FOR AGENDA

SM/86/193

CONTAINS CONFIDENTIAL INFORMATION

August 5, 1986

To: Members of the Executive Board

From: The Secretary

Subject: International Capital Markets: Developments and Prospects, 1986

There is attached for consideration by the Executive Directors a paper on developments and prospects in the international capital markets, which has been tentatively scheduled for discussion on Wednesday, September 3, 1986. A paper containing background material will be issued shortly.

As in previous years it is planned that an Occasional Paper be prepared based upon the staff report and the background paper. The revised text will reflect Executive Directors' comments and delete certain sensitive material.

Mr. Watson (ext. 7350) or Mr. Kincaid (ext. 7356) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

International Capital Markets: Developments and Prospects, 1986

Prepared by the Exchange and Trade Relations Department

(In consultation with other departments)

Approved by C. David Finch

August 4, 1986

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I. Introduction

This report reviews major trends in international capital markets, focusing in particular on developments in the external debt situation. 1/ The Executive Board last reviewed conditions in international capital markets on the basis of the staff report on "International Capital Markets: Developments and Prospects, 1985" (SM/85/267, 9/27/85; EBM/85/166, 11/13/85). Since that review, the Executive Board has discussed the external debt situation in the context of the staff papers "The Debt Situation: Prospects and Policy Issues" (EBS/86/43, 2/28/86) and "Implementing the Debt Strategy: Financing Issues" (EBS/86/41, 2/24/86) (EBM/86/54, 3/25/86). Enhanced surveillance was discussed by the Board in connection with "The Role of the Fund in Assisting Members with Commercial Banks and Official Creditors" (EBS/85/173, 7/23/85; EBM/85/130, 8/30/85; EBM/85/131, 9/4/85; and EBM/85/132, 9/4/85).

An overview of recent trends in international financial markets is provided in Section II. Section III reviews issues that relate to the debt situation. As agreed when the Executive Board discussed the work program (EBM/86/79, 5/9/86), foreign investment, capital flight, and the activities of multilateral development banks are discussed, and the section concludes with a review of experience thus far with enhanced

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1/ A staff team comprising Messrs. C.M. Watson, G.R. Kincaid (both ETR), D. Folkerts-Landau (RES), Ms. C. Atkinson (ETR), and Ms. A. Deleva (Secretary, Office in Europe), held informal discussions with bankers and with the staff of monetary and bank supervisory authorities and international organizations (BIS, European Commission and OECD) in Amsterdam, Basle, Berlin, Berne, Brussels, Frankfurt, London, Luxembourg, Paris, and Zurich. Ms. S. Eken (Office in Europe) participated in the meetings in Paris. Similar discussions were held in New York, Washington (including the World Bank, the International Finance Corporation, and the Institute of International Finance), Ottawa and Toronto, Singapore, Hong Kong, and Tokyo (including the Japan Center for International Finance). Mr. E. Kalter (ETR) participated in the meetings in Asia. Other staff members who participated in some meetings were Messrs. L. Kenward and L.E. deMilner (both WHD). These meetings took place at various times during April-June 1986. Staff of the Bureau of Statistics developed and compiled the data based on the Fund's International Banking Statistics. Messrs. L. Hansen, K.P. Regling, B. de Schaetzen, R.B. Johnston, and C.T. Demir (all ETR) also contributed to the paper.

It should be noted that the term "country" used in this document does not in all instances refer to a territorial entity which is a state as understood by international law and practice; the term also covers some territorial entities that are not states, but for which statistical data are maintained and provided internationally on a separate and independent basis.

surveillance. Other changes in financial markets are reviewed in Section IV. Section V presents some concluding observations, which may serve as a basis for discussion by the Executive Board.

A fuller analysis of capital market flows is contained in an accompanying background paper, which also provides information on bank debt restructuring, enhanced surveillance, capital flight, and foreign direct investment. Activities of multilateral development banks are discussed in an Appendix. This paper is also accompanied by a report on "Recent Experience with Multilateral Official Debt Restructuring" (forthcoming), and a supplement "Officially Supported Export Credits--Recent Developments" (forthcoming). Medium-term projections and economic prospects for debtor countries will be reviewed in the World Economic Outlook (WEO) papers (forthcoming).

II. Overview of Recent Trends

The growth and distribution of international capital flows during 1985-86 have reflected the pattern of current account imbalances, as well as structural changes deriving from liberalization and innovation in major financial markets. As indicated in the WEO, current account imbalances among the industrial countries continued to expand during this period; the aggregate current account deficits of developing countries remained at a relatively low level in 1985, but increased considerably in 1986.

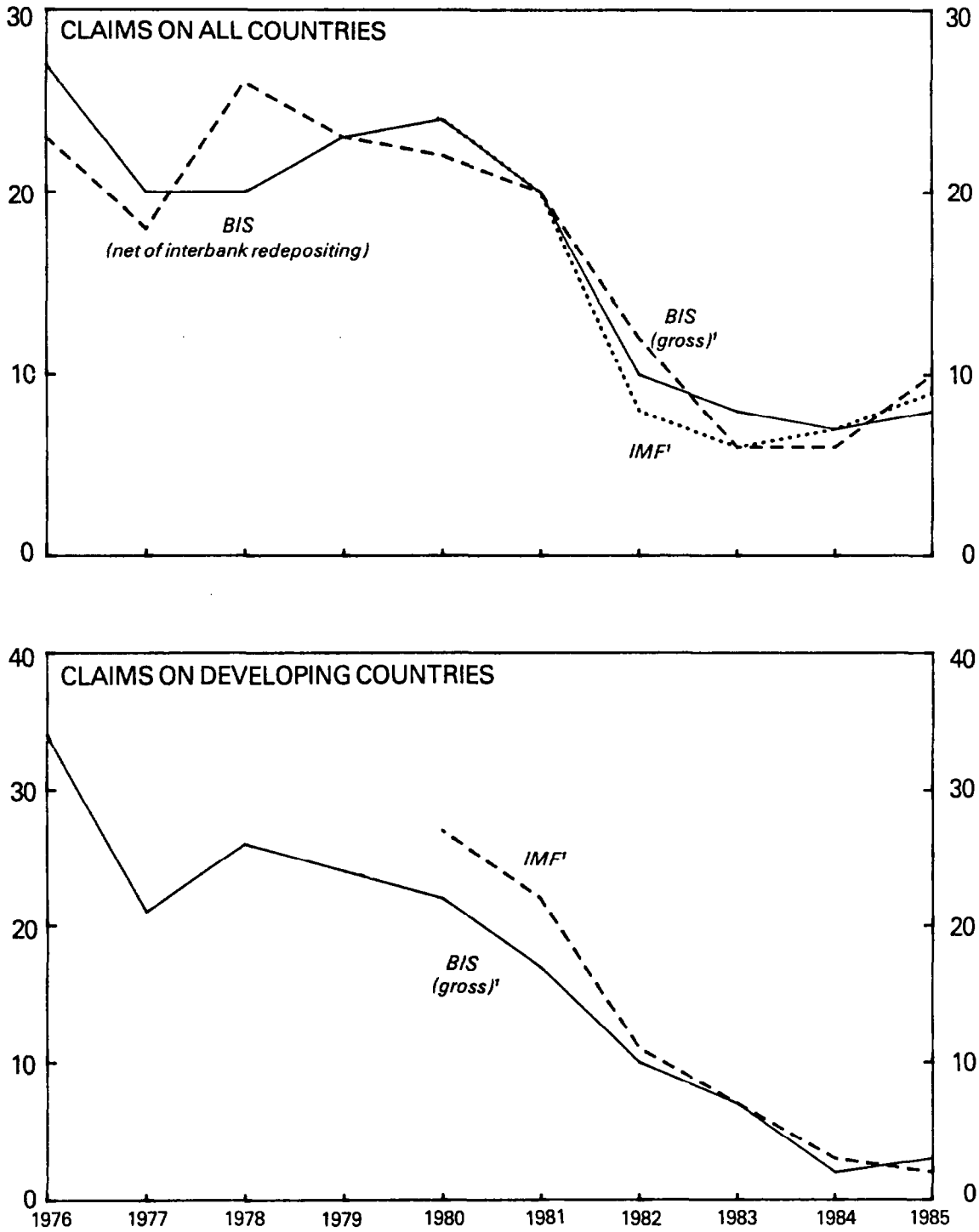
There was a rapid increase in total net lending through international bank credit and bond markets in 1985. Such lending rose by more than $67 billion to $310 billion (Table 1 and Chart 1). The sharply differentiated pattern of surpluses and deficits among the industrial countries contributed to a continuing high level of activity in international bond markets, and to substantial foreign purchases of domestic securities which are not recorded in these statistics. Savers and investors in industrial countries have exhibited a preference for tradeable assets, and they have increasingly channeled funds through securities markets rather than through banks to intermediate flows. Associated with the growth in securities transactions has been an expansion of interbank lending within the industrial country group. In contrast, the reduced external financing of capital importing developing countries has been largely met through sources other than international capital markets.

Total net lending to industrial countries through international bank credit and bond markets increased by $97 billion in 1985 to $268 billion. Bank lending to industrial countries, continuing the upswing begun in 1984, rose by $86 billion to $206 billion in 1985 (Appendix Table I) a growth rate of 13 percent based on outstanding claims of $1.6 trillion at end 1984. This growth was dominated by an

CHART 1

GROWTH RATE OF INTERNATIONAL BANK CLAIMS, 1976-85

(In percent)



Sources: Bank for International Settlements; *International Banking Statistics* and *Annual Report*, International Monetary Fund; *International Financial Statistics*; and Fund staff estimates.

[1] These data do not net out interbank redepositing.

Table 1. International Lending and Selected Economic Indicators, 1980-85

(In billions of U.S. dollars, or in percent)

	1980	1981	1982	1983	1984	1985
International lending through banks and bond markets						
Total 1/						
IMF based	414	433	235	195	243	310
BIS based (gross)	260	290	231	149	178	292
BIS based (net of redepositing)	179	190	145	130	145	170
Bond issues (net) 2/	19	29	49	46	62	76
Bank lending 1/						
IMF based	395	404	186	149	181	234
Growth rate	24	20	8	6	7	9
BIS based (gross)	241	265	181	104	123	222
Growth rate	22	20	12	6	6	10
BIS based (net of redepositing)	160	165	95	85	90	100
Growth rate	24	20	10	8	7	8
International lending to developing countries 3/						
Bond issues 4/	2	4	4	3	5	10
Bank lending 1/						
IMF based	85	87	51	35	16	9
Growth rate	27	22	11	7	3	2
BIS based	56	53	34	26	11	14
Growth rate	22	17	10	7	2	3
World economic developments						
Total of identified current account deficits 5/	154	176	174	158	196	200
Industrial countries	61	41	41	55	114	125
Of which: Seven largest	33	16	18	43	101	111
Developing countries	93	135	133	103	82	75
Overall current account deficits of capital importing developing countries 6/	66	97	91	50	22	23
Reserve accumulation of capital importing developing countries 7/ (accumulation +)	19.2	-2.9	-17.4	8.7	21.0	11.9
Growth rate in value of world trade	21.4	-0.5	-6.6	-1.8	6.3	0.9
Growth rate of real GNP of industrial countries	1.2	1.4	-0.5	2.6	4.7	2.8
Inflation rate of industrial countries (GNP deflators)	9.3	8.8	7.3	4.9	4.3	3.8
Interest rates (six-month Eurodollar deposit rate)	14.0	16.7	13.6	9.9	11.3	8.6

Sources: Bank for International Settlements (BIS); Organization for Economic Cooperation and Development; International Monetary Fund, International Financial Statistics; and Fund staff estimates.

