25X1
Declassified in Part - Sanitized Copy Approved for Release 2012/05/29 : CIA-RDP90T00114R000404330001-4

Page Denied

Next 1 Page(s) In Document Denied

Declassified in Part - Sanitized Copy Approved for Release 2012/05/29 : CIA-RDP90T00114R000404330001-4

Declassified in Part - Sanitized Copy Approved for Release 2012/05/29 : CIA-RDP90T00114R000404330001-4 25X1

[redacted]

Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

International Financial Situation Report #61
12 February 1987

Summary

The Third World debt situation is fast approaching another crisis point. This time the crystallizing problem is Brazil. Brazil's economy is deteriorating rapidly with the trade surplus plunging and inflation soaring. We see a growing risk that President Sarney may suspend or limit payments to divert criticism for failed domestic policies and to refurbish his flagging popular support. The Sarney administration has yet to formulate a coherent strategy to stem the rapidly decaying economic situation due to dissension within the government's economic team. Most recently, the Central Bank President resigned due to irreconcilable differences with Finance Minister Funaro over economic policy. His replacement, Francisco Gros, who is a protege of Funaro, is expected to advocate expansionary fiscal and monetary policies, and take a tougher position on foreign debt. [redacted] 25X1

Brazil, however, is not the only country where debtors' relations with creditors are being disrupted.

- We expect the Argentine-bank creditors talks, scheduled to begin today, will be long and difficult, reflecting Buenos Aires insistence on larger-than-expected new money requests, narrow interest rate spreads, and the bankers' reluctance to commit new funds.
- Ecuador already failed to make its January and February interest payments, totaling some $80 million.
- Chile recently threatened to suspend debt service if a way was not found to close Santiago's $650 million financing gap.

25X1
25X6

- [redacted]
- The Philippines [redacted] is publicly taking a tough negotiating position. [redacted] 25X1

NOTE: REPORT #62 WILL BE PUBLISHED ON 19 MARCH 1987

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

[redacted]

25X1

GI M 87-20029C

[redacted] 25X1

25X1

Copy of 75

[redacted]

Declassified in Part - Sanitized Copy Approved for Release 2012/05/29 : CIA-RDP90T00114R000404330001-4

Declassified in Part - Sanitized Copy Approved for Release 2012/05/29 : CIA-RDP90T00114R000404330001-4 25X1

[redacted]

KEY ISSUE

Brazilian Debt Negotiations

Evidence is mounting that Brazil is prepared to take a firm stand in demanding lenient debt rescheduling terms — comparable to those won by Mexico — in upcoming negotiations with bank creditors. [redacted] 25X1 We believe Brasilia will use the same heavy-handed negotiating tactics with its bank creditors if they refuse to meet demands for sharply lower interest spreads, about $2 billion of new money, and no IMF conditionality. [redacted] 25X1

We believe bankers, for their part, will remain reluctant to grant major concessions unless Brasilia implements sounder steps to stabilize Brazil's economy. Indeed, they are steadfastly opposed to committing new loans without an IMF-supported program. [redacted] 25X1 Nonetheless, Brazil and its creditors will seek to avoid a collapse in negotiations, 25X1 realizing that there is too much to lose by both sides failing to participate. [redacted] 25X1

With the demise of the Cruzado Plan and diminished credibility of the administration, interest rates on certificate of bank deposits have soared from 200 percent in early January to over 800 percent this week and inflation could move toward four digits this year. The President's efforts to forge an agreement with business and labor have so far failed. As a result, labor unions are threatening another general strike if significant wage hikes are not granted soon, according to the US Consulate in Sao Paulo. Meanwhile, [redacted] continued paltry monthly trade surpluses have caused cash reserves to fall to $2 billion or less. [redacted] 25X1

25X1

We see a growing risk that President Sarney may suspend or limit payments to divert criticism for failed domestic policies and to refurbish his flagging popular support. The Sarney administration has yet to formulate a coherent strategy to stem the rapidly decaying economic situation due to dissension within the government's economic team. Most recently, Central Bank President Bracher resigned due to irreconcilable differences with Finance Minister Funaro over economic policy. He was replaced by Francisco Gros, a director of the National Bank of Economic and Social Development. Gros, a protege of Funaro, is expected to advocate expansionary fiscal and monetary policies, and take a tougher position on foreign debt, according to the US Embassy. [redacted] 25X1

