GMD | 015 | 0085 | 19   Banks   112

THE NEW INTERIM AGREEMENT BETWEEN THE BANKS AND SOUTH AFRICA
1 July 1990 through 31 December 1993
AND ITS IMPLICATIONS

by

John E. Lind, Ph.D.
CANICCOR Research
P.O.Box 6819 San Francisco, CA 94101
(415) 885-5102: FAX (415) 362-2583
23 October 1989

THE IMPLICATIONS OF THE THIRD INTERIM AGREEMENT

The international banks agreed on 18 October 1989 to a South African proposal for rescheduling the approximately $8.5 billion of South African debt falling due in mid-1990 under the second interim agreement. This third interim agreement is for 3 1/2 years with the repayment rate in the last half of 1990 remaining the same as that paid for the last year and one half of the second interim agreement (1.5% semi-annually). Since the debt repayment outside of the interim arrangement in 1990 is similar to that in 1988 but $0.7 bilion less than that in 1989, the South African economy will probably continue on in 1990 at somewhat below its present growth rate of about 2%.

The repayment rate under the interim agreement nearly doubles in 1991, reaching 3% semi-annaully in 1983, and attaining nearly 7.5% annually in 1993 at the end of the agreement. However, because of the decrease by $0.5 billion in the repayment rates on debt outside the interim agreement in these three years, total repayments of all debt are reduced from about $2 billion in 1990 to only $1.5 billion each in these three years. Thus while the repayment rate under the interim agreement nearly doubles in 1991, it does not increase fast enough to maintain pressure on the South African economy because of the rapid decline of the repayment of debt under guarantees.

To force South Africa into a difficult economic situation, there should be an additional net flow out of South Africa of at least $0.5 billion in 1990 and of at least $1 billion in each of remaining years of the 3rd interim agreement. These numbers could be decreased if, as the economy gets worse, massive capital flight occurs, and on the other hand, they should be increased if trade credits increase and roll overs of existing debt occur.

These net flows out of the South African economy can be generated either (1) by a decrease in trade finance and other credits flowing into South Africa (capital accounts) or (2) by a worsening of their trade balance through sanctions against their exports such as gold (balance on current account):

1. Decrease Financial Flows:
   a. New trade credits are provided primarily by European and British banks and are often insured by their respective government's insurance agencies. Thus these governments should take South Africa off insurance cover and cease providing official export credits such as the Federal Republic of Germany continues to provide.

Pressure should be brought to bear on the British and European banks both in Europe and through their branches and subsidiaries in North America to (1) decrease or stop trade finance, (2) not convert any more debt from under the interim agreements into 10-year exit loans, and (3) cease all roll overs of existing debt or refinancing of bonds. As shown in Table V, Appendix III, the German and Swiss banks are the lead managers for almost all bonds maturing in the next several years and thus will be involved in any refinancing.

b. Banks in the U.S. are not providing significant new credits and had essentially all their exposure under the second interim agreement. Now about one-third of that debt has been converted into 10-year exit loans as shown in Table III of Appendix II.

If HR 3458, The South Africa Financial Sanctions for Democracy Amendment of 1989, were passed by the U.S. Congress during this session in its present form, it would require divestment of all $1.66 billion of the debt which the U.S. banks would have rolled over into the 3rd interim agreement. It would also require the selling of $700 million of 10-year exit loans at the end of 1982. Such a sale of loans on the secondary market would probably reduce new British and European trade credits to South Africa. These British and European banks, with already high South African exposures, would be forced to buy these loans to protect the value of the debt they already hold. Thus their purchases would increase their holdings of South African debt and increase their already large risk in South Africa, and thus it would reduce the likelyhood that they would provide any new credits.

However, such a divestment would of course cause the U.S. banks to take losses, since the debt would need to be sold on the secondary market. The present discount in this market is such that they would only receive about $0.70 on the dollar and this market price would probably be driven down further by these large sales. The minimum losses for all U.S. banks would be $500 million on the debt under the interim agreement and $210 million on the 10-year exit loans.

