

**CONFIDENTIAL****INTERNATIONAL: Implications of Debt Rescheduling**

*The financial problems of certain developing countries and East European nations were not of great concern to lenders until Poland and Mexico shocked the banking system. Debt problems, albeit increasingly prevalent, were easily manageable because the total amount of debt rescheduled paled in comparison with total debt outstanding. Chronic reschedulers such as Sudan, Togo, and Zaire were more of a nuisance than a problem. Now, however, the Western banking system will probably be faced with a higher number of sizable debt reschedulings this year.*

Led by Mexico, Argentina, Poland, and Romania, a total of 18 countries have announced or indicated they will reschedule. They hold one-fourth of the total external debt of the developing countries and Eastern Europe. The volume of debt rescheduled in 1982 could more than double the record \$10.8 billion attained last year when 14 countries, led by Poland, applied for relief.

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In addition to the countries that probably will reschedule this year, Chile, East Germany, Hungary, Peru, and Yugoslavia are attracting greater attention from international lenders. Although they may be able to avoid rescheduling this year, continued financial pressure could increase the possibility of later reschedulings.

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Many international financial experts believe Brazil also could be at risk. Its sudden difficulty in obtaining foreign loans raises the prospect of a serious foreign exchange crisis.

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Impact

The biggest effect of the expected and potential reschedulings would be on the willingness of commercial banks to continue to expand lending. Just as individual bankers took comfort from and joined in the expansion of lending in the 1970s, now they may draw back or limit the growth of exposure in unison. In addition, banks that were the heaviest lenders in the 1970s are finding their ability to continue lending is being constrained.

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A growing share of Western bank loans that were scheduled to be repaid this year is having to be restructured into longer term assets, decreasing the banks' liquidity. Several sources indicate creditors also are concerned about the potential loss of investor and depositor confidence in large banks heavily exposed to major Third World and East European borrowers. [redacted]

A reduction in the rate of growth in Western bank lending would force many debtor countries to impose austerity measures to compensate for reduced foreign exchange availability. Such moves would slow economic growth and could stimulate political and social unrest in some countries. [redacted]

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At the extreme, this could lead countries to stop payment on external debt and could result in changes in governments. A general reduction in the growth of Western bank lending also could determine whether Brazil, Chile, Hungary, and East Germany are forced to reschedule. [redacted]

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No Quick Solutions

Debtors are operating against an economic backdrop of an OECD growth recovery probably insufficient to give a substantial boost in demand for their exports. Interest rates are easing, but the real cost of credit is rising to the extent that inflation is falling faster than interest rates. Moreover, the austerity measures most debtor developing countries will have to adopt to bring their finances back in line are not instantaneous in implementation or effect and are often proscribed by political conditions. [redacted]

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## **Debt Reschedulings in 1982**

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### **Definite or Probable Reschedulers**

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Argentina  
Costa Rica  
Cuba  
Dominican Republic  
Guyana  
Honduras  
Madagascar  
Malawi  
Mexico  
Nicaragua  
Poland  
Romania  
Senegal  
Sudan  
Togo  
Uganda  
Vietnam  
Zaire

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### **Possible Reschedulers**

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Bolivia  
Central African Republic  
Ecuador  
Liberia  
Pakistan  
Peru  
Sierra Leone  
Yugoslavia


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HUNGARY: Limited Financial Progress

A senior Hungarian banker has told the US Embassy that Hungary's reserves would be insufficient to meet immediate obligations if the Bank for International Settlements does not approve a \$300 million short-term loan next week. The country's reserves have fallen in recent weeks because of additional withdrawals by CEMA banks. The IMF team in Budapest expects the Fund to inform the BIS that progress has been made in negotiating an economic stabilization program. The BIS has insisted on such an indication from the IMF before it approves the loan request. (C NF OC)

Comment: Although the banker may have exaggerated the immediacy of Hungary's financial needs, Budapest requires more funds from the BIS or the IMF to remain solvent through this year. The IMF statement and Budapest's recent actions to improve its payments position are likely to win BIS approval of the loan. Even with these emergency funds, Hungary faces more painful austerity measures if it is to avoid debt rescheduling. (C NF OC)

State Dept. review completed

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