1/ IMF based data on cross-border lending by banks are derived from the Fund's International Banking Statistics (IBS) (cross-border interbank accounts by residence of borrowing bank plus international bank credits to nonbanks by residence of borrower), excluding changes attributed to exchange rate movements. BIS based data are derived from quarterly statistics contained in BIS's International Banking Developments; the figures shown are adjusted for the effects of exchange rate movements. Differences between the IMF data and the BIS data are mainly accounted for by the different coverages. The BIS data are derived from geographical analyses provided by banks in the BIS reporting area. The IMF data derive cross-border interbank positions from the regular money and banking data supplied by member countries, while the IMF analysis of transactions with nonbanks is based on data from geographical breakdowns provided by the BIS reporting countries and additional banking centers. Both IBS and BIS series are not fully comparable over time, owing to expanding coverage.

2/ Net of redemption and repurchases, and of double-counting due to bank purchases of bonds.

3/ Excludes the seven offshore centers, which are: the Bahamas, Bahrain, the Cayman Islands, Hong Kong, Netherlands Antilles, Panama, and Singapore.

4/ Unadjusted for redemptions and double counting due to bank purchases of bonds.

5/ Goods, services, and private transfers.

6/ Goods, services, and transfers.

7/ Based on balance-of-payments definitions.

expansion in interbank claims, which accounted for 85 percent of lending. The major destinations of interbank lending were the principal financial centers, where a high proportion of world securities market transactions took place. The United States absorbed interbank flows amounting to $33 billion, while such lending to Japan and the United Kingdom totaled $42 billion and $43 billion respectively (Appendix Table II).

A number of factors may account for these developments. One factor was the funding by bank head offices of increases in trading portfolios held by branches and subsidiaries located in major financial centers. Another factor was the further integration of Japanese financial markets into the international financial system, one aspect of which was the high level of interbank flows in and out of Japan.

Lending to nonbanks in industrial countries increased to $27 billion in 1985 from $7 billion in 1984, but was still only about half of its level in 1982 (Appendix Table III). Nonbanks in the United States accounted for almost 80 percent of the 1985 total. Overall bank and nonbank borrowers in the United States increased their net liabilities to banks by $29 billion.

Gross international bond issues by borrowers from industrial countries expanded by 50 percent in 1985 (to $136 billion), and during the first half of 1986 they grew further to an annualized rate of $184 billion (Table 2 and Chart 2). Net international bond issues (gross issues adjusted for refinancing and scheduled amortization) also reached a record level.

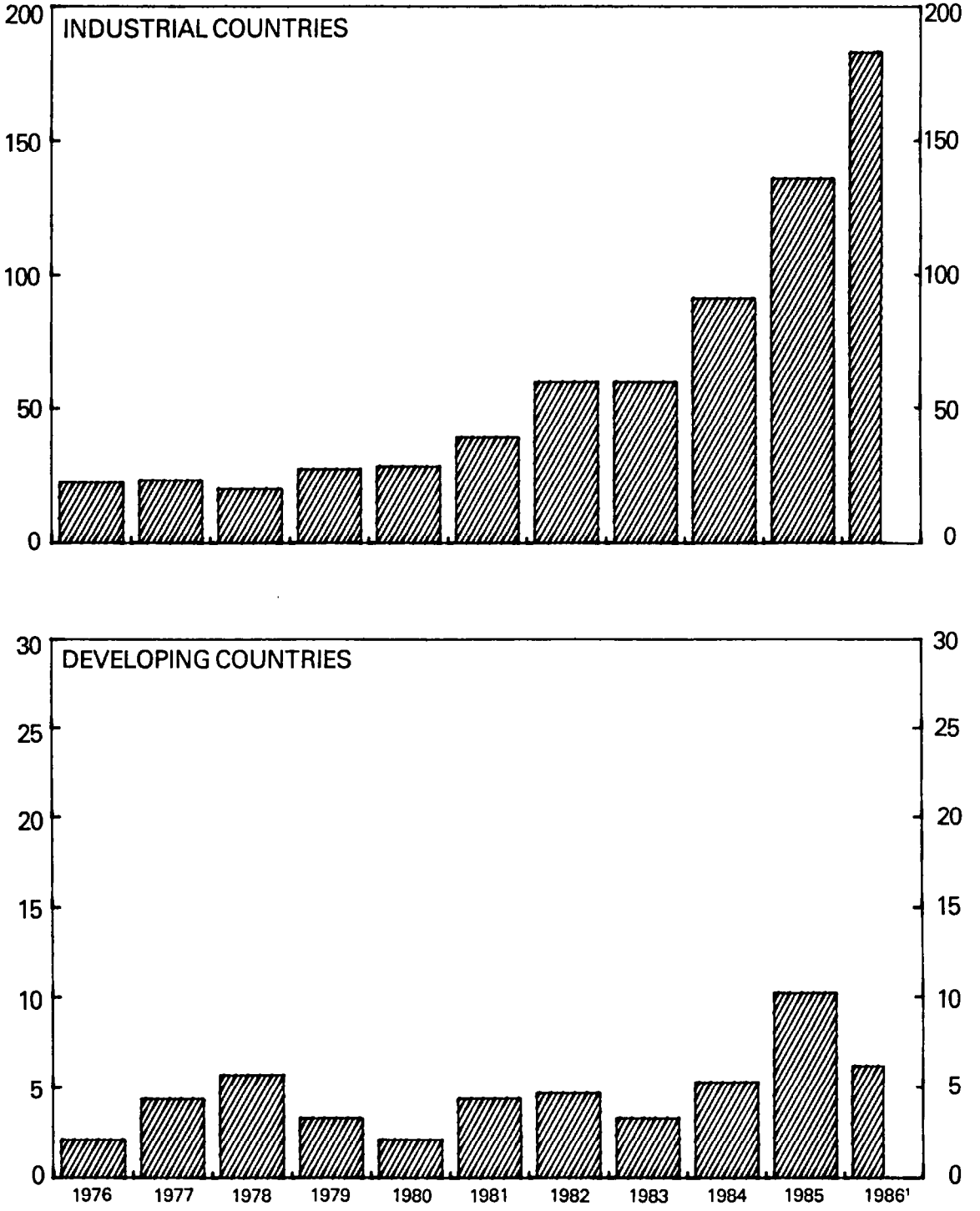
An important impetus for the expansion of activity in international bond markets has been the continuing growth in bond issues associated with medium-term currency and interest rate swaps, which allowed borrowers to tap markets where their names enjoyed a scarcity value. The volume of interest rate swaps rose to $85 billion in 1985 from $70 billion in 1984, while currency swaps associated with primary issues increased to $20 billion in 1985 from $6 billion in 1984. These instruments have enabled borrowers to utilize markets in certain currencies (e.g., Japanese yen, Australian dollars, and New Zealand dollars) to a greater extent and have been a major factor accounting for the increased share of non-U.S. dollar-denominated bond issues since 1984.

The increase in the swap market has been complemented by an expansion of the futures and options markets. These short-term hedging and arbitrage instruments have increased the scope for banks and nonbanks to cover financial risks associated with fluctuations in exchange and interest rates. The ability to hedge risks associated with holding securities has been a factor encouraging the growth of the securities markets.

CHART 2

GROSS INTERNATIONAL BOND ISSUES, 1976-FIRST HALF OF 1986

(In billions of U.S. dollars)



Sources: Organization for Economic Cooperation and Development,. *Financial Statistics Monthly.*

[1] First half annualized.

Table 2. Developments in International Bond Markets, 1980-86

	1980	1981	1982	1983	1984	1985	1986 1/
			(In billions of U.S. dollars)				
International bond issues:							
By category of borrower							
Industrial countries	29	39	60	60	91	136	184
Developing countries	2	4	5	3	5	10	6
Other (including international organizations)	8	8	11	14	13	20	20
Total international bonds	38	52	76	77	110	166	210
Amortization	10	16	18	18	20	35	46
Net issues 2/	28	36	58	59	90	131	164
Bond purchases by banks	9	7	9	13	28	55	...
Net issues to nonbanks 3/	19	29	49	46	62	76	...
Memorandum items:							
Net issues by industrial countries to nonbanks 3/	15	22	39	36	51	62	...
Net issues by developing countries to nonbanks 3/	1	2	3	2	3	4	...
			(In percent)				
By currency of denomination							
U.S. dollar	43	63	64	57	64	61	53
Deutsche mark	22	5	7	9	6	7	8
Swiss franc	20	16	15	18	12	9	10
Japanese yen	5	6	5	5	6	8	10
Other	11	10	9	11	12	15	19
			(In percent per annum)				
Interest rate developments							
Euro-dollar deposits 4/	17.8	13.3	9.5	10.1	9.0	8.0	7.0
Dollar Euro-bonds 5/	13.3	14.9	13.4	12.5	12.1	10.6	8.9
Deutsche mark international bonds 5/	9.4	9.2	8.2	8.1	7.4	7.0	6.8

Sources: Organization for Economic Cooperation and Development, Financial Statistics Monthly, and Financial Market Trends; International Monetary Fund, International Financial Statistics, and Fund staff estimates.

1/ First half 1986 annualized.
2/ Gross issues less scheduled repayments and early redemption.
3/ Gross issues less scheduled repayments and early redemption and bond purchases by banks.
4/ Three-month deposits.
5/ Bonds with remaining maturity of 7-15 years.

One of the major developments in 1985-86 has been the expansion and evolution of international facilities for the issuance of short-term notes by sovereign and corporate borrowers. Initially, expansion in note issuance facilities was confined to those backed by banks. Long-term international bank facility commitments (excluding those that were merger-related), amounted to almost $47 billion in 1985, compared to $29 billion in 1984 and an average of less than $8 billion in 1982-83. During 1985-86, however, the pattern of short-term issues has shifted, with rapid recent growth in non-underwritten facilities, such as eurocommercial paper programs, which did not exist prior to 1984. Non-underwritten facilities totaled over $18 billion in 1985 compared to less than $1 billion in 1984. This trend accelerated during the first half of 1986, with non-underwritten facilities totaling $49 billion at an annualized rate, and accounting for over two thirds of new facilities for issuing short-term notes. In addition, commercial paper programs were introduced in several industrial country markets.

A general factor underlying the growth in securities markets has been banks' preference for acquiring tradeable assets and issuing longer maturity liabilities. Banks are estimated to have purchased $55 billion of bonds in 1985 and to have issued an estimated $35 billion of floating rate notes, or 60 percent of such notes. Under certain conditions, bond issues by banks may be counted as primary capital for supervisory purposes in some countries. Banks also held a substantial proportion of the short-term notes issued, especially in the case of sovereign borrowers.

In discussions with staff, banks and securities houses also attributed the expansion of commercial paper and other securities market activities to a disintermediation of credit flows to nonbanks. This disintermediation reflected a strong appetite among international investors for securities issued by nonbanks with a high credit standing (in part, this trend was related to persisting concerns about the quality of bank balance sheets), and reflected the relative low cost of direct borrowing through the securities markets. More generally, the deepening and integration of securities markets and the continuation of financial imbalances among the industrial countries have favored a diversification of portfolios away from bank deposits and toward a wide range of financial market assets.