25X1

[redacted] 25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/05/29 : CIA-RDP90T00114R000404330001-4

Declassified in Part - Sanitized Copy Approved for Release 2012/05/29 : CIA-RDP90T00114R000404330001-4 25X1

[redacted]

DEVELOPMENTS IN MAJOR COUNTRIES

Mexico

25X1

Mexico still lacks 100 percent commercial bank commitment to its new money package. The country's bank advisory committee contends an agreement can be reached by the end of the month, but the difficulty in working out a compromise could postpone final approval until late March. To encourage full participation, Mexican officials recently have made trips to the United States and Europe to drum up support for the plan, which asks banks to lend a fixed portion of their 1982 exposure levels. [redacted] 25X1

[redacted]

[redacted] Mexico's announcement earlier in the month that it was able to build foreign exchange reserves last year — despite receiving only $500 million of the $3.5 billion it originally sought from commercial banks for 1986 — has raised doubts about the country's true borrowing needs. [redacted] 25X1 25X1

[redacted] 25X1

[redacted] 25X1

[redacted] Government forecasts currently project an inflation rate of 70 to 80 percent, but Mexicans and outside observers generally are convinced the level will exceed 120 percent. Budget Minister Salinas, closely identified with Mexico's growth plans, could see his presidential aspirations dashed if recovery is stalled. [redacted] 25X1 25X1

Argentina

Buenos Aires is scheduled to begin formal talks with commercial banks on 12 February; Argentina will request $2.1 billion in new financing, according to the US Embassy. The government hopes for a quick agreement so that any adverse domestic political fallout will have cleared before campaigning for the November congressional and gubernatorial elections enters into full swing. We believe, however, that the larger-than-expected new money request, Buenos Aires' likely insistence on narrow interest rate spreads, and bankers' growing reluctance to commit new funds to any Latin debtor presage long, difficult negotiations. [redacted]

25X1

The Paris Club is requiring that Argentina sign and make payments due under all 1985 debt rescheduling agreements before it considers 1986-87 debt rescheduling, according to Embassy reporting. Buenos Aires has not yet signed bilateral agreements with Denmark, Israel, the Netherlands, Sweden, the UK, and the US, although a special

 25X1

[redacted]

Declassified in Part - Sanitized Copy Approved for Release 2012/05/29 : CIA-RDP90T00114R000404330001-4

Declassified in Part - Sanitized Copy Approved for Release 2012/05/29 : CIA-RDP90T00114R000404330001-4 25X1

[redacted]

task force is working hard to reconcile remaining differences. The Paris Club has proposed a March meeting date should Argentina fulfill its conditions. [redacted] 25X1

Other Latin American Countries

In Latin America, Chile, Venezuela and Ecuador continue to negotiate debt relief packages with their commercial creditors. [redacted] 25X1

Chile

25X1

Negotiations between Chile and its bank advisory committee continue to falter over disagreement on how to close the projected $650 million financing gap. [redacted] 25X1 [redacted] three proposals are currently on the table. The first would allow Chile to pay interest once rather than twice annually, thus deferring interest payments. All but one of the twelve banks on the committee support this plan because it meets regional and foreign bank insistence on no new lending to Santiago. The second scheme would garner funds through a bond issue that bankers would guarantee. Although this proposal would not require lending Chile new money, most banks are reluctant to become a guarantor for Chile. The third and most recent plan stipulates that the World Bank and commercial bank cofinance Chile's gap, with the IBRD contributing $20 million and the commercial banks $430 million. The advisory committee is presently considering this plan, but creditor country concerns over the misuse of this lending window could nix World Bank approval, according to the US Embassy. [redacted] 25X1