In order to facilitate passage of HR3458, it could be amended in several ways to reduce and, under favorable circumstances, eliminate some or all of these losses on the $1.66 billion U.S. bank exposure held under the interim agreements:

I. If the banks were required to reduce their $1.66 billion exposure under the interim arrangements by 20% per year for 5 years, then the difference between the scheduled repayment and 20% of the exposure would be sold on the secondary market each year. These sales would result in losses for all U.S. banks totalling $85 million in the first year of the 3rd interim agreement and dropping to $67 million by the third year, assuming a discount of 30% on their value. The banks would then have 1-1/2 years after the new agreement terminates to eliminate the remaining debt either through negotiated repayment or sale. If South Africa met the basic conditions of the act before the end of 1990, there would be no losses to the U.S. banks.

II. If the U.S. banks were to keep their debt under the interim agreement and receive the scheduled repayments, they could be required to eliminate their exposure by the end of five years, or within in 1-1/2 years at the end of the new agreement. This would give South Africa nearly 4 years to meet the conditions of the Amendment for ending apartheid and the opening up of the capital markets before U.S. banks would sustain losses through sale of the remaining $1.35 billion exposure. Such a sale of assets over the last 1-1/2 years would depress the value of the debt and making British and European banks less likely to lend to South Africa.

The carrot which is offered to South Africa for meeting the conditions of the Amendment is the opening up of the capital markets so that new loan monies can flow into South Africa and growth of the economy can increase to 4% per year. (See **Quarterly Bulletin**, South African Reserve Bank, pp. 29-30, June 1989.)

2. Sanctions against South African exports are more difficult to enact but sanctions could be started agaist South African gold in some of the other major gold producing countries that also import gold products, for example the U.S.

APPENDIX I
THE THIRD INTERIM ARRANGEMENT

This agreement is the second proposal by the South African goverment. The first one, which was proposed in Zurich in mid-September and not agreed to by the banks, was for an agreement of 7 years with 3% repayment each year. Thus this first proposal amounted to just a continuation of the second interim agreement but for over twice the term. This new proposal which has been accepted by the bank committee is for half the period and at twice the average repayment rate that was proposed in September. The details of the payment schedule are given in Table I.

Table I. The Repayment Schedule for the Principal of the South African Debt under the Third Interim Arrangement. Each payment is estimated on the basis of a total initial debt of $8.5 billion and based on a declining balance.

Payment Date		Amount	Estimated $ Amount
1990	December	1.5%	$128 million
1991	February	2.5%	209 million
	August	3.0%	245 million
1992	February	3.0%	238 million
	August	3.0%	230 million
1993	February	3.0%	224 million
	August	3.0%	217 million
	December	1.5%	105 million
Total			1596 million
Remaining Debt			6904 million

This calculation of dollar amounts in Table I assumes that there have been no further conversions of debt under the second interim agreement into 10-year exit loans since the Spring of 1989.

Banks may take an exit option by converting their loans into 10-year exit loans which have the following repayment schedule: Same repayment schedule as above until 1994; grace period on principal payments from January 1994 through mid-1997; repayment of the remaining 81% of the loan from mid-1997 through 1990, when there is little debt under South African guarantees to be paid.

APPENDIX II
ESTIMATED REPAYMENT SCHEDULE FOR SOUTH AFRICA'S TOTAL DEBT

The repayment schedules for the principal of South Africa's debt are estimated in Table II in the final three columns. These columns include the debt guaranteed by the government outside the interim agreement, the amount repaid under the interim agreement and the total of these two amounts.

Table II. Repayment Scheule for the Total South African Debt under the Third Interim Arrangement with an Estimate of the Total Debt as of 31 December 1989.

Year	Debt Guaranteed by South African Government: Reported as of 31 Mar 88 (1)	Conversions to 10-Year Exit Loans (2)	Total: Sum of Mar 88+ Exit Lns.	Total: Fin.Mail Report (3)	Total: This Estimate (4)	Debt Payments to Banks under 3rd Interim Agreement	Total Payments
	Billions of U.S. Dollars						
1990	1.58	0	1.58	1.9	1.9	0.13	2.2*
1991	2.08	0	2.08	1.0	1.0	0.45	1.5
1992	0.77	0.10	0.87	1.0	1.0	0.47	1.5
1993	0.42	0.50	0.92		0.9	0.55	1.5
	---End of 3rd Interim Agreement---					6.90	
1994	0.14	0.70	0.84		1.2		1.2**
1995	0.13	0.70	0.73		1.1		1.1**
1996	0.03	0.70	0.73		1.1		1.1**
1997	0.02	0.60	0.62		0.6		0.6**
1998	0.02	0.20	0.22		0.2		0.2**
1999	0.01	0	0.01		0.0		0.0**
2000	0.01	0	0.01		0.0		0.0**
Total	5.20	3.50	8.70		9.0	8.5	

