The 'ruinous' LDC debt situation

Funding Third World debt demands for 1980 is looking to be a high-risk venture. But U.S. bankers have indicated they are willing to play with these stakes.

In 1980, the lesser developed countries will come to the Euro-currency markets looking for anywhere from $70 to $100 billion. If there is a significant recession in the United States that spreads to Europe and Japan, it could be much more. Faced with the dilemma of financing everything that is requested, or of pulling down one or more countries by saying "no," U.S. bankers have nothing to lose but their shirts.

And despite the deafening silence that top U.S. bankers are maintaining for public consumption on the crisis, most know, as one securities analyst put it, that the real situation is "ruinous." That has put the major banks in the absurd position of throwing worse money after bad, and in larger quantities than ever before. If in 1978 and 1979, the U.S. banks stayed away in droves from participation in many LDC loans because the risk was too high, they apparently intend to return in 1980 when the risk is far greater and the stakes far higher.

Brazil is of course the *primus inter pares* among LDC debtor countries. Fantasy has so far dominated Finance Minister Delfim Neto's kited projections for the Brazilian economy and financing needs.

Those calculations, as presented to bankers in New York last month, break down as follows: A balance of trade deficit of 0 (based on the assumption of $20 billion in both imports and exports), $3.7 in services, $5.4 billion in net interest charges, $7 billion in rollover of principal, for a total of $16 billion to be covered by: $2 billion suppliers credits, $2 billion direct investment, $2 billion drawdown of reserves, leaving $10 billion in need of financing.

The projected trade balance assumes $28 per barrel oil. But at the more realistic $30-32, the oil bill goes up $1-2 billion. It also assumes no break in coffee, soybean and iron ore prices, a dubious assumption if there is any weakening of the industrialized economies. Moreover, Delfim's plan calls for a 31 percent increase in exports. Realistic estimates are for a $2-4 billion trade deficit. As for Delfim's $12.5 billion in debt service estimate, it relies on a very low figure for average interest costs (well below the 17 percent LIBOR now prevailing); New York's *Journal of Commerce* pegs it at $14 billion.

In short, Brazil is likely to need from $2 to $6 billion more than the $10 billion so far requested.

The banking community has responded by saying that Brazil will get its money—even if it's more than $10 billion—but only at much higher spreads than have prevailed recently. After all, the only choice is to bring Brazil and the whole LDC debt pyramid down, and maybe with it Citibank and New York City.

All of this misses the real issue. The calculations for Brazil, which could be repeated for a dozen other LDCs, depend absolutely on the continuation of the inflationary spiral in the world economy. Any deflation, a serious recession, and all bets are off.

Almost any debt, LDC or otherwise, can be refinanced, no matter what the interest rate, if the funds are plentiful at the price. But most of the highly indebted LDCs, like Peru, Algeria, Argentina, Indonesia and Mexico, are considered good risks solely because of the huge run-up in raw materials and petroleum prices. A deflationary break in the hyperinflation cycle will turn most of the $315 billion in LDC debt into the modern equivalent of Tsarist bonds.

Fed Chairman Paul Volcker, aware that all is not well, recently surmised that there could be some LDC financing problems this year. But Volcker's preferred nostrum—tapping what he estimates to be $23 billion in IMF moneys—is wishful thinking. The conditions under which that money would become available would necessitate such levels of austerity as to be economically—and politically—impossible to administer.

So the banks just keep on pumping money and aggravating the underlying unviability of the financial pyramid so constructed. Bereft of positive alternatives, which would *solve* the LDC debt problem, the banks are determined to play out their losing hand to the end.