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Prime Minister

There is
~~at least~~ no time for a

Discussion with the Chancellor

Treasury Chambers, Parliament Street, SW1P 3AG and Governor
01-233 3000

1 September 1983

"Towards the end
of next week"

(The Governor is abroad)

W F S Rickett Esq.
10 Downing Street
LONDON
SW1

Discuss with the

Chancellor, ~~possibly~~

Dear Willie,

Yes not

at Chagners?

MCS 2/9

BRAZIL

I promised to let you have a further report on Brazil following John Kerr's letter of 5 August. This letter summarises developments during the past month.

Renewed negotiations at technical level have taken place between the Brazilian authorities and IMF officials, and there have also been the informal (but widely publicised) contacts between the senior Brazilian economic Minister, Delfim Netto, and the Managing Director of the IMF in Paris. Last week the Advisory Group of Brazil's commercial bank creditors met in New York, with the Brazilians present (as were observers from some central banks, including the Bank of England). The Brazilians have applied to the Paris Club for rescheduling of maturities due in 1983 and 1984 on official and officially guaranteed debt, and, as foreshadowed in John Kerr's letter of 5 August, have told the BIS that they are not at present in a position to pay the next instalment due on their BIS loan on 31 August. With the agreement of BIS Governors, the BIS are for the time being treating this instalment on the same basis as the overdue 31 May instalment, ie neither formally rolling it over nor calling it in default.

On Monday the IMF's Managing Director gave a moderately encouraging report to the Executive Board about the Fund's negotiations with the Brazilian authorities. In brief, agreement has been reached on some exacting objectives, notably deceleration in the inflationary path from the present monthly rate of 13 per cent to about 5 per cent by the end of this year and about half that level by the end of 1984; and limitation of the 'operational' budgetary deficit to 2.7 per cent of GDP in 1983, and a targetted surplus of between 0.2 per cent and 0.3 per cent of GDP in 1984. Budgetary objectives will be underpinned by monthly ceilings to be monitored jointly by the Fund and the Brazilian authorities, applicable to all public sector entities. The Fund still need more specific undertakings from the Brazilians on certain aspects of the programme and the monthly monitoring mechanisms, but de Larosiere was confident that these would be forthcoming. He told the Board that he had been personally heartened by the degree of co-operation and responsiveness of the Brazilian team in Paris. Nothing had been 'left under the carpet'. The Fund envisage that the programme, including a Brazilian letter of intent, will be ready to go forward to the Board in the second half of September, for Board discussion probably in late October. It is hoped this will coincide with clearance by the Brazilian Congress of the key law on wage de-indexation.



The Fund put the overall requirement for external financial support at some \$10-11 billion from now to end 1984. At last week's meeting in New York the commercial banks indicated willingness to put up \$6 billion in new money; official rescheduling is likely to yield between \$1.5 and 2.0 billion; and up to a further \$0.5 billion is believed to be available from the World Bank and other multilateral agencies. All reports indicate, however, that the banks are increasingly taking the strong view that private funds have hitherto borne a disproportionate share of the cost of the Brazilian operation, and that the remaining gap - which is unlikely to be less than some \$2 billion - should now be covered by official funds. De Larosiere has apparently indicated to the bankers that they could count on IMF support in pressing G5 Governments, and Switzerland and Canada, to put up sums of this order.

Brazil is likely to be the main subject on the agenda of a private meeting of G5 officials concerned with debt issues in Washington next Tuesday and Wednesday (5 & 6 September). There are indications that the US are likely to use this as an opportunity to press the case for a G5 financial effort to complement whatever the banks can do. Our line will be non-committal, and we shall give the US no encouragement to expect any UK Government financial support for Brazil.

The next monthly meeting of BIS Governors will take place in Basle the following weekend. As you know, the BIS had previously set an informal (and unpublished) deadline of 15 September for repayment of the overdue instalments of the bridging facility granted to Brazil last December. The Governors will need to decide whether it would be right to enforce that deadline in the light of the progress made in Brazil's negotiations with the IMF and the commercial banks.

On 15 September there is to be a preliminary and informal discussion of the Brazilian request for official debt rescheduling in the Paris Club. In the UK's case, rescheduling could add about £190 million to the PSBR spread over the current and following financial year. The rest of the G5 are believed to have heavier exposure (with the Germans likely to be the worst affected) and the total amount which the Brazilians are asking to be rescheduled is around \$2 billion.

The domestic political background to these various discussions between creditors continues to be difficult and unstable. Opposition within Brazil to the IMF austerity programme now spans the whole political spectrum (including a splinter group from the Government's own party), as well as trade unions, businessmen and industrialists.

In the Brazilian Congress, the opposition is currently engaged in trying to overturn the wages de-indexation Decree Law, referred to at the end of paragraph 3 above. The Government may now be hard pressed to drive this through the Chamber of Deputies. Even if they succeed, and the various pieces of the financial jig-saw fall into place over the next 2-3 months, a break with the IMF and a unilateral moratorium still cannot be ruled out. There is a danger that the nationalist alternative may continue to gain in appeal. However, early confirmation of agreement with the IMF, a continued understanding with the BIS, a settlement with the commercial banks, and a satisfactory Paris Club negotiation would demonstrate the continuing support of the international community and strengthen the hand of the Brazilian Government in sticking to



the necessary adjustment course. But the situation will require very careful handling if the present delicate balance is not to be upset.

In brief, our best assessment at present is that there are grounds for cautious optimism about the prospects for agreement between the IMF and the Brazilian authorities on a satisfactory programme (though not formally before late October at the earliest). But doubts must remain about the ability of the Brazilian Government to put the programme through in the face of growing domestic political opposition. And the cost to creditor Governments of supporting the programme is likely to be significant.

No immediate decisions are required and no new propositions are on the table. But BIS Governors will need to decide at the Basle meeting on 11-12 September whether to continue to roll forward informally the overdue instalments beyond 15 September; and Brazil will almost certainly come up at the informal meeting of EC Finance Ministers in Greece earlier that same weekend. Brazil is also likely to be discussed at the IMF annual meeting in Washington later in the month.

The Chancellor therefore thinks that, as suggested in your letter of 9 August, it might be useful if the Prime Minister were able to discuss the position with the Governor and himself towards the end of next week. They would then be able to have a report on the outcome of the G5 officials' meeting in Washington next Tuesday and Wednesday, and possibly further news of the negotiations with the Fund. The Chancellor also thinks that these developments show that we shall need to have a more fundamental look at current international debt issues and he has put this in hand.

I am copying this letter to John Bartlett at the Bank of England.

*Yours sincerely,
Margaret O'Mara*

MISS M O'MARA
Private Secretary

ECON POR: Indebtedness Pt 2



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