Total Debt 31 Dec. 1989 (5):	
Total Guaranteed and 3rd Interim Debt	$17.3
Last payment 2nd Interim Agreement	0.1
Estimated credits without Guarantee	2.3
Total South African Debt 31 Dec. 1989	$19.7 (lower bound)

* Includes last payment of $0.13 million under the second interim agreement on 15 June 1990.
**Exclusive of remaining $6.9 bn debt at end of the 3rd interim accord.

Table II. Notes and sources:

(1) **Government Gazette**, Vol. 279, No. 11519, p.8-9, Johannesburg, 30 September 1988. Currencies converted at rates on 30 June 1989.

(2) These data represent the repayment of the $3.5 billion of loans which have been converted from under the second interim agreement into 10-year exit loans with a 5 year-grace period on the payment of principal as reported by the **Financial Times** (22 Nov. 1988, 16 May 1989). The conversion in the last half of 1987 is assumed to be about $1 billion with $2.0 billion converted in 1988 and with $0.5 converted in the first quarter of 1989. This convrsion in the last two quarters of 1987 and the first quarter of 1988 appears not to be listed in the **Government Gazette** (1), for the amounts in the latter 1990's are not large enough to accommodate the repayment.

(3) **Financial Mail**, p. 41, 16 June 1989; **Finance Week**, 29 June-5 July 1989.

(4) Because of the differences between the amount reported by the **Financial Mail** (3) and the sum of debt guaranteed on 31 March 1988 plus conversion to 10-year exit loans from that time, a final estimate of this debt was made as follows: The higher numbers from the **Financial Times** for 1990 and 1992 are assumed to be correct because of new loans or rescheduling of earlier guaranteed debt such as the reported reissuing of SFr70 million of bonds by Union Bank of Switzerland in February 1989 with a three year maturity in 1992.(**Weekly Mail** (South Africa) 3 February 1989). The lower value for the repayment in 1991 is assumed to have arisen out of the same mechanism, for **Finance Week**(29 June - 5 July 1989) reports that perhaps half of the bonds dues in 1990-91 will be so "rolled over". Since the new 10-year exit loans have a grace period from 1994 through mid-1997, the differnce of $1.1 billion between the two numbers is assumed to have been rescheduled into those three years equally at $0.35 billion each in "This estimate".

(5) The total South African debt at the end of 1989, calculated here, is a lower bound since it does not include new trade credits like those guaranteed by the U.K.'s ECGD for Mossel Bay, etc. The credits without guarantees are primarly short-term trade credits which are repaid on time but not under the formal guarantees.

Continued on the next page.

The repayment schedule for the U.S. banks is extracted from Table II into Table III. The analysis is much simpler, because essentially none of the debt to the U.S. banks is guaranteed by South Africa except for conversions into 10-year exit loans under the second interim agreement.

Table III. Estimated Repayment Schedule of the Principal of the South African Debt to U.S. Banks. This table assumes no conversions to exit loans after the first quarter of 1989.

Year	Debt Converted to 10-Year Exit Loans	1990 Interim Agreement	Total Payments
	Million U.S. Dollars		
1990	0	25	50*
1991	0	89	89
1992	47	91	138
1993	138	106	244
--End 3rd Interim--		1346	
1994	150		150**
1995	150		150**
1996	150		150**
1997	102		102**
1998	12		12**
1999	0		0**
2000	0		0**
Total	748	1657	
Total Debt	$2405	as of 30 June 90	

* Includes last payment of 2nd Interim Agreement of $25 million.
** Exclusive of remaining $1346 million at the end of the 3rd Interim Agreement.

Source: **Country Exposure Lending Survey**, federal Financial Institutions Examination Council, Washington, DC, quarterly.

APPENDIX III
HOW MUCH CAN SOUTH AFRICA PAY?

