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Reference ~~ECGD~~ SAUDI ARABIA.

To: Mr Titchener OT4

From: Mr M M Baker
Head PEP2
Rm 252 1 V/S
215 3667

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cc Mr Benjamin
Mr Chapman
Mr Rhodes
Mr Petter OT4
Mr Bowder Air2
Mr ~~Pedder~~ PEP2
Mr Richards PEP2

EGC: SAUDI ARABIA

Summary

I attended the EGC meeting yesterday on DTI's behalf, explaining that other commitments prevented you from doing so. The shortness of notice and incomplete nature of the proposals circulated by ECGD led to a prolonged and disjointed debate. It was finally agreed that a further discussion would be required once:-

(a) MoD had produced a more thorough financial analysis;

(b) ECGD had prepared a revised country risk paper in the light of (a) and an agreed interdepartmental analysis of oil market prospects. This paper will deal with the wider cover question.

Detail

The analysis of the Saudi economy provided by the FCO, Bank of England , Treasury and Cabinet Office was bleak. Although ECGD argued that it should continue to be a good market in the medium to long term, other Departments pointed out Saudi Arabia's overwhelming dependence on oil exports, the poor quality of its economic management, IMF's latest estimate of the current account deficit ($24b), and the improbability of cuts in imports on the scale required to avoid eating heavily into reserves. Although the time horizon of the proposed overdraft facility was short it coincided with a period in which the country would have to go through a major readjustment.

Although the analysis of the down turn in the oil market is not yet agreed the overwhelming view was that ECGD's price assumption ($20 per barrel) was much too optimistic, although movements between sterling and the dollar needed to be taken into account. With such large reserves Saudi might still choose to side step OPEC and pump much larger quantities to maintain overall earnings at a far lower price per barrel. But the effects on its neighbours would be very great. So it remained questionable whether Saudi would maintain its recent refusal to act as the swing producer to restrain overall OPEC production. In either event OPEC's price or volume assumption was unrealistic.

MoD were not able to explain very satisfactorily why it had not been possible to secure rather more significant upfront payments from the Saudis (as was done in the case of the Boeing/RR B747 deal) particularly since the first batch of

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aircraft are to be delivered shortly. Nor did they have a breakdown of the very substantial front end loading for BAe in 1986 (40% of total project cash flow) which would create a maximum liability for ECGD of £1.3b by the first half of next year. MoD has therfore agreed to provide a paper (a) examining ways of minimising the scale of prefunding and (b) identifying the maximum dead loss figures (on the assumption that the oil escrow account is established outside the country) were the Saudis to invoke the oil contract let-out clauses (in failing to provide oil of sufficient value) and then refuse to make up the default (ie by clearing the overdraft).

The market risks for ECGD were seen as economic rather than political, the scale of the proposed business representing a very large proportion of their overall portfolio. The reluctance of HMT and other departments to endorse the overdraft guarantee as presently proposed was tempered by a recognition of the political commitment already made to the project. Hence the request to ECGD to produce a more manageable proposition, bearing clearly in mind that neither BAe/MoD nor the banks/ other credit agencies (following their recent bad treatment by the Saudis) appear willing to shoulder the risk.

M M Baker

PS There is an OPEC meeting next week which should help focus the debate about oil prospects. The next EGC meeting should take place prior to MoD's next round with the Saudis in mid February. In the meantime the downgrading from A to B earlier recommended to and approved by EGAC will now take place.