The net increase in bank claims on developing countries in 1985 slowed to $9 billion (a growth rate of 2 percent, based on banks' total claims on developing countries of $555 billion at end-1984) (Table 3 and Chart 1). This compares with an increase of $16 billion (3 percent) in 1984. Bank claims on the 15 heavily indebted countries increased net by $1 billion in 1985, compared to $5 billion in 1984. These data on claims understate actual bank flows to developing countries because of, inter alia, unrecorded bank purchases of bonds and write-offs of bank claims. However, the provision of new official export credit guarantees covered a significant part of the increase in bank claims on developing

Table 3. Bank Lending to Developing Countries, 1983-85 1/ 2/

(In billions of U.S. dollars)

	1983	1984	1985
Developing countries 2/	34.7	16.0	9.2
(Growth rate)	(7)	(3)	(2)
Africa	5.0	0.2	1.0
Of which:			
Algeria	0.3	0.7	1.6
Cote d'Ivoire	-0.1	-0.3	0.1
Morocco	0.2	0.1	0.1
Nigeria	1.3	-0.4	-0.7
South Africa	2.9	-1.5	-0.2
Asia	8.8	8.2	4.8
Of which:			
China	0.7	1.0	3.3
India	0.9	0.1	1.7
Indonesia	2.9	1.0	--
Korea	2.2	3.5	2.5
Malaysia	1.9	1.4	-1.4
Philippines	-1.4	0.1	-0.8
Europe	2.8	2.2	3.0
Of which:			
Greece	1.3	1.8	1.4
Hungary	0.9	0.2	1.8
Turkey	--	0.9	0.5
Yugoslavia	--	0.2	0.2
Middle East	3.0	-0.3	-2.1
Of which:			
Egypt	-0.6	0.6	-0.2
Israel	-0.4	-0.7	-0.8
Western Hemisphere	15.2	5.8	2.5
Of which:			
Argentina	2.3	-0.2	1.2
Brazil	5.3	5.2	-0.8
Chile	0.3	1.5	0.3
Colombia	0.6	0.3	0.3
Ecuador	0.2	-0.1	0.2
Mexico	2.8	1.2	0.7
Venezuela	-1.3	-2.2	0.4
Memorandum items:			
15 heavily indebted developing countries	11.4	4.8	0.5
Total BIS-based	26.4	11.0	13.8
(Growth rate)	(7)	(2)	(3)
Gross bond issues	3.3	5.3	10.2

Note: Owing to rounding, components may not add.

Sources: Bank for International Settlements (BIS); Organization for Economic Cooperation and Development; International Monetary Fund, International Financial Statistics; and Fund staff estimates.

1/ IMF-based data on cross-border lending by banks are derived from the Fund's International Banking Statistics (BIS) (cross-border interbank accounts by residence of borrowing bank plus international bank credits to nonbanks by residence of borrower), excluding changes attributed to exchange rate movements. BIS-based data are derived from quarterly statistics contained in BIS's International Banking Developments; the figures shown are adjusted for the effects of exchange rate movements. Differences between the IMF data and the BIS data are mainly accounted for by the different coverages. The BIS data are derived from geographical analyses provided by banks in the BIS reporting area. The IMF data derive cross-border interbank positions from the regular money and banking data supplied by member countries, while the IMF analysis of transactions with nonbanks is based on data from geographical breakdowns provided by the BIS reporting countries and additional banking centers. Both IBS and BIS series are not fully comparable over time, owing to expanding coverage.

2/ Excluding the seven offshore centers which are: the Bahamas, Bahrain, the Cayman Islands, Hong Kong, the Netherlands Antilles, Panama, and Singapore.

countries in 1985. 1/ After allowance for these offsetting factors, the increase in banks' underlying risk exposure to developing countries is estimated to have been between $8 and $13 billion in 1985--a growth rate in exposure of 1 1/2 to 2 1/2 percent, relative to banks' unguaranteed claims. Because reliable regional information is not available, flow figures in the remainder of this paper have not been adjusted for write-offs, unidentified bond purchases, or guarantees.

Disbursements under concerted lending packages were halved from the 1984 level to $5 billion in 1985. Over 80 percent, or about $4.2 billion, of these disbursements went to five countries in the Western Hemisphere (Argentina, Chile, Ecuador, Mexico, and Panama); the remainder was directed to Cote d' Ivoire and the Philippines. During the first six months of 1986, disbursements of concerted bank finance totaled $1.4 billion and were confined to Argentina and Chile. New concerted packages were also arranged for Colombia and Costa Rica in 1985; no concerted lending packages were arranged during the first six months of 1986.

In aggregate, commitments under concerted packages totaled $2 1/2 billion in 1985 and the first six months of 1986, compared with $16 1/2 billion in 1984. A bank lending package involving cofinancing by a limited group of banks was arranged for Cote d'Ivoire in 1985, while analogous "semi-spontaneous" packages have been initiated for Uruguay (also including a cofinancing) and Ecuador. Total publicized long-term bank credit commitments to developing countries declined from $31 billion in 1984 to under $18 billion in 1985, and to $8 billion during the first half of 1986 (Chart 3).

In late July 1986, Mexico requested from its commercial bank creditors a concerted financing package which would call for an amount of net lending equivalent to $6 billion. This package would be linked to a special scheme calling for additional funding in case the price of oil falls below a certain level, and for a reduction in net lending if the price of oil exceeds another specified level. Banks were also requested to participate in a contingency mechanism that would provide additional financing for productive investments if economic recovery fails to materialize.

The trend toward lower spreads for developing countries continued in 1985 and during the first half of 1986, while the decline in international interest rates also helped to reduce borrowing costs (Chart 4). A further lowering of spreads and lengthening of maturities was evident in bank debt restructuring agreements, and banks negotiated

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1/ A tentative estimate of the impact of such guarantees is included in the accompanying paper on officially-supported export credits, and a description of the adjustments made to arrive at banks' risk exposure is contained in the background paper on capital markets.

CHART 3

BOND ISSUES AND LONG-TERM COMMITMENTS OF CREDITS AND FACILITIES TO CAPITAL-IMPORTING DEVELOPING COUNTRIES, 1981-FIRST HALF OF 1986

(In billions of U.S. dollars)