The order of magnitude of the upper limit of amount that South Africa can pay on the principal of the debt is roughly indicated by the balance on current account which South Africa was able to maintain during the stressful years of the 1985 moratorium. This balance is the net of exports, imports and service payments, ncluding interest payments on the debt. It is shown in Table IV together with the price of gold. Since gold represents 40% of South Africa's exports, export earnings and thus the balance on current account are very dependent its price.

In 1986 when the price of gold averaged $368/oz, a figure comparable to that in 1989, South Africa maintained a balance on current account of about $3 billion. Admittedly, this balance must also cover any capital flight which may occur at a time of economic stress. Thus a more

Table IV. Upper Limit to Foreign Exchange Available for Payment of Principal of Debt.

Year	Balance on Current Account Millions US$	Average Gold Price $/Tr Oz
1985	2611	317
1986	3132	368
1987	3027	447

realistic limit might be of the order of $2.5 billion. This suggests, that if South Africa can not roll over more of the guaranteed debt falling due in 1990, the economy will be much as it was in 1987 and 1988, but these constraints will lighten up in 1991 and 1992 because the overall debt burden will decrease by $0.5 billion. Thus to pinch the South African economy significantly, the net flow of capital out of South Africa should be increased by $0.5 billion in 1990 and by $1.0 billion annually in 1991 through 1993. Once the third interim agreement is in place, the only simple ways to increase the net flow out are by reducing the inward flow of trade credits in the capital account or by reducing South Africa's exports to reduce the balance on current account. The latter would be most easily affected by gold sanctions.

Other Factors Increasing South Africa's Ability to Pay

1. South Africa is arranging credits through its Central Energy Fund for its $3.8 billion Mossel Bay oil from Gas project. Kleinwort Benson is reported as the U.K. bank arranging financing with ECGD cover for L70 million ($130 million). Undoubtedly a portion of this financing will not be just export credits for British and Italian firms but will find its way into South Africa, thereby providing the Reserve Bank with foreign exchange to repay debt.

2. Spill over of hard currencies from the $3 billion Lesotho Highlands Water Project, particualry from contracting in hard currencies with South African corporations for work on the project, will provide the Reserve Bank with foreign exchange for debt repayment. The amount of the spill over can not be estimated until contracts are let. Standard Chartered Merchant Bank is the primary arranger of private funds with government export agencies involved: ECGD (U.K.), SACE (Italy), COFACE (France). Initial funding of $150 million has been from the World Bank, the European Investment Bank, the Oversea's Development Programme, and USAID for preliminary infrastructure. Phase IA, the Katse dam and Muela power station, will cost $1.1 billion and contracts will be tendered in 1991.

3. Roll overs and refinancing of debt guaranteed by the South African government may further reduce the debt payments outside the interim arrangement. As the **Finance Week** (29 June-5 July 1989) pointed out: "The worst expected outflows for 1990 and 1991 have been officially reduced to $1.8 billion and $1 billion from the intial offical projections of 2.1 billion and $1.5 billion. Prospects that around a sizeable chunk (but less than half) of the $2 billion of bearer bonds maturing over 1990-91 will be quietly rolled over in effect although that will actually mean new credits technical-

ly." Table V shows the amount of maturing bonds by currency for each year and lists the lead managers in order of importance. Note that independent of the currency of the issues, the German and Swiss banks are almost always the lead managers.

Table V. Bonds Issued by South African Entities by Currency of Issue, together with the majorr lead managers for bonds in each currency.

Year	Deutsche Mark	Swiss franc	British Pound	European C.U.	U.S. Dollar	Total in US$
			In millions of currency units			
1990	625	510	40	100	-	793
1991	680	155	-	-	325	768
1992	650	70*	50	-	-	453
1993	600	-	-	-	-	308

*Reissued by Union Bank of Switzerland in 1989

Table V (Continued). Lead Managers of Bond Issues by Currency:

DM	SFr	Pound	ECU	US$
Dresdner	Sw.Bk.Co.	Std.Ch.	CCF	Commerzb.
DeutscheB	UnionBkSw	Sw.Bk.Co.		UnionBkSw
BHF	Credit Sw			Soc.Gen.
Commerzb.				
Bayer.V.				

Source: J.E. Lind & D.V. Espaldon, **South Africa's Debt at the Time of Crisis**, CN-ICCR (CANICCOR), San Francisco, April 1986. Currencies converted at the rates on 30 June 1989.