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June 5, 1991

To: Members of the Executive Board

From: The Secretary

Subject: Financing of Programs in Eastern Europe

There is attached a memorandum from the Managing Director on the financing of programs in Eastern Europe.

Att: (1)

Office Memorandum

To: Members of the Executive Board June 4, 1991

From: The Managing Director

Subject: Financing of Programs in Eastern Europe

This memorandum updates the information Executive Directors have received on the financing requirements of the five countries in Eastern Europe under Fund arrangements, and on financing assurances received up to now, and draws the attention of Directors to the difficulties encountered in the cases of Bulgaria and Romania in obtaining such assurances.

1. Revised estimates of financing requirements

Earlier estimates of financing gaps have been revised to take account of changes in the price of oil, in interest rates, and in other external factors such as direct foreign investment. More recent projections for domestic output and imports, and for exports, have also been incorporated where available. The revised estimates of the financing gaps for the five East European countries are, in aggregate, in line with those presented in SM/91/46 ("The Role of the Fund in Assisting Eastern European Countries"). The fall in the price of oil from an average price of $22 in 1990 to an estimated price of $18 in 1991 would, by itself, lower overall financing requirements by almost $1 billion (net of the reduced CCFF entitlement). However, this is more than offset by sharply lower exports in most of the countries, as a result of the disruption of trade with the former CMEA area, notably with the U.S.S.R. Despite much lower non-oil imports than originally projected, current account deficits are unchanged or larger in three of the five countries. Private capital flows are also in some cases somewhat lower than expected.

It is possible, of course, that *ex post* financing gaps may turn out to be lower than original estimates as a result of a compression of domestic demand and imports due to difficulties in assembling the financing that had been expected. As the original estimates were already predicated on a strong adjustment effort--that was nonetheless regarded as both feasible and sustainable--the position into which those countries may now be forced is unlikely to be sustainable for long.

Bulgaria's projected gross financing needs for 1991 are about unchanged from the original estimate of $3.9 billion. An external current account deficit of $2 billion is still envisaged, with a foreign exchange reserves buildup of $500 million (only about one month of expected 1991 imports). However, both exports and imports have been revised downward by more than $1.5 billion, after much lower than expected trade with the U.S.S.R in the first quarter and on the basis of considerably weaker domestic demand than initially envisaged. Total imports are now estimated to decline in volume terms by about 40 percent in 1991, after a fall of more than 25 percent in 1990. The cost of energy imports is projected to be slightly higher than originally envisaged, reflecting higher prices of natural gas supplied by the U.S.S.R. On the capital account, a more generous than assumed rescheduling from the Paris Club is expected to about offset lower World Bank financing in 1991 resulting from revisions in the timing of releasing the second tranche of the proposed SAL.

Czechoslovakia is also now expected to have much weaker exports and lower non-oil imports than originally programmed. In this case, however, there are significant savings from lower oil prices (the program was drawn up when price projections were at their peak) and the current account deficit is now expected to be lower. This, together with somewhat stronger direct foreign investment, is expected to offset some unexpected outflows of short-term capital and delays in G-24 disbursements. Such delays may require a smaller reserve accumulation during 1991, to be recouped in 1992. For Hungary, preliminary indications are that a somewhat better current account may offset in part lower private capital inflows and a smaller than expected drawdown of accumulated balances with the U.S.S.R. How to close the financing gap that has emerged is one of the subjects of the review scheduled for August 1991. Again, projections for both exports and imports are being revised sharply downwards. Poland's financing needs would have been more than covered after the Paris Club agreement, on the assumption that debt reduction comparable to that afforded by the Paris Club would be forthcoming from CMEA creditors and commercial banks. However, the capital account was significantly weaker than expected in the first quarter, and achievement of the annual reserve target under the program now appears to be uncertain.

Highly tentative revisions to the projections for Romania incorporate a slightly higher current account deficit ($2 billion rather than $1.7 billion), financed by higher than expected suppliers' credits from Western Europe. The larger current account deficit reflects a collapse in exports to the Soviet Union, although imports have also been revised downwards. The staff team which is now in Bucharest will bring back more up-to-date estimates of the current account deficit and financing gap, but these now seem unlikely to be lower than original estimates.

2. Present status of financing assurances

The situation varies a great deal depending on the source of financing and on the recipient country. Generally, contributions from the Paris Club have been higher than anticipated and disbursements from the World Bank may slip by comparison with initial assumptions.