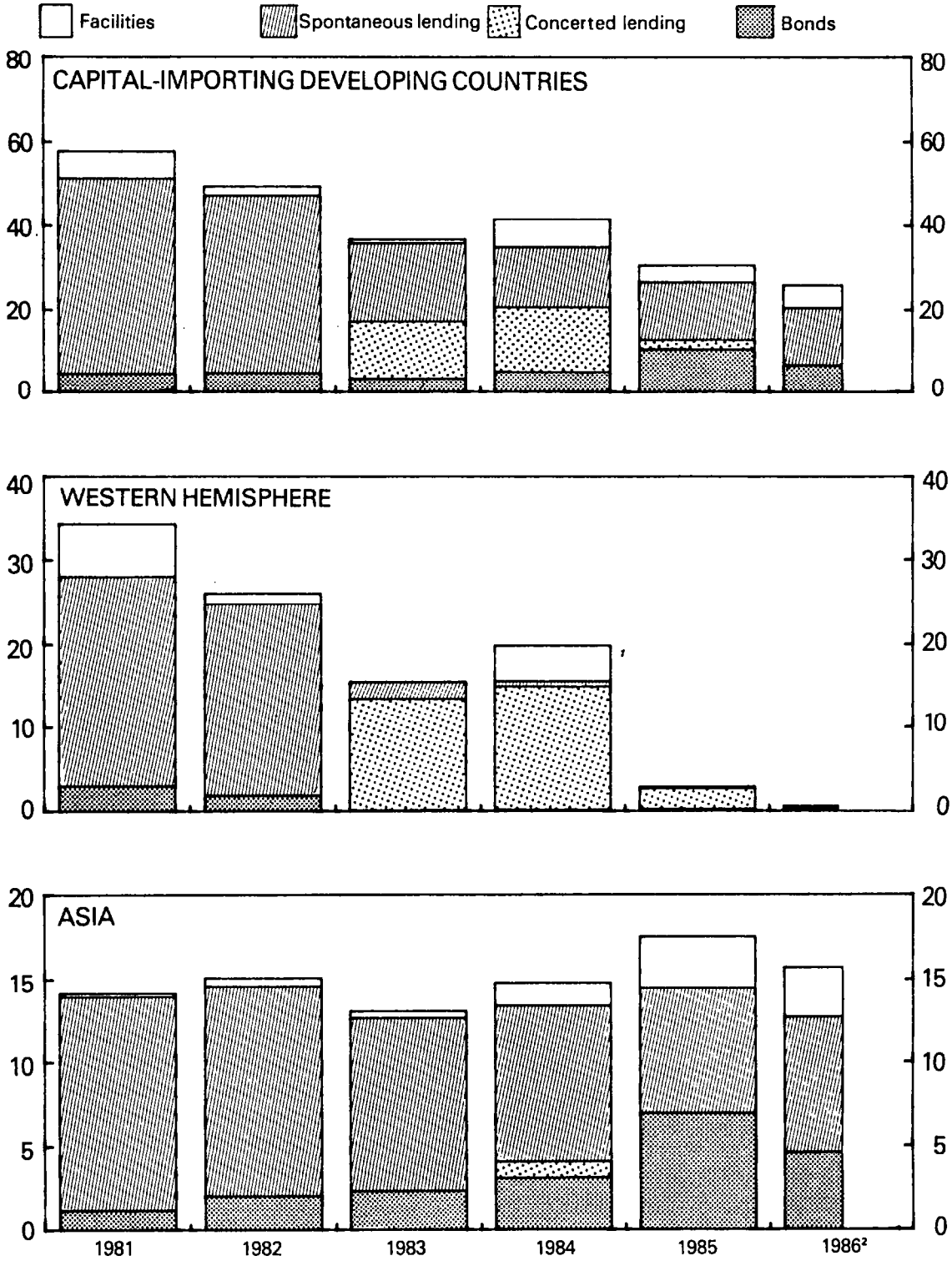

CHART 3
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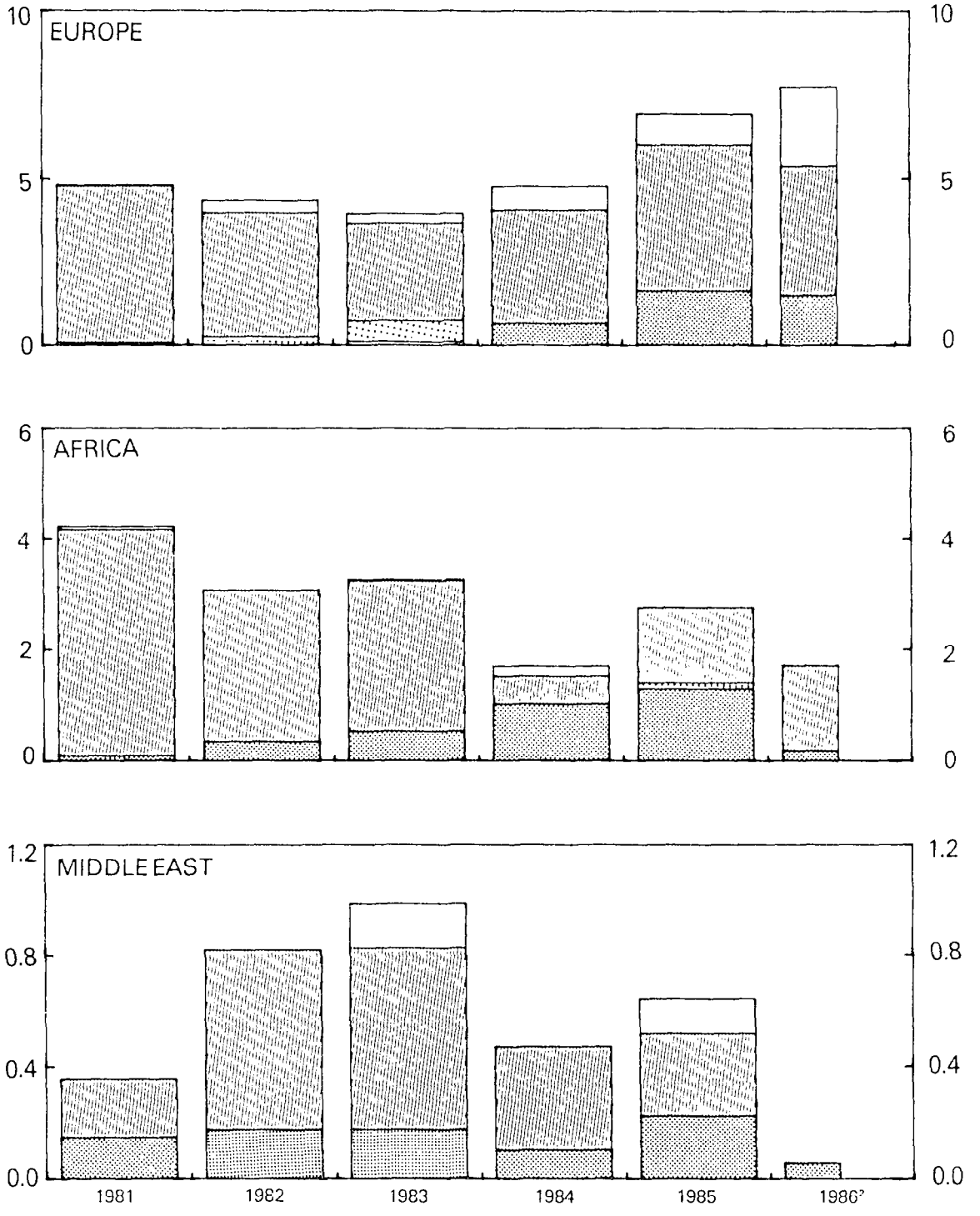
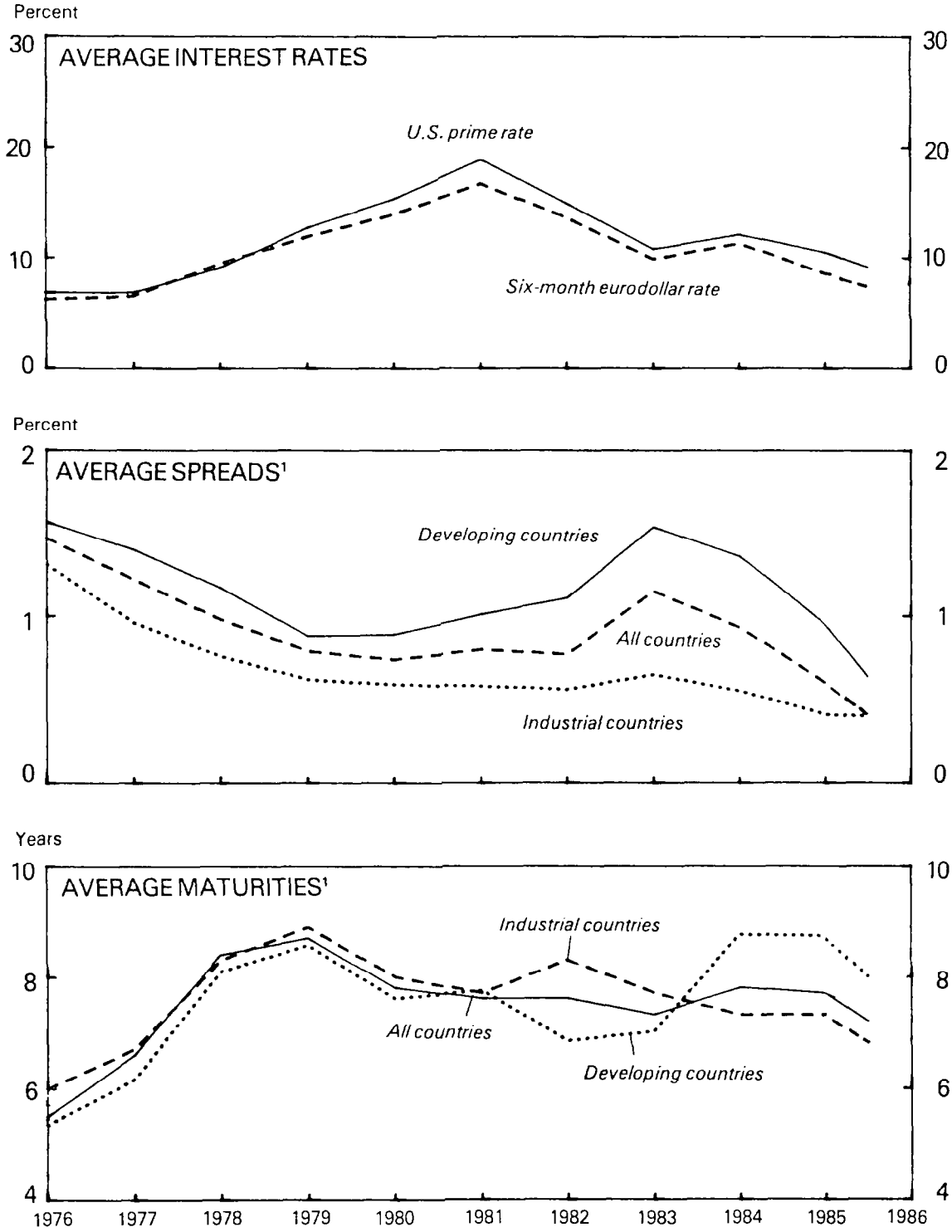


Source: Organization for Economics Cooperation and Development, *Financial Statistics Monthly*; and Fund staff estimates.
[1] Includes a facility arranged for Mexico.
[2] First half annualized.

CHART 4

TERMS ON INTERNATIONAL BANK LENDING COMMITMENTS, 1976-FIRST HALF OF 1986



Sources: Organization for Economic Cooperation and Development, *Financial Market Trends*; Federal Reserve Bulletin for Prime Rate; International Monetary Fund, *International Financial Statistics*, and Fund staff estimates.

[1] New publicized long-term international bank credit commitments.

additional MYRAs, including the first MYRA in Africa (for Cote d'Ivoire). The amounts of bank debt restructured in agreements signed or reached in principle, excluding short-term debt rolled over, are estimated at $15 billion for 10 developing countries. During the first six months of 1986, restructuring agreements were reached with three countries for a total of $9 billion.

Gross international bond issues by developing countries doubled in 1985 to $10 billion. Even though the number of developing countries borrowing in international bond markets rose to 21 from 18 in 1984, eight developing countries from Asia and Europe accounted for 80 percent of the total value of these issues. Over 60 percent of the bonds issued by developing countries were in the form of floating rate notes; these bonds may have largely been purchased by banks and, in many cases, may not have been reported as bank lending to developing countries. In 1985, 13 developing country borrowers also arranged note issuance facilities (NIFs) amounting to $3.2 billion, compared with 10 such countries in 1984 for an amount totaling $1.2 billion. Purchases of notes under these facilities by banks may also be omitted from reports of some banks' exposure to developing countries.

During the first half of 1986, however, bond issues by developing countries were only half of the level during the comparable period of 1985. The principal borrowers were Asian countries, which accounted for 85 percent of total bond issues. Several developing countries (e.g., Algeria, Malaysia, South Africa, and Thailand) did not issue any bonds during the first half of 1986, although collectively their bond issues had totaled $2.1 billion during the first half of 1985.

The growth in developing countries' cross-border bank deposits declined to $16 billion in 1985 from $23 billion in 1984. Interbank depositing was virtually flat in 1985, after having risen by $18 billion in 1984, reflecting a slowdown in accumulation of official reserves in 1985. In contrast, deposit taking from nonbanks in developing countries rose to $14 billion in 1985 from $2 billion in 1984, and may indicate some increase in capital flight.

The regional pattern of bank lending to developing countries became still more differentiated in 1985, both as regards sources and uses of funds. Spontaneous bank lending to developing countries was mainly accounted for by lending to countries in Asia and Europe that had not restructured their debt. The small increase in claims on developing countries in the Western Hemisphere was more than accounted for by concerted lending. Africa received little net bank financing, and there was a continued withdrawal from the Middle East.

Lending to developing countries also varied significantly among banks of different nationalities. In 1985, U.S. banks' claims on developing countries fell by 8 1/2 percent, although nearly 2 percentage points of this decline was due to a sale of claims by one U.S. bank to a bank in the United Kingdom. U.S. banks reduced their claims on

developing countries in all regions. U.K. banks' claims on developing countries also declined in 1985, in U.S. dollar terms, entirely as a result of reductions in Africa and the Western Hemisphere. Although detailed geographical data are not available on other countries, it can be inferred that the rise in total lending stemmed principally from Japanese banks, whose lending offset the drop in U.S. bank claims, especially in Asia. German banks may also have increased modestly their claims on both the Western Hemisphere and Asia in 1985.

Supervisors commented on the widespread strengthening of banks' balance sheets since 1982, achieved in some cases mainly through a continued build-up in capital and reinforced in other cases by increased provisioning. In the United States, there was a significant increase of capital in relation to banks' developing country claims (from 50 percent of exposure in 1982 to 80 percent in 1985) (Chart 5). The recent sharp decline in the U.S. dollar has helped to diminish exposure relative to capital and reserves for banks outside the United States. Thus the exposure of banks in industrial countries to developing countries relative to capital and reserves has decreased considerably.

Supervisors cautioned, however, that off-balance sheet risks have increased and that new capital was not all of the same quality, especially where it has taken the form of loan capital, held at times by other banks. Moreover, provisioning levels were uneven, varying substantially between countries and also among banks within individual countries. While significant strengthening has been achieved, the banking system would thus remain vulnerable to a widespread deterioration in payments relations.