Chilean negotiators — frustrated by the delay in resolution — threatened to suspend debt service last week, but switched to a wait-and-see stance after speaking with the US Treasury, according to US Embassy reporting. The US Treasury believes a final agreement—possibly including the retiming proposal—may be in place this week. Meanwhile, Chile may ask for a relaxation of its IMF reserve targets to bridge a projected financing shortfall in June. Santiago has requested Paris Club debt relief and we expect Chile will ask to reschedule about $200 million due in 1987-88. [redacted] 25X1

Venezuela

Venezuela has softened somewhat its position in negotiations with commercial banks over public-sector debt [redacted] Unless the banks yield to remaining pressure, however, it is unlikely that an agreement will be reached by 29 March, the current deadline for principal repayments. [redacted] 25X1

[redacted] According to US Embassy sources, Finance Minister Azpurua is optimistic that Venezuela can renew its access to international capital markets — if it makes some principal repayments — and secure as much as $400 million in new lending in 1987. [redacted] 25X1

[redacted] 25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/05/29 : CIA-RDP90T00114R000404330001-4

Declassified in Part - Sanitized Copy Approved for Release 2012/05/29 : CIA-RDP90T00114R000404330001-4 25X1

[redacted]

Ecuador

Ecuador remains at an impasse with foreign bank creditors. Complicating factors in the negotiations have been Quito's claimed inability to make its January or February bank interest payments totaling $80 million without exceptional short-term financing and continuing disagreements over the terms of a 1987 finance package. [redacted] 25X1

Commercial bank representatives and members of Ecuador's economic team are meeting this week to try to resolve the deadlock. [redacted] 25X1

President Febres-Cordero has been on the defensive since his temporary abduction by Air Force paratroopers last month and he does not want to be seen slashing reserves to satisfy foreign economic interests. According to US Embassy reporting, he has been angered by bank demands for assurances that Ecuador will not seek recourse to creditors for February debt service. He feels Ecuador deserves special consideration, given his administration's responsible debt payment record. [redacted] 25X1

Asia

In Asia, Paris Club creditors rescheduled some Philippine official debt, Indonesia has gone a long way in allaying bankers' fears in part by announcing an austere draft budget [redacted] 25X1

Philippines

The Philippines' Paris Club creditors, impressed by the scope of Manila's economic adjustment effort, agreed to reschedule $870 million in long-term loans over 10 years, with a five-year grace period. All principal and 70 percent of interest falling due between January 1987 and June 1988 will be rescheduled. Meanwhile, the Philippines consultative group (CG) of creditor governments and multilateral financial institutions agreed to provide $1.5 billion in official development assistance in 1987 — a 15-percent increase over 1986 levels but short of Manila's $2 billion request. The CG dismissed Manila's bid to establish a $7 billion "growth contingency fund" to bridge projected medium-term financing gaps. [redacted] 25X1

Negotiations with commercial bank creditors [redacted] may be delayed until some progress has been made on Argentine and Brazilian debt talks with bankers. Although the Philippines [redacted] is publicly taking a tough negotiating position, we believe government officials are privately beginning to think that a continued stalemate will soon begin to work against Manila's interests by delaying the normalization of its relations with the major international banks. As a result, Philippine negotiators may be more receptive to its BAC's offers. [redacted] 25X1

25X1

[redacted] 25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/05/29 : CIA-RDP90T00114R000404330001-4

Declassified in Part - Sanitized Copy Approved for Release 2012/05/29 : CIA-RDP90T00114R000404330001-4

[redacted] 25X1

Indonesia

25X1

Indonesia's austere draft FY 87/88 budget has gone a long way in restoring bankers' confidence. [redacted] Jakarta will not have to reschedule its foreign debt in either 1987 or 1988 unless oil prices plunge to $10 a barrel for a prolonged period. The current account deficit also is expected to fall from $4 billion in 1986 to between $2.6 to $3 billion in 1987. With its $10.1 billion in gross foreign reserves and $2.3 billion in unused commercial credits, Jakarta probably will not be forced to seek additional funds to cover this year's deficit unless oil prices fall below $13 a barrel [redacted] 25X1 Western bankers, however, predict Jakarta will try to shore up its economy with a return to the commercial market after April. The government, however, hopes to ease the debt burden with $3.8 billion in export credits, soft loans, and bilateral aid from donor countries this year. [redacted] 25X1

