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③ file Saudi Tornados

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Dear Bob

SAUDI ARABIA TORNADOS: YAMAMAH PROJECT  
(ECGD's letter of 29 August)

We have little to add to the doubts and reservations about the Saudis' ability to deliver as agreed and the various legal and interest rate complications which were expressed in Tim Downing's letter of 9 January. The overall economic and financial position of Saudi remains under strain as evidenced by the devaluation of the riyal in June - with rumours of a second devaluation to come - and the recent, further postponement of the budget for FY 1986/87, originally due in March, until December. It is too early to assess the impact of the recent OPEC agreement on the country's finances, but the short-term prospects look to be for continuing sizeable deficits on the fiscal and external current accounts and continuing rapid depletion of official foreign assets.

However in view of the fact that this project has UK Ministerial approval, in practice it is now very much a question of putting in place the best possible financing facility from HMG/ECGD's point of view. In this context, we note MoD's view (para 8 of Peter Henley's letter) that the July 30 exchange of letters goes as far as the Saudis will go in giving commitments to service and repay the financing facility. This is probably right, but it

does of course leave open the risks and caveats outlined in Peter Henley's para 7, which echo some of our own earlier doubts. It would be useful to have confirmation from the FCO and perhaps the Embassy in Riyadh as to the continuing firm commitment of the Saudis to honour their 'obligations' under the financing facility.

If there is a questionmark, however, over the Saudis' obligation to maintain oil production at the levels insured by ECGD, there is a risk that the security of ECGD's position may not be watertight. On this point, we would endorse the reservations expressed by Will Pedder in his letter of 4 September.

As far as the Banque Indosuez proposal is concerned, the outline seems reasonably clear: we welcome the fact that the level of ECGD cover is being scaled down, given the risks involved, and that the cover would be strictly limited in time. On the other hand, important details, such as the percentage of oil revenues to be dedicated respectively to repaying and servicing the facility, have still to be thrashed out. It will clearly be necessary to know the exact proposal before a balanced assessment can be made. Perhaps there is a case for a further EGC meeting to review progress before Ministerial approval is sought. I should also mention that, on the information available, the bank supervisors think that the ECGD-guaranteed loan would not warrant a nil-weight for risk asset ratio purposes.

I am copying this letter to Philip Curry (MoD), Reg Ludford (ODA), Will Pedder (DTI), Peter Sullivan (FCO) and Peter Henley (ECGD).

Yours sincerely

*K Y Butler*

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