III. Developments in the Debt Situation

1. Commercial banks

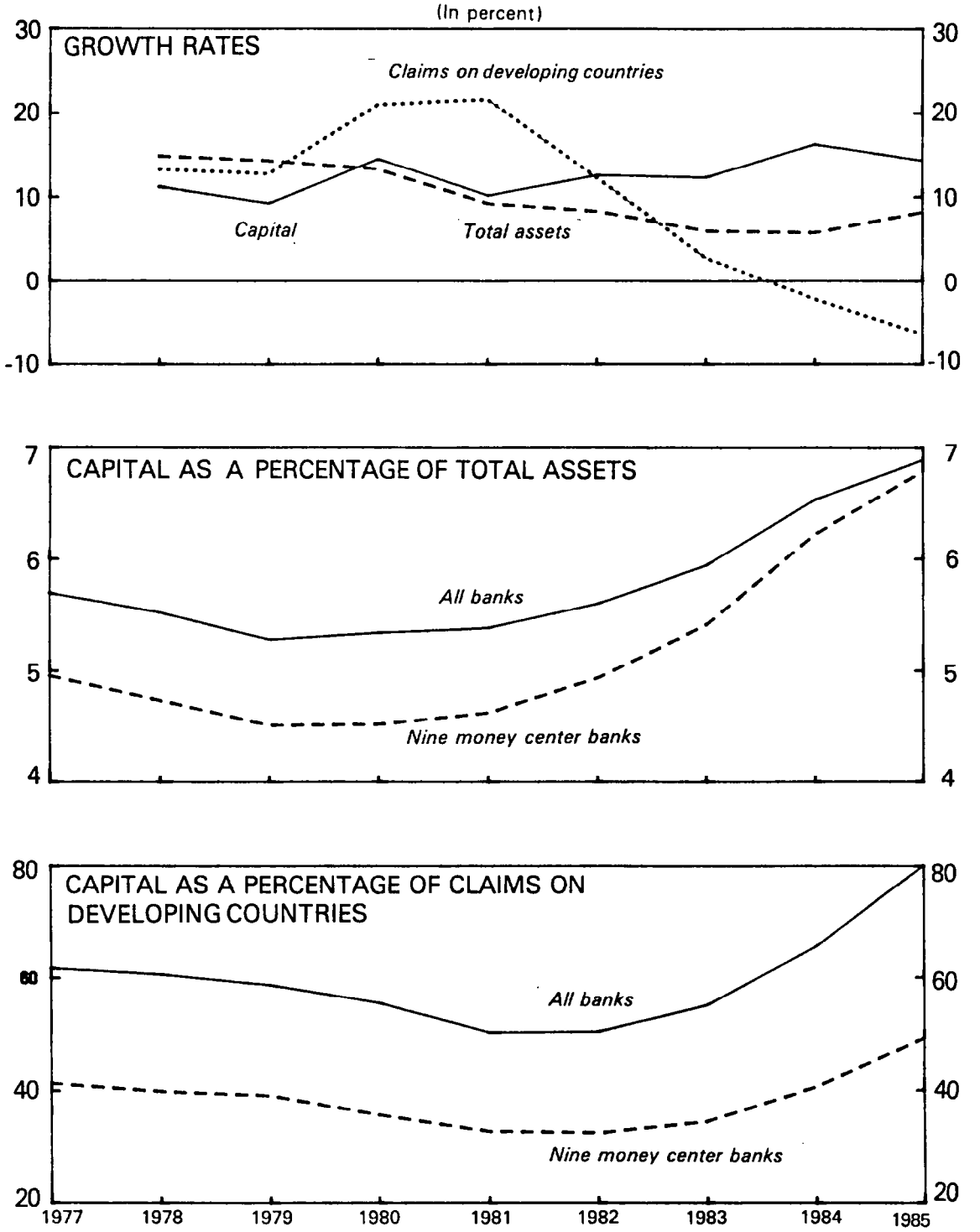
Staff discussions with commercial banks focused firstly on factors that would influence their future willingness to lend to developing countries and on the implications for the debt situation. Banks indicated that the fundamental influences on their lending were developing countries' economic policies and prospects, although at times they may respond to changes in these policies and prospects with a considerable lag. In this context, many banks noted the usefulness of the economic analyses and data provided by the Institute for International Finance.

There were, however, significant differences in attitudes toward lending to developing countries within the banking community. These attitudes were influenced by banks' long-term business interests, including regional trading ties and financing patterns. To the extent that banks are interested in business with developing countries, this business is largely related to trade and project lending, generally in support of the activities of industrial country clients and often

CHART 5

SELECTED BALANCE SHEET DATA FOR U.S. BANKS, 1977-85

(In percent)



Sources: Federal Financial Institutions Examination Council, *Country Exposure Lending Surveys.*

benefiting from officially supported export guarantees. Large banks with more multinational corporate clients--and in some cases with significant domestic banking operations in developing countries--expressed the greatest interest in maintaining business links to developing countries. A few large banks identified as a strategic priority the development of their local banking business in selected developing countries. Differences in regulatory practices and in banks' exposure have also affected attitudes toward lending, especially to countries that have restructured their debt.

These factors have interacted in complex ways, at times operating in a mutually reinforcing manner. In Asia, for example, these influences have, on balance, favored a growth in bank claims, reflecting the policies of developing countries in the region and strong financing ties to regional banks (e.g., Japanese), which have continued to expand their international lending.

While there is thus considerable diversity in bank attitudes toward lending to developing countries, staff conversations confirmed a continuing reluctance among banks, except to some degree banks in Japan, to increasing their exposure to developing countries in the form of balance of payments lending. The operations preferred by banks have the common characteristic that they do not result in a substantial increase in banks' cross-border exposure and are thus not likely to be associated with a substantial transfer of resources by banks to developing countries.

Banks' preference to shift away from balance of payments loans has been recognized in restructuring and new money agreements. These agreements have tended to include, to the extent feasible, options to match the form of these claims more closely to banks' different interests. Banks have, for example, switched their claims back to the private sector and to parastatals in developing countries (via "on-lending" facilities). In addition, currency redenomination features have permitted banks, especially Japanese and Swiss banks, to hold claims in their own currencies.

Banks' loan claims have also been transformed into longer term investments through arrangements to convert debt to equity, although the amounts involved so far have been relatively modest. In some cases, a bank may undertake to convert its own loan claims into equity, for example to purchase a local financial institution or to expand existing local operations. For banks in many countries there are regulatory difficulties with equity participation in nonbanks. In other cases, banks may assemble packages of loans and broker sales of these loans to a third party that wants to make an investment in the country, for example a multinational company.

The divergence of banks' interests and the diversification in banks claims was seen by banks as part of a long-term "healing process" that involves a normalization of creditor/debtor relations based on

underlying commercial interests. The staff questioned banks on the relationship between this healing process, involving a lessening of cohesion among creditor banks, and the degree of cohesion needed for further "concerted" financing packages (loans involving equiproportional increases in exposure by all existing creditor banks).

Leading banks recognized that, in order to protect existing claims and to permit desired activities to expand, there would be a continuing need in some cases for concerted lending. Banks stressed, however, that their contributions would be conditioned not only on comprehensive policy reforms in debtor countries, but also on the commitment of funds by other creditors. It was clear from discussions that banks, while supporting the broad objectives of the Baker Initiative, were adopting a "wait and see" approach with regard to its implementation.

The conditional nature of this support for the debt strategy implies that there may be considerable operational difficulties in mustering new money packages. Staff discussions with banks indicated that sound policies in debtor countries would remain the key to assembling concerted financing packages. Advisory committee banks thought that economic subcommittees could play an even greater role in preparing assessments of policies and prospects in borrowing countries. These banks and their national subgroups would need to present information fully and effectively to other banks, to encourage participation by a wide range of banks. In the past, the process of mustering new money has been facilitated where communications between debtors and their bank creditors have been conducted effectively.

Once initial agreement of creditor banks for a new money package has been finalized, banks anticipated that disbursements would be phased, as in the past, in line with policy implementation. Banks also indicated they would seek increasingly to link their disbursements to prior actions by other creditors--for example, specifying "minimum" contributions from the Paris Club, export credit agencies, or the World Bank. In some cases, arrangements to modify such conditions have required approval of all banks, which has involved delays. Advisory committee banks noted that limiting approval for such modifications to a qualified majority of banks has in some instances avoided such delays.

Burden sharing within the banking community remains a contentious issue. New money packages have continued to be based on exposures existing at the time debt servicing difficulties emerged for each country (i.e., the base date), although as time has passed, some banks have provisioned heavily against their exposure or even sold their claims. Advisory committee banks noted that, for this reason, the 1982-83 new money bases have become increasingly artificial. However, these banks felt that shifting to a later base date--one that reflected more fully banks' current exposure--would send the wrong signals by penalizing banks that have contributed to spontaneous increases in exposure, and legitimizing the withdrawal of others. More broadly, most advisory committee banks did not consider it feasible to reach a consensus on a different basis for burden sharing.

Leading banks believed that a major problem existed in ensuring the participation of banks with small exposures. Possible approaches to the problem of banks with small exposures were described in the Board paper on "Implementing the Debt Strategy: Financing Issues" (EBS/86/41, 2/24/86), including notably trust funds, loan sales and swaps, applications of cofinancing, or arrangements such as a cut-off point below which banks would not be expected to participate. The discussion of this subject among banks has not advanced significantly since the time of that Board paper. After studying this issue in a working group, banks reached no agreement on providing financial protection exclusively to banks with small exposures. More generally, banks saw great difficulty in setting a cut-off point below which banks would be specially treated or not approached at all. Such cut-off points would be viewed as arbitrary and difficult to enforce, and could also affect burden sharing among different nationalities of banks.

Advisory committee banks thus envisaged continuing to approach all banks for contributions to new money packages. Some banks noted two techniques that may in practice accommodate recalcitrant banks, albeit to a limited degree. First, in some cases banks have swapped debt so as to consolidate claims with those banks that have a continuing business interest in a country. Second, formal arrangements along the lines of the discounted loans/equity conversion scheme operating in Chile 1/ could allow some banks to dispose of their claims in a manner acceptable to other creditor banks. Banks observed that it would be crucial that legal arrangements clarify that the potential new money obligation of a "selling" bank had been extinguished in a manner that was indeed definitive and satisfactory to all parties.

In addition, it was noted that some banks, particularly those that have provisioned heavily, have stated that their reluctance to provide new money does not mean that they would not provide financial support through some other modality such as interest capitalization. This suggests that some diversification of financing modalities within a financing package may, to a limited degree, help secure more rapid assistance from banks. Nevertheless, there may be some banks that would seek to avoid any financial contribution to a new money package, while still receiving their full interest payments; in discussions with staff, banks viewed that position as unjustifiable.

Banks noted that they had recently adopted a more differentiated approach to financing, in light of countries' varied economic situations. To a high degree, developing countries' adjustment efforts, by determining the magnitude of financing and influencing banks' perceptions of creditworthiness, were viewed as influencing the appropriate form of bank financial assistance. In some key cases, as

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1/ Implementing the Debt Strategy: Financing Issues - Conversion of External Debt to Equity and Liquidation of Loan Claims at a Discount (EBS/86/41 Supplement 1, 3/21/86).

discussed above, concerted lending packages were viewed as necessary. However, for some countries that have advanced to a point where their financing needs were small, and their economic policies and prospects favorable, it has been possible to shift toward managed loans. These loans will be feasible chiefly where limited group of banks with longstanding ties are prepared to strengthen relations with the country through lending that is "semi spontaneous" in nature.

Such semi-spontaneous arrangements were generally facilitated by special types of financing. In Uruguay and Cote d'Ivoire, project loans cofinanced by the World Bank facilitated such packages, while in Ecuador a package has been initiated in the form of a trade facility to pre-finance oil exports. When developing countries reach this point, the divergence and regional nature of banks' interests can work to developing countries' advantage. However, banks warned that a premature move toward such a semi-spontaneous loans could jeopardize a country's subsequent ability to arrange concerted financing if that should prove necessary.