25X1

We believe Indonesia will experience little or no economic growth in 1987, and that the economy will remain vulnerable to external shocks. Foreign bankers believe Jakarta could hedge against further appreciation of the yen or declining oil prices by negotiating an IMF standby program. Senior government officials, however, reject the conditions attached to IMF standby programs, and prefer to negotiate drawing under the Compensatory Financing Facility. However, an oil based CFF for a leading OPEC member such as Indonesia would be unprecedented. [redacted] 25X1

25X1

[redacted]

Africa/Middle East

In Africa, Egypt's negotiations with the IMF continue and South Africa's renegotiation of last year's commercial debt accord will begin on 24 February. [redacted] 25X1

25X1

Egypt

Negotiaions between Egypt and the IMF for a standy program resumed last month with growing evidence that Cairo plans to test the Fund's firm position. Egypt is maintaining the position — set out in the November economic policy paper — that

[redacted] 25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/05/29 : CIA-RDP90T00114R000404330001-4

Declassified in Part - Sanitized Copy Approved for Release 2012/05/29 : CIA-RDP90T00114R000404330001-4

25X1

standby conditionality must be on terms favorable to Cairo. Egypt is seeking support from at least one European country for a standby based on these conditions, even though many official creditors feel the policies set forth in November are insufficient to tackle Egypt's economic troubles, according to the US Embassy. [redacted] even if the two sides can agree on the term of the standby, the remaining differences over interest rates, exchange rate unification, and energy price increases make it unlikely that an agreement will be reached in the near term. [redacted]

25X1

25X1

South Africa

The opening round of talks to renegotiate last year's South African-commercial bank debt accord has been moved up two months to 24 February, in part due to growing creditor concern that the negotiations may get caught up in Pretoria's increasingly anti-Western election campaign. South African negotiators have already formed a hard line position and have hinted at discrimination against American creditors — by offering better terms and faster repayment to other foreign banks. Nevertheless, both South African and private bank negotiators are satisfied with the basic structure of the existing agreement, and will probably renew the accord with minimal changes, according to the US Embassy. The overriding question during the negotiations will be the amount of principal South Africa pays this year. The banks are asking for repayments totaling $1.3 billion — about 15 percent of outstanding principal — or more than twice the amount under last year's agreement. But South Africa, stressing growing political constraints, will hold out for a repayment of less than $500 million, according to the US Embassy. [redacted]

25X1

25X1

[redacted] Eastern Europe

25X1

[redacted] Poland failed to reach agreement with the Paris Club last month. [redacted]

25X1

25X1

Poland

Poland failed to reach agreement with the Paris Club last month to revise the previously initialed 1986 rescheduling. The agreement was not finalized due to a lack of agreement on 1987 debt servicing. The creditors offered to reschedule over nine years more than $1.3 billion in principal and interest payments agreement due in 1986 and the first half of 1987, except for debt service due under the earlier 1981 agreement.

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/05/29 : CIA-RDP90T00114R000404330001-4

Declassified in Part - Sanitized Copy Approved for Release 2012/05/29 : CIA-RDP90T00114R000404330001-4

25X1

Warsaw, which requested better terms including a longer consolidation period and a halt to late interest charges through the end of September 1987, refused to compromise. Negotiations may resume in March. Meanwhile, Polish estimates concerning its debt servicing ability are bleak: Poland owes more than $5 billion on commercial and official debt this year, plus at least $2 billion in arrears from 1986, but projects paying only $1.6 billion.

25X1

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/05/29 : CIA-RDP90T00114R000404330001-4

Declassified in Part - Sanitized Copy Approved for Release 2012/05/29 : CIA-RDP90T00114R000404330001-4

25X1

FINANCIAL BRIEFS

Americas

25X1 The World Bank and IDB renewed loan disbursements to **Paraguay** after one month suspension due to overvalued guarani ... Asuncion recently devalued export rate of 550 guaranies to the dollar for cotton and soybeans ... Paraguay risks future suspensions unless it keeps the cotton-soybean export and loan disbursement rates equal. 25X1