As regards the G-24 and the EC Commission, the situation is the following. For Czechoslovakia, pledges from the G-24 practically reached the $1 billion target, but some disbursements are expected to slip from 1991 to 1992. For Hungary, formal pledges stand at $368.5 million, including up to $250 million from the EC on a matching basis, by comparison with a target of $500 million, and Japan's Export-Import Bank is considering the co-financing of the second Bank SAL.

For Bulgaria, pledges by the G-24 countries amounted to $510 million by mid-May, including $400 million by the EC, in principle on a matching basis. For Romania, pledges by the non-EC G-24 amounted to only $105 million. Thus, for both countries, financing remains still short of target, even if the target for Romania is revised to $800 million (due to an additional $200 million in humanitarian aid over original expectations). There is thus a real degree of urgency as regards the situation of these two countries which cannot rely on accumulated official reserves to maintain a minimum volume of imports. It should also be noted that for none of the countries has any disbursement of G24 financing taken place so far. In view also of the extremely difficult situation created by the magnitude and speed of the collapse of trade with the U.S.S.R., and within the ex-CMEA area in general, I would appreciate any step Executive Directors could take to speed up the decision-making and disbursement process.

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Table 1. Eastern Europe: Tentative Revised Balance of Payments Outlook and Financing Needs in 1991, May 1991 1/

(In billions of U.S. dollars)

	Bulgaria		Czechoslovakia		Hungary 2/		Poland		Romania 2/	
	G10	5/31	G10	5/31	G10	5/31	G10	5/31	G10	5/31
Current account	-2.0	-2.0	-2.5	-2.0	-1.2	-0.9	-2.7	-2.7	-1.7	-2.0
Other capital 3/	-1.0	-1.0	0.4	-0.4	-2.7	-2.9	-4.6	-6.7	-0.3	-0.3
Reserve change (increase -)	-0.5	-0.5	-1.6	-1.1	-0.9	-0.9	-0.7	-0.7	-0.7	-0.7
Elimination of arrears	-0.4	-0.3	--	--	--	--	--	--	--	--
Financing requirements	3.9	3.8	3.7	3.4	4.8	4.7	8.0	10.1	2.7	3.0
Financing	3.9	3.8	3.7	3.4	4.8	4.3	3.7	10.1	2.7	3.0
Private capital 4/	1.6	1.6	1.0	1.2	2.1	1.9	0.3	2.1	0.5	0.8
Of which: Direct investment	(0.1)	(0.1)	(0.4)	(0.6)	(0.6)	(0.6)	(0.3)	(0.3)	(0.1)	(0.1)
Debt relief	(1.5)	(1.5)	--	--	--	--	--	(1.8)	--	--
Official capital	2.3	2.2	2.7	2.2	2.7	2.4	3.4	8.0	2.2	2.3
World Bank and parallel financing 5/	0.3	0.1	0.3	0.2	0.5	0.5	0.6	1.2	0.3	0.3
EC (outside G-24)	--	-- 6/	...	...	0.4 7/	0.4	...	0.1	...	...
G-24 1/ 9/	0.8	0.8	1.0	0.8	0.6	0.5	...	--	1.1	1.1 8/
EC	0.4	0.4	0.5	0.5	0.3	0.3	...	--	...	...
Other	0.4	0.4	0.5	0.3	0.3	0.3	...	--	...	...
Debt relief	0.7	0.8	--	--	--	--	1.9	5.6	...	...
Use of Fund resources	0.5	0.5	1.4	1.3	1.2	1.0	0.9	1.1	0.8	0.8
Remaining financing gap 1/	--	--	--	--	--	0.4	4.3	--	--	--

Source: For G10 columns derived from Table 2, "The Role of the Fund in Assisting Eastern European Countries," SM/91/46 and update 3/8/91; staff estimates for 5/31 columns.

1/ For Czechoslovakia and Hungary, G24 disbursements have been estimated on the basis of present commitments and information received from the EC Commission. On this basis, financing needs appear confidently to be met. In the cases of Bulgaria and Romania, the assumption is still made that the amounts required to close the financing gaps will be forthcoming. Any shortfall would automatically create a financing gap *ex ante*.

2/ Highly tentative; figures not yet discussed with authorities.

3/ Includes amortization (including Fund repurchases); short-term trade credit; and utilization of CMEA balances accumulated under the CMEA trading system.

4/ Includes officially supported export credits.

5/ Excludes parallel financing that is extended under the aegis of the G-24.

6/ A small amount of PHARE and other assistance is incorporated in the capital acount.

7/ Second tranche of loan approved February 1990. Does not include additional contribution to 1991 financing.

8/ Assumed disbursements from the EC; the G-24; the EIB and the EBRD.

9/ Includes parallel financing of World Bank loans that is extended under the aegis of the G-24.