In contrast, there could be cases where a country's payments situation and prospects had deteriorated to a point where a classic new money package was not deemed appropriate or feasible by the advisory committee. An example could be a low-income country with large interest arrears, such as Bolivia. In such cases, most banks recognized a need to consider solutions attuned to the particular situation of the country. In the past, banks have been prepared to reschedule or formally defer interest for a very limited number of countries whose debt problems were exceptionally serious and whose prospects for regaining access to spontaneous bank financing were considered remote.

Banks noted two considerations in this connection. First, as a principal financing modality rescheduling of interest obligations would signal a departure from market-oriented financing, which would be inappropriate for debtor countries that were still able to raise medium-term loans, albeit on a concerted basis. Second, while interest rescheduling was sometimes viewed as a form of debt relief, it added to countries' commercial indebtedness to the same extent as a new loan, and could result in a buildup in obligations beyond the extent justified by a country's debt servicing capacity.

As far as genuine debt relief through concessional interest rates or outright reductions in principal was concerned, most banks appeared unwilling to consider this option at the present time. Banks were sympathetic to the situation of low-income countries implementing macroeconomic and structural reforms. They saw, however, a number of very difficult issues, including selection of appropriate criteria to determine eligibility for, and scale of, relief as well as problems of contagion to "inappropriate" country cases.

Several points emerged during discussions with banks on the question of <u>countries re-entering international financial markets</u>.

These points were based in part on experience in the case of Turkey, following its restructuring, and Hungary, which had experienced a period of constrained access to spontaneous commercial financing. They also reflected the so far limited experience with semi-spontaneous credits and some spontaneous short-term financing for certain countries that have restructured since 1982.

Re-entry was likely to begin at the short-term end of the maturity spectrum. Access to short-term trade finance was typically the first form of financing to return. Project loans, perhaps involving officially supported export credit guarantees or cofinancing with a multilateral development bank, might also be attractive for banks with domestic customer interests in a developing country. Loan instruments that were transferable could be helpful for some countries in the transition to general purpose bank loans, as could private placement of bonds with a group of banks. Public issues of bonds would be a much later step. In this connection, it was stated that floating rate notes, principally a bank instrument, might be more accessible to developing countries and that for fixed rate financing the Japanese bond market had been especially receptive to placements and issues by developing countries.

Developing countries that regained access to capital markets might be able to benefit from some of the current innovative financing techniques in capital markets. For countries that have rebuilt their creditworthiness, these new techniques offered opportunities to minimize borrowing costs, to hedge risks, and to tap new portfolios. At the same time, banks cautioned that on occasion borrowers have been offered expensive arrangements that would not improve their market standing because they were viewed as premature. Even techniques designed to enhance the credit rating of bonds (e.g., through collateralization), need careful study to determine whether they are appropriate in individual cases. Rebuilding creditworthiness was not seen primarily as a matter of financing techniques: it depended rather on solid improvement in debt servicing prospects, combined with sustainable economic growth.

The staff asked bank supervisors and banks for their assessment of the impact of bank supervisory practices on lending to developing countries. Bank supervisors have been proceeding with a strengthening of banks' balance sheets during the past several years. Banks expressed some concern about the divergence in national supervisory and accounting regimes, and the differing degrees of tax deductibility afforded to loan loss reserves. Banks in some countries identified a particular concern that mandatory provisions on all exposure to a group, or "basket," of countries for a predetermined number of years may deter spontaneous lending and provide an unfortunate signal to developing countries pursuing adjustment policies. The basket approach assigns the same level of provisions to all countries within the basket, regardless of economic performance, and to all types of exposure, including trade finance, irrespective of the payments record. A flexible approach to

upgrading debtor countries in a basket as their economic performance improves would appear more consistent with the case-by-case approach to debt problems. In addition, a return to spontaneous financing would be facilitated if trade finance, where serviced regularly, were treated flexibly with regard to provisioning requirements; this is already the case in a number of countries.

In the past two years, there has been a general move among supervisors toward using as an indicator of banks' capital adequacy a risk asset ratio that assigns different weights to various types of assets--distinguishing, for example, between claims on public sector bodies, banks, and nonbanks. In a number of cases, a higher risk weight is applied to claims on governments in developing countries, reflecting, inter alia, transfer risk. In discussions with the staff, banks and supervisory authorities expressed the view that differentiation of risks in capital ratios does not have a significant impact on the availability of loans to developing countries because banks' business interests and own perceptions of creditworthiness would be predominant in lending decisions.

The proposed risk asset ratio for U.S. banks was issued for public comment; it proposed using the Fund's country classification to distinguish between industrial and developing countries in this connection. The Deputy Managing Director, in a letter to the U.S. Federal regulatory authorities, pointed out that the Fund's country classification was devised for economic analyses and not with a view to prudential concerns, and that judgments of prudential classifications are based on assessments made by supervisory authorities.

2. Foreign investment

During 1984-85 foreign direct investment flows to developing countries averaged approximately $10 billion, or only somewhat less than the sharply reduced level of bank lending during those years. Nonetheless, these investment flows were considerably below their average level ($15 billion) before the emergence of widespread debt servicing difficulties and significantly below the average level of bank lending ($70 billion) during 1979-82. Direct investment in developing countries has been depressed by, inter alia, the decline in investment and economic activity in these countries.

Comments by banks concerning attitudes of their corporate customers provided some broad indications of the various areas in which changes could positively influence their investment decisions. These included sectoral entry restrictions, limitations on equity participation of foreign firms in domestic firms, restrictions on profit remittances, absence of patent protection, complex regulatory environments, and certain noncommercial risks. Banks emphasized that existing and potential trade barriers in industrial countries were also a major source of concern to their industrial clients when deciding whether to manufacture products in developing countries. This concern was seen as discouraging investment in the export sectors of developing countries.

A number of developing countries consider that there are certain broad advantages of greater reliance on foreign direct investment, principally the greater sharing of economic risks associated with using foreign savings. Some countries are studying or undertaking measures to encourage such flows; examples of such recent measures are outlined in the background paper. Banks have indicated that their corporate customers were taking stock of such changes and may respond, especially where external factors--such as the sharp appreciation of the Japanese yen--provide added inducement to engage in foreign investment. Nevertheless, even with a recovery in the economies of developing countries, direct investment flows were not expected, in the near term, to increase sufficiently to offset the decline in bank lending.

The Multilateral Investment Guarantee Agency (MIGA), being launched by the World Bank, may help stimulate an increase in direct investment flows. The MIGA would issue guarantees for foreign investment against noncommercial risks and promote investments by undertaking research, providing information, and rendering technical assistance. A preparatory committee is scheduled for September 1986 to formulate regulations and policies. Signatories of the MIGA convention totaled 31 at end-June 1986, of which 26 were developing countries. The authorized capital is approximately $1.1 billion.

Some investment banks in major financial centers have indicated an interest among clients in portfolio investment in a limited group of developing countries, as part of a general diversification strategy. In Japan, for example, a strong interest in Korean equity was noted. The success of the Korea Fund and the recent convertible bond issues by Korean private sector firms were cited. An equity mutual fund for India was launched in July 1986. Demand by investors for equity instruments in developing countries was seen as dependent on several factors, including suitable investment vehicles, adequate stock exchanges, proven remittance policies, and considerable effort at investor education. Multilateral institutions, such as the International Finance Corporation (IFC), can help establish the necessary capital market and legal structures, while assisting in disseminating information.

As noted earlier, some recent bank debt restructuring agreements have included provisions permitting the conversion of debt into equity. This subject was reviewed recently in "Implementing the Debt Strategy: Financing Issues--Conversion of External Debt to Equity and Liquidation of Loan Claims at a Discount" (EBS/86/41, Supplement 1, 3/21/86). Some banks have expressed considerable interest in debt-equity conversions and the scheme in Chile continues to operate successfully. In several other countries banks have purchased loan claims at a discount on the market and assembled these into packages for conversion into equity to provide an advantageous cost of financing for investment by industrial country clients. The overall scale of activity was thought to be relatively modest thus far. An update of developments in this area is included in the background paper.

3. Capital flight

There are considerable difficulties in assessing, or even defining, capital flight. A number of recent studies have indicated that the external position of several major borrowing countries has been weakened by large outflows of capital by private residents. These studies are difficult to compare because of differences in definition and methodology, in the countries covered, and in the periods reviewed. An overview of these studies is provided in the background paper. There are significant methodological shortcomings in these studies, and they do not provide adequate guides to the dimensions of capital flight.

Although the estimates in these studies show substantial differences in annual and cumulative flows, some common features in the studies have attracted attention in the banking community. In particular, cumulative private capital outflows estimated for certain developing countries were observed to be significant in relation to their outstanding bank debt, while in some other countries such cumulative flows were seen to be a relatively small proportion of total bank debt. Given the general shortage of foreign savings, banks noted that repatriation of flight capital could be an important source of external flows.

Banks acknowledged indications that capital flight in the aggregate for developing countries had declined since 1982-83, because of an improvement in domestic policies and a shortage of foreign exchange. This decline is apparent in statistics available in the WEO and from the Fund's IBS data. They stressed the need for developing countries to tackle the problem of capital flight, and insisted that their willingness to lend would be influenced strongly by action in this area, reflecting a concern that additional bank lending might finance further capital flight. This worry has heightened banks' desire to link their lending to the pursuit by developing countries of appropriate fiscal, monetary, interest and exchange rate policies to provide incentives for domestic savings to be invested at home.

Some banks also emphasized the need for institutional development, in particular the creation of domestic capital markets, to encourage residents to employ their savings within the economy. Technical assistance by the multinational agencies was seen as having a role to play in this area by helping to devise measures that promote banking system competition; to develop local stock exchanges; and to broaden and deepen financial markets. Further measures designed to combat capital flight have also been considered in some cases. In Chile, for example, the arrangements to facilitate the purchase at a discount of external loan claims may have encouraged the repatriation of residents' capital.

4. Multilateral development banks 1/

The World Bank and the three regional development banks--the Inter-American Development Bank (IDB), the African Development Bank (ADB) and the Asian Development Bank (AsDB)--together made new lending commitments of close to $22 billion in 1985, compared to $18 billion in 1984. The World Bank accounted for 72 percent of the total, followed by the IDB (14 percent), and the AsDB (9 percent). New commitments to the group of 15 highly indebted countries by the four multilateral development banks exceeded $7 billion in 1985 (compared to $6 billion in 1984), about two-thirds of which was provided by the World Bank.

Well-designed and efficiently implemented projects were seen by banks as essential for the restoration of growth in debtor countries. They can also enhance export capacity, and the ability to finance future development. In Africa, there has been an increased emphasis on agricultural lending, while in Latin America, the largest share of IDB lending went to industry and mining and energy. The largest proportion of World Bank lending over the past six years has been directed to agriculture and rural development, followed by energy. Given the constraints on funds for development and investment in many debtor countries, there is greater stress on the efficiency and productivity of those investments that are made. The World Bank, in particular, can assist countries to design an overall investment plan that allocates resources well between different sectors.