Peruvian officials, euphoric over 9-percent GDP growth last year, project 7-percent growth this year with inflation dropping to 40 percent ... surging prices in December and January and rapidly expanding public deficit, however, suggest inflation underestimated ... private forecasters predict 5-percent growth at most, due to lagging private investment. 25X1

Asia

25X1

Brunei's seizure of the privately-owned National Bank of Brunei has developed into one of Southeast Asia's biggest financial scandals in recent years ... about 90 percent of the loans outstanding — $621 million — went to companies linked to wealthy Malaysian financier Tan Srk Khoo, whose family owned over 70 percent of the bank ... almost no interest or principal has been paid on these loans for years ... Khoo's close relationship to Brunei's ruling royal family is central mystery in the affair.

25X1 25X1

India's rising foreign debt, $40 billion projected by year-end 1987, will make it second largest Asian debtor ... currently debt is manageable but New Delhi may face debt servicing problems in a few years

25X1 25X1

North Korea is interested in joining Asian Development Bank (ADB) ... may view ADB as useful forum for propoganda activities and other mischief-making ... but if it is prepared to play constructive role in bank, North Korea could be drawn into a more responsible pattern of international behavior. 25X1

25X1

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/05/29 : CIA-RDP90T00114R000404330001-4

Declassified in Part - Sanitized Copy Approved for Release 2012/05/29 : CIA-RDP90T00114R000404330001-4 25X1

Africa/Middle East

[redacted] 25X1

Iraq considering pegging dinar to basket of currencies rather than US dollar ... may raise domestic prices of some imported consumer goods but likely to have little impact on trade imbalance. [redacted] 25X1

IMF last week approved one-year, $825 million standby agreement for **Nigeria** ... requires floating exchange rate, tight fiscal policies, financial deregulation ... Lagos had pledged not to draw down available funds, but could reverse position if confronted with serious foreign exchange shortage later in year. [redacted] 25X1

Sudan made $6.7 million token payment to the IMF late January ... does not remove the country from ineligibility list because Khartoum owes $585 million in arrears. [redacted] 25X1

Bank of **Zambia** suspended indefinitely the "commercial pipeline" proposal to settle short-term debt arrears in January ... due to deterioriation in foreign exchange inflows ... Zambia says it will try to settle debts, but through reinvestment of Kwacha in approved local projects. [redacted] 25X1

Eastern Europe

Borrowing by **East European** countries, down to $1 billion last year from $3.3 billion in 1985, probably will increase this year because of reduced hard currency earnings and continuing debt obligations ... troubled debtors, Poland, Yugoslavia and Romania, probably will remain unable to secure new commercial loans. [redacted] 25X1

Romania exploring possibility of repaying official debt rescheduled in 1982-83 by year-end, roughly $300-400 million ... 1986 balance of payments estimates indicate Bucharest would be hard pressed to do so ... part of ongoing attempt to eliminate Western debt as soon as possible. [redacted] 25X1

Probable waiver by creditors of **Yugoslavia's** export target for October-December 1986 will allow second phase of Belgrade's 1985-88 commercial bank rescheduling agreement to proceed without further negotiation ... likely financing gap in 1987 could force revision of rescheduling agreement later in the year, however. [redacted]

25X1

[redacted] 25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/05/29 : CIA-RDP90T00114R000404330001-4

Declassified in Part - Sanitized Copy Approved for Release 2012/05/29 : CIA-RDP90T00114R000404330001-4 25X1

APPENDIX

Key LDC Debtors: Poor Trade Performance in 1986

Most key debtors experienced substantial reductions in export earnings in 1986. Oil exporters —Ecuador, Mexico, Nigeria, and Venezuela — were hard-hit by the sharp drop in oil prices. Lower commodity prices and reduced grain sales cost Argentina nearly $1 billion. High domestic demand in Brazil — the result of the ill-fated Cruzado Plan — increased domestic sales but reduced the quantity of goods available for export, reducing export receipts by over $3 billion. On the other hand, the Philippines benefited from a modest rebound in prices for traditional exports such as coconut products and managed to post a small export gain.

