF and World Bank have suspended disbursements pending clarification of Zaire's economic policy. President Mobutu this month sought to

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moderate creditors' reaction by assuring them Zaire would meet all debt service and IMF and IBRD commitments through the end of this year. Mobutu said, however, he wants to renegotiate Paris Club, IMF, and World Bank agreements for 1987. According to the US Embassy, Mobutu has proposed sending a delegation to Washington to begin talks with all concerned parties to reduce Kinshasa's debt payments, and he almost certainly will personally raise the issue in his scheduled meeting with President Reagan next month. Mobutu has instructed his new finance minister — who reportedly drafted the economic proposals that prompted the IMF and World Bank suspensions — to prepare Zaire's negotiating position. 25X1

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25X1 [redacted]

FINANCIAL BRIEFS

International

[redacted] 25X1

Americas

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Colombia trying to reassign $361 million of a $1 billion commercial bank loan earmarked for coal and oil to the electrical power system ... banking officials unlikely to approve change before the end of the year deadline... Bogota may ask for a six-month extension. [redacted] 25X1

[redacted] 25X1

Guyana hoping to resume formal negotiations with the IMF ... [redacted] 25X1 [redacted] ... has no 25X1 reserves to make arrearages payments to Fund or World Bank. [redacted] 25X1

Haiti issued deflationary budget for FY 1987 ... $28 million deficit likely covered by external assistance ... indicates effort to foster sound economic policies ... follows IMF guidelines and paves the way for IMF structural adjustment facility and World Bank loan. [redacted] 25X1

Uruguay continues to comply with its current IMF-supported program ... economy growing but rapidly expanding money supply fueling inflation, which could exceed 75 percent by yearend ... IMF probably will approve Uruguay's application for enhanced surveillance arrangement next year. [redacted] 25X1

Europe

[redacted] 25X1

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Poland offered no concrete proposals to Paris Club last month for dealing with 1986 payment arrears ... Paris Club offered to reconvene to consider rescheduling additional maturities due in 1986 under the 1982-84 rescheduling agreement, but only if Warsaw pay

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half its more than $300 million in arrears due under the 1981 accord. [redacted] 25X1

[redacted] 25X1

Asia

Malaysia announced a 6-percent cut in spending for 1987, slashed development spending by 24 percent ... nonetheless, overall deficit expected to increase by two-thirds ... foreign creditors likely to be concerned as Malaysia anticipates more borrowing. [redacted] 25X1 25X1

Thailand set a ceiling at $1 billion for external borrowing in FY 1987 ... $113 million from multilateral financial institutions, $418 million from foreign governments, and the remainder from commercial banks ... borrowing may surpass $1 billion, however, if Bangkok hopes to complete 44 proposed projects estimated to cost $1.6 billion. [redacted] 25X1 25X1

Africa/Middle East

[redacted] 25X1

France signed agreement with **Iran** to repay Tehran's $1 billion loan to European uranium enrichment company EURODIF, according to press report ... [redacted] total repayment to be only $750 million, less than half what Iran has been seeking ... France to repay Iran $330 million immediately, [redacted] 25X1 25X1 25X1

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Bank creditors will resist **Iraqi** request to defer repayment for another two years on 1983 $500 million Euroloan, [redacted] ... bankers instead insisting Baghdad pay half its $65 million arrears on the loan immediately. [redacted] 25X1 25X1

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Signing of **Ivory Coast**'s $1 billion commercial bank debt rescheduling likely this week ... President Houphouet-Boigny won limits he sought on swaps of Ivorian debt on secondary market ... was concerned Arabs might acquire loans for political leverage ... Abidjan will have preemptive purchase rights, and buyers not already Ivorian creditors will be limited to $15 million. [redacted] 25X1

Rumors of further devaluation are again prominent in **Saudi Arabia** ... new rate expected to be 3.85 riyals to the dollar ... part of Riyadh's effort to offset declining oil revenues ... may be timed with change to new fiscal year and budget announcements expected in late December. [redacted] 25X1

[redacted] 25X1 25X1

[redacted]

UPCOMING IMPORTANT DATES

Date	Event	Comment
25 November	World Bank Executive Board Meeting (Washington)	Vote on Chile's Structural Adjustment Loan. [redacted] 25X1
4 December	Foreign Minister-Level Meeting of the Latin American Integration Association (Montevideo)	Agenda will include an assessment of the regional economic situation, bilateral issues, and the prospects for Latin American integration. [redacted] 25X1

[redacted] 25X1

Date	Event	Comment
Week of 15 December	Paris Club Meeting (Paris)	Countries tentatively on the agenda include Gabon, Philippines, Poland, Cuba, Nigeria or Sierra Leone, and Brazil (1986/87 Economic Review by IMF Rep). [redacted] 25X1
January	Possible Foreign Minister-Level Meeting of the Cartagena Group	Meeting probably will include discussions of the effects of protectionism and export subsidies on the foreign debts of Latin American nations. [redacted] 25X1

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