A greater proportion of structural and sectoral adjustment loans were approved by the World Bank in 1985 and early 1986 in support of the broad reforms being undertaken in a number of key debtor countries. Policy-based lending commitments of the World Bank to the group of 15 heavily indebted countries amounted to $850 million in 1985, equivalent to 17.5 percent of the World Bank's total lending to these indebted countries, which was a higher proportion than in 1984 (16.2 percent), and also well above the ratio for the World Bank's policy-based lending to all countries. Policy-based lending has emphasized structural reforms including trade liberalization; improved pricing policies and greater managerial efficiency in public sector enterprises; deregulation, and measures to support private initiative, particularly where this can be substituted for costly public sector investments. A substantial increase in World Bank disbursements during 1986-88, is expected to include a higher share of fast disbursing funds under policy-based lending.

Regional development banks also may engage in policy-based lending to support sectoral reform and/or comprehensive country strategies aimed

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1/ A companion paper reviews recent developments in project and policy-based lending from the World Bank for the group of heavily indebted countries. Activities of regional development banks are also reviewed.

at promoting growth. Some regional development banks have already engaged in such lending on a small scale, and others are in the process of discussing such activities. The AsDB has indicated that it is increasingly concerned with sectoral issues that affect project performance. The ADB and the IDB are also studying this question. The ADB has to a significant extent associated its lending with that of multilateral and regional development institutions and bilateral donors. The ADB recently initiated policy-based lending through cofinancing loans with the World Bank. At its 1986 annual meeting, it was noted, however, that such lending would probably remain a small part of the total, especially in the early stages, given the ADB's limited expertise and experience in nonproject lending. At the IDB's 1986 annual meetings the possibility of engaging in quick-disbursing sectoral loans tied to implementation of policies was raised by various governors, but a decision has not yet been taken. In some cases, it may be possible for project lending by regional development banks to be coordinated with sectoral policies supported by the World Bank.

Multilateral development banks can also add to the flow of finance to developing countries through formal cofinancing arrangements with commercial banks, for example, by fostering the association of commercial banks with viable investment activities. The World Bank has recently cofinanced loans for Chile, Cote d'Ivoire, Colombia, Costa Rica, and Uruguay. Both the AsDB and the IDB have mobilized resources from commercial banks in support of projects. The IDB and the World Bank engaged recently in parallel financing of projects in Colombia and Uruguay.

Multilateral development banks have an important role in the provision of long-term finance in support of sound projects and needed structural reforms, and in catalyzing commercial financing. Commercial banks made clear in discussions with staff that they view World Bank involvement in debtor countries as extremely important. They emphasized their interest in linking their funding to trackable sector and project activities--designed to enhance countries' longer-run development and growth prospects--in a framework of financial and macroeconomic stability. Export credit agencies also see a role for the World Bank in assisting identification of productive projects.

5. The Fund's role and enhanced surveillance

The central nature of the Fund's role in helping developing countries resolve their debt problems was stressed by virtually all institutions. In particular, convincing macroeconomic and structural policies were cited as the key to facilitating the assembly of new commercial bank financing. Arrangements to use Fund resources were also expected to continue for a number of debtor countries, especially where adjustment was at a relatively early stage and the financing gap was still relatively large.

Commercial banks have increasingly linked their disbursements of concerted lending both to implementation of Fund programs and to structural reforms and projects supported by the World Bank. As banks outlined their intentions to extend this process, the staff registered a concern that such arrangements should not introduce indirect forms of cross conditionality or, through their rigid nature, lead to unwarranted delays in the provision of bank financing.

Desire to demonstrate to creditor banks the linkage of refinancing arrangements to the Fund has led advisory committee banks in some cases to insert clauses in such arrangements that appear to precommit the use of Fund resources or of enhanced surveillance. These clauses have tended to occur in bank MYRAs with consolidation periods that extend beyond an existing Fund arrangement. In such cases, a new Fund arrangement or enhanced surveillance was made a condition precedent for continued restructuring under the MYRA. Banks have also attempted to make the absence of such Fund involvement an event of default on the country's debt.

Fund management has confirmed to banks a willingness to propose to the Executive Board, upon request from the member country, further stand-by arrangements if needed, or enhanced surveillance, within the Fund guidelines. However, Fund management and staff have also made clear to banks that the Fund's Executive Board would not be bound by conditions specified in loan agreements, involving procedures that have not been agreed to for a specific member by the Fund's Board. The Fund is not a direct participant in negotiations between banks and a member country, and banks do not always provide draft clauses relating to the Fund for review by the Fund staff when agreements are in preparation. In a number of cases where clauses relating to the Fund have been discussed with the management and staff, banks have modified such clauses.

In the case of Colombia, an exceptional procedure was developed to facilitate commercial bank financing that was considered by Executive Directors during their discussion of "The Role of the Fund in Assisting Members with Commercial Banks and Official Creditors" and their conclusions were reflected in the Managing Director's Summing-Up of that meeting (EBM/85/132, 9/4/85). The Fund was requested by Colombia to endorse its policies as sufficiently strong and comprehensive "to have qualified for access to the Fund's resources under an arrangement in the upper credit tranches," and to monitor observance of performance criteria negotiated with Colombia. Banks have linked their disbursements of a concerted bank loan to observance of those criteria. The Colombian authorities may provide bank creditors with copies of the reports prepared by the Fund staff on the economic situation. The Fund staff has sent communications on quarterly developments related to performance criteria to the Colombian authorities for distribution to creditor banks. Executive Directors will have the opportunity to examine Colombia's experience during the next review of its economic situation.

Enhanced surveillance was developed to facilitate the return to normal market access--through a MYRA--of countries with a good record of adjustment and in a position to present an adequate quantified policy program in the framework of consultations with the Fund. Experience in the four cases of enhanced surveillance--Venezuela, Mexico, Ecuador, and Yugoslavia--is described in greater detail in the accompanying background paper.

The first Article IV consultation reports under enhanced surveillance were prepared for Venezuela. Three such reports have been discussed by Executive Directors. The Venezuelan authorities have not distributed these reports to creditor banks since the MYRA has not yet been implemented. Consequently, enhanced surveillance has not become fully effective in the case of Venezuela.

Enhanced surveillance for Mexico was due to begin in January 1986. Mexico presented a quantified annual economic and financial program to its bank creditors, but this program was not reviewed by the Fund staff under the enhanced surveillance procedures. The monitoring procedures in the Mexican MYRA envisaged that a material deterioration in Mexico's financial condition could result in a return to an arrangement for the use of Fund resources. A request for use of Fund resources is expected to be discussed by the Executive Board in the near future.

Ecuador was the first country to conclude a MYRA with both official and private creditors. The bank MYRA does not envisage enhanced surveillance beginning until after the existing Fund arrangement expires in mid-1987. The official MYRA provides that the third stage of rescheduling--covering maturities due June-December 1987--may occur provided Ecuador is inter alia implementing a comprehensive and satisfactory economic program set forth in the process of consultation with the Fund. If the assessment by official creditors is not positive, then a new meeting could be convened in order to discuss if, and under what conditions, the rescheduling can proceed. Official creditors, in making their assessment, will have available both the staff report and the Managing Director's Summing Up of the Board discussion.

Enhanced surveillance for Yugoslavia began on the expiration of the Fund arrangement on May 16, 1986; the Executive Board will have an opportunity to discuss the first staff paper under enhanced surveillance for Yugoslavia prior to discussion of this paper. On April 17, 1986, official creditors reached agreement in principle on a rescheduling with Yugoslavia but made the signing of that agreement subject to ratification of the monitoring procedures which were set forth in the agreement and were to be implemented in the context of enhanced surveillance. The Executive Board met on May 12 to discuss the conclusion reached in Paris between official creditors and the Yugoslav authorities; the agreement was signed on May 13. Official creditors agreed with the Yugoslav authorities on a two stage rescheduling. Terms and conditions for the second year are to be agreed early in 1987 if the first phase of restructuring has been concluded successfully, including a positive

assessment of economic performance during 1986 and the formulation of a satisfactory economic program for 1987.

During the Board discussion, Directors agreed that the targets and limits established by the Yugoslav authorities did not represent performance criteria. Nevertheless, "in the minds of some Directors the type of arrangements discussed today should be exceptional" (SUR/86/40, 5/12/86) reflecting concerns that Yugoslav procedures might too closely resemble a stand-by arrangement. Directors stressed that it was desirable for any differences of view between the Yugoslav authorities and the Fund staff to be narrowed as much as possible and, optimally, eliminated.

A novel aspect of the bank MYRA with Yugoslavia was the inclusion of a trigger mechanism to indicate likely difficulties in meeting future repayments. The major purpose of this mechanism is to shorten the time lag between implementation of remedial action, if needed, and the diagnosis of such a need and to facilitate the assessment of the situation by creditor banks. Remedial actions could potentially lead to an approach to the Fund by the authorities. The trigger clauses agreed between the creditor banks and the Yugoslav authorities apply to external reserves and export earnings. The experience with these triggers is yet to be tested.

Official creditors agreed to a MYRA for Cote d'Ivoire in June 1986. The first two and a half years of the restructuring (1986 to mid-1988) coincide with Fund arrangements; thereafter, the Ecuador formulation, referring to a program set forth in process of consultation with the Fund, was applied to maturities falling due from July 1, 1988 to December 31, 1988. For maturities falling due in 1989, official creditors have indicated their willingness to reschedule, if conditions warrant, and provided Cote d'Ivoire "has an appropriate relationship with the International Monetary Fund." Commercial bank's monitoring procedures have not yet been finalized; however they presently envisage for the period after the expiration of the existing Fund arrangement either a new Fund arrangement or enhanced surveillance.

While there has been no experience of creditors using enhanced surveillance papers, recent developments may illustrate certain important general issues. First, enhanced surveillance can only facilitate a return to spontaneous financing where countries show persistence in the implementation of appropriate policies. Second, adverse circumstances can arise which would lead a country engaged in enhanced surveillance to request a financial arrangement with the Fund. Third, official creditors have sought to exert influence on debtor countries' economic policies by agreeing only to serial MYRAs wherein each annual restructuring is linked to an acceptable economic program. Commercial banks have moved progressively in this direction by requiring successive subperiods within a consolidation period to be subject to their approval. This practice places particular responsibility on creditors to determine the adequacy of policies. If, in their judgment, drawing inter alia on

the Fund staff appraisal, the member country needs to adapt its policies in order to ensure a sustainable external position, then discussions between the country and its creditors will be needed to determine an appropriate course of action.

IV. Other Changes in Financial Markets

Last year's report on international capital markets described the rapid pace of change in financial markets arising from liberalization and the spread of innovative financing techniques. These trends have continued during 1985-86, increasing the integration of major financial centers and diminishing the segmentation within various sectors of domestic markets. This section identifies some key developments in this continuing process and discusses their policy implications.

1. Recent structural developments

Liberalization has been carried further in several major financial markets. In France, the Euro-French franc bond market was reopened, with foreign banks permitted to be co-lead underwriters, and exchange controls were relaxed; currency swaps, financial futures, and convertible issues were authorized; and commercial paper and negotiable certificates of deposits were introduced in the domestic market. In Germany, new financing techniques were permitted as of May 1985 (e.g., floating rate notes, zero coupon bonds, equity-related issues, and interest and currency swaps) and the calender system for new issues was reformed. On a reciprocal basis, foreign banks with subsidiaries in Germany were also permitted to lead-manage deutsche mark bond issues. Since June 1986, foreign banks may join the German government's bond issuing syndicate. Issuance of negotiable certificates of deposit was authorized as of May 1, 1986.