25X1

For the debtors as a group, import cutbacks in 1986 did not match export declines. As a result, the combined trade surplus was cut nearly in half, aggravating financial woes and further delaying sustained economic recovery. Among individual countries, Mexico and Nigeria slashed imports in response to lower oil exports, but in both countries the trade surplus still declined sharply. Argentine efforts to boost real GNP growth led to an import surge, slicing over $2 billion from the trade surplus. Brazil was forced to cut imports to limit reductions in its trade surplus, despite an urgent need for higher import growth to boost domestic productive capacity.

25X1

Key LDC Debtors: Exports and Imports, 1985-86*

(billion US dollars)

	Exports			Imports			Trade Balance		
	1985	1986	%chng	1985	1986	%chng	1985	1986	chng
Argentina	8.4	6.9	-18	3.8	4.6	21	4.6	2.3	-2.3
Brazil	25.6	22.4	-12	13.2	12.9	-2	12.4	9.5	-2.9
Ecuador	2.9	2.1	-28	1.6	1.7	6	1.3	0.4	-0.9
Mexico	21.9	15.8	-28	13.5	11.4	-16	8.4	4.4	-4.0
Nigeria	12.8	6.5	-49	8.5	5.5	-35	4.3	1.0	-3.3
Philippines	4.6	4.7	2	5.1	4.7	-8	-0.5	0.0	0.5
Venezuela	14.2	9.2	-35	7.3	7.0	-4	6.9	2.2	-4.7
Totals	90.4	67.6	-25	53.0	47.8	-10	37.4	19.8	-17.6

*1986 figures are estimated.

25X1

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/05/29 : CIA-RDP90T00114R000404330001-4

Declassified in Part - Sanitized Copy Approved for Release 2012/05/29 : CIA-RDP90T00114R000404330001-4

[redacted]

25X1

SUBJECT: International Financial Situation Report #61 [redacted] 12 February 1987

25X1

Copy No. 1 Sec. James Baker Treasury
2 R. G. Darman "
3 James W. Conrow "
4 Robert Cornell "
5 Thomas J. Berger "
6 Charles Schotta "
7 James A. Griffin "
8 Doug Mulholland "
9 Robert M. Kimmit "
10 David Mulford "
11 Sec. George Shultz State
12 John C. Whitehead "
13 Morton I. Abramowitz "
14 Jerome H. Kahan "
15 Michael Armacost "
16 Ralph Lindstrom "
17 W. Allen Wallis "
18 Elliot Abrams "
19 Rozanne Ridgway "
20 Douglas McMinn "
21 Chester Crocker "
22 Gaston Sigur "
23 Richard Murphy "
24 Harry Gilmore "
25 Byron Jackson Commerce
26 S. Bruce Smart "
27 [redacted]
28
29 Steve Farrar NSC
30 Stephen Danzansky "
31 Randall Fort PFIAB
32 Leo Cherne PFIAB
33 David Tarbell OSD (ISA)
34 DCI
35 ExDir
36 SA/DDCI
37 DDI
38 ADDI
39 Ch/PES/DDI
40 NIO Economics
41 ADD/NIC AG
42 DDO

[redacted]

25X1

[redacted]

25X1

[redacted]

25X1

1 - Manuel H. Johnson, Vice Chairman, Federal Reserve System
1 - H. Robert Heller, Federal Reserve Board
1 - Edwin Truman, Federal Reserve Board
1 - David Roberts, Federal Reserve, New York
1 - Leo Cherne, PFIAB, New York
1 - E. Gerald Corrigan, President, Federal Reserve Bank, New York
1 - John Bohn, Chairman, ExIm Bank
2 - Doug Mulholland, Treasury
1 - Ambassador Richard McCormack, State
1 - Martin A. Wenick, State
1 - Nicholas Burakow, State
1 - Peter W. Rodman, State
5 - Byron Jackson, Commerce
1 - Warren E. Farb, Commerce
1 - [redacted] DIA
1 - Ron Silverman, OMB
1 - Beryl Sprinkel, CEA
1 - Eugene McAllister, EPC
1 - [redacted]
1 -
1 -
1 -
1-
1 -
1 -
1 -
1 -

25X1

[redacted]

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/05/29 : CIA-RDP90T00114R000404330001-4