In Japan, the spectrum of domestic money market instruments was broadened in 1985 and 1986 with the introduction of money market certificates, banker acceptances, and publicly auctioned short-term government refinancing bonds. Conditions applicable to certificates of deposit were further liberalized. In early 1986, legislation was passed to allow the opening of an offshore banking market in Tokyo. Institutional separation of banking and securities market activities has also been lessened as domestic banks have been permitted to establish overseas securities subsidiaries, and to deal in long-term government securities in the domestic market. A number of further measures were implemented to liberalize access to--and instruments available in--the Euro-yen bond market. Foreign financial institutions have been permitted to begin trust banking operations and to become members of the Tokyo Stock Exchange.

In the United Kingdom, a major reform of the Stock Exchange is currently underway, involving liberalization of ownership rules pertaining to Stock Exchange firms, the abolishment of minimum commissions,

and the introduction of dual capacity trading. A comprehensive regulatory regime for the financial services industry is being introduced, aimed at ensuring that the system remains sound and at increasing investor protection. The structure of the gilt edged securities market has also been reorganized substantially. A sterling commercial paper market was established in May 1986. In the United States, geographical segmentation of banking markets has continued to lessen.

Liberalization measures were implemented in a number of other national financial markets. The segmentation of financial markets has continued to erode, as leading financial institutions have become established in each of the major domestic financial markets.

During 1985-86, use of the new financing instruments discussed in last year's paper has expanded and been extended to new markets. The volume of medium-term currency and interest rate swaps has expanded sharply, partly accounting for the bouyancy of international bond markets. Options and futures markets have grown and a wider range of participants have taken advantage of the hedging opportunities available. The use of securities to intermediate savings has continued to expand. The issuance of short-term paper in the Euromarkets, previously mainly underwritten by banks, has developed into a non-underwritten commercial paper market, and commercial paper programs are being introduced in some domestic capital markets in Europe.

Liberalization and innovation have tended to increase the efficiency of capital markets in three ways. First, intermediation costs have been sharply reduced by the substitution for bank credits of direct transactions in securities, by reduced commissions and by increased competition. Second, new instruments have facilitated arbitrage between markets in different countries and between different instruments. Swaps have been particularly effective in arbitraging differences between markets in the cost of loan funds to individual borrowers. Recently first signs have been emerging of an international equity market, which may narrow differences between markets in the cost of equity capital. Third, it has become possible to hedge exposure to risks associated with fluctuations in exchange rates and interest rates through a variety of techniques and over a longer maturity period, thus achieving a wider sharing of risk among market participants.

2. Issues raised by recent developments

Many of the issues raised by recent market developments were discussed in a report prepared by a Study Group established by the central banks of the G-10, under the chairmanship of Mr. S.Y. Cross (Senior Vice President of the Federal Reserve Bank of New York), on "Recent Innovations in International Banking." This report was published in April 1986 by the Bank for International Settlements.

The Cross Report noted that innovations have improved the efficiency of international financial markets but cited a number of

concerns relating to the implications of innovation for macroprudential policy, for the interpretation of financial conditions, and for the timing and incidence of monetary policy. Several dangers in the securitization process were mentioned, including a lowering in the quality of banks' loan portfolios due to the sale of higher quality assets, and a possible decline in the ability of banks to meet sudden liquidity needs as the share of flows through securities markets expands. Market participants and authorities underlined the value of this comprehensive survey in identifying potential areas of concern. Staff discussions concentrated on those areas and issues which were most relevant to the Fund's activities.

A key attribute of effectively functioning financial markets is the appropriate allocation of savings based on risk adjusted rates of return. New instruments have allowed various risks to be unbundled, separately priced, and sold to new portfolios. This process has made it possible to distribute these instruments and their associated risks more widely through the financial system and to nonbanks. To the extent that these instruments are priced properly, they can help financial markets to allocate resources more efficiently. A major issue is whether risks are adequately priced. Some market participants and supervisors expressed concern that the pricing of new instruments, especially swaps and note issuance facilities, may not also fully reflect the associated credit risks but may instead be influenced by efforts to gain market share. The proper market-pricing of credit risk becomes increasingly important as the share of saving flowing through these markets grows relatively to the share of savings flowing through the banking sector. Bankers raised the concern that traders may not rely on their own indepth credit analysis to make portfolio decisions, but rather may depend on credit assessments performed elsewhere, and also view the marketability of assets as implying that there is less need for credit analysis.

An important potential aspect of the efficient allocation of savings would be greater access by developing countries to innovative techniques that reduce borrowing costs, hedge risks, and tap new sources of foreign savings (e.g., medium-term swaps, financial options, tradeable assets). Approximately two dozen developing countries have tapped the international bond market in 1985 and the first half of 1986, with more than half of those countries also using note issuance facilities. In a few cases, swaps have been employed to lower borrowing costs. Market participants stressed that access to such instruments depended on the borrower enjoying a very high credit standing. In addition to these examples of direct access to capital markets by developing countries, the World Bank has been an important avenue of indirect access, especially to innovative techniques.

The greater marketability of assets may at times cause financial institutions to overestimate the liquidity of assets, especially if market conditions were adverse. However, the availability of new instruments has facilitated banks' efforts to lengthen the maturity of

their liabilities on advantageous terms, for example through the swapping of issues of fixed rate bonds into floating rate debt.

The risk of liquidity strains in the interbank market has been diminished by banks' efforts over the past several years to monitor their interbank positions more closely, and to make more selective placements, as well as by the successful containment of banking disturbances in several industrial country markets. Nevertheless, banks are aware that the interbank market remains a sensitive transmission mechanism for financial strains. Overall, the liquidity of international markets remains an area where considerable vigilance appears justified.

Monetary officials have expressed a concern that liberalization and innovation may be changing the transmission of financial impulses to the domestic economy and to the international economy. Innovations, such as swaps, and international liberalization measures have tended to integrate national financial markets more closely, increasing the sensitivity of capital flows to interest rate differentials and exchange rate movements. Greater financial integration may alter the transmission mechanism for monetary policy by increasing the responsiveness of exchange rates--relative to domestic interest rates--to monetary policy and by shifting its impact from interest rate sensitive sectors, such as housing and capital goods, to the tradeable goods sector. Uncertainty concerning the impact of these changes on the transmission mechanism and on the measurement of monetary aggregates was cited as a potential problem.

A crucial characteristic of an effective market is resilience to external shocks. The widespread application of new communications and computer technology to financial transactions has permitted markets to react more quickly and to process a significantly larger volume of transactions. While the ability to process information has increased, recent innovations may have reduced the quality of information available to prudential and monetary authorities because transparency in financial markets has been reduced considerably. These developments have also made financial markets more vulnerable to equipment and transactions failure as evidenced by the problems at the Bank of New York in November 1985.

3. Policy implications

Opinions differ about the degree of concern that is warranted by the recent pace of structural change. Nonetheless, there is agreement that the concerns that do exist can be addressed by official actions. Structural changes in financial markets thus have implications for the supervisory agencies, monetary authorities, and the Fund, pertaining to the soundness of financial institutions, the allocation of resources, and the coordination of macroeconomic policies.

In recent years, markets have developed in areas where statistical coverage is relatively weak, such as the bond market and off-balance sheet activities of banks. Since many of the recent innovations in capital markets offer new ways of taking old risks and adapting liquidity instruments to new portfolios, the issue of transparency is arguably the central concern for monetary and supervisory authorities. This is especially true with regard to the ability of markets to withstand sharp changes in prices or perceptions of creditworthiness. Reduced transparency makes it more difficult for monetary authorities to evaluate conditions in financial markets even as the effectiveness of monetary policy is altered. While reduced transparency may represent a cost of innovation and liberalization, this cost may be highest in the short run when transparency is least and experience is limited.

These costs and risks can be diminished by effective procedures to collect information, coordinating efforts where appropriate. Efforts by supervisory authorities, and monetary institutions including the Fund, are under way to improve and broaden statistical reporting especially of activity in bond markets and off-balance sheet transactions. Certain monetary authorities have taken measures to extend statistical reports to include data on banks' holding of bonds. The BIS is engaged in an effort to compile information on outstanding stocks of bonds in different markets.

Regulatory authorities have also been reviewing the implications for financial market supervision in the Basle Supervisors Committee. In particular, the integration of the activities of commercial banks and other financial institutions has raised issues concerning the scope and the structure of prudential supervision. One of the major extensions in the scope of supervision has been the recent review of off-balance sheet risks. Supervisors have recently established a framework for evaluating risks associated with off-balance sheet business, and have issued a paper on this subject ("The Management of Banks' Off-Balance Sheet Exposures: A Supervisory Perspective," Committee on Banking Regulations and Supervisory Practices, Basle, March 1986). In some countries, capital adequacy requirements are being extended to include note issuance facilities, and other types of new off-balance sheet activity.

Differences in supervisory practices may result in "regulatory arbitrage" as business is shifted to financial institutions governed by different regulatory practices. This is the case made by those who argue for a regulatory "level playing field" among financial institutions within and between countries, and for an approach to supervision which applies the same rules to an activity, irrespective of the type of financial institution engaged in it. Contacts among regulators of securities markets has intensified, focusing initially on investor protection. Regardless of the precise supervisory approach adopted, close coordination between supervisory authorities--domestically and internationally--remains crucial for maintaining the soundness of the financial system.

The need to increase supervision of nonbank financial institutions may suggest an extension of the bank safety net, especially liquidity support by the central bank. However, this could weaken the impact of market discipline on these institutions and result in an underpricing of risks and misallocation of savings. Market discipline can be allowed to operate more effectively if the risks of contagion and financial disturbances are reduced by an environment of stable economic and financial conditions.

Recent structural changes in financial markets may also affect the operation of macroeconomic policies. The greater degree of capital mobility associated with financial liberalization and innovation implies that industrial countries may find it easier to finance fiscal and current account imbalances, while more difficult in some cases to pursue independent monetary policies. Heightened international financial integration may also imply that the impact of policies can spread more widely and more quickly through the international community. Improved policy coordination, including a strengthening of Fund surveillance procedures, was viewed as necessary to foster more orderly conditions in financial markets and to improve global resource allocation.

V. Concluding Observations

Spontaneous private credit flows to developing countries are expected by banks to continue at a low level in the near term and to be concentrated among countries in Asia and Europe that have not recently restructured their bank debt. Following the pattern of recent years, credit flows from banks of different nationalities may also continue to differ significantly, with perhaps some further regionalization of flows. Banks have indicated that their willingness to provide financing depends on several factors, foremost of which are sound macroeconomic and structural policies in borrowing countries and a healthy and growing world economy. Banks noted that countries' efforts to repatriate flight capital would have a major influence on their lending decisions.

Trade and project lending is expected to be the dominant form of spontaneous bank lending to most developing countries, associated with export activities of banks' customers in industrial countries. Banks noted that export credit agencies can also help developing countries to maintain or regain access to spontaneous commercial financing by extending export cover to those creditworthy countries that are implementing appropriate economic policies. They indicated also that the World Bank can help stimulate bank lending through its involvement in project loans and structural policies. Notwithstanding some growth in trade and project lending, a number of developing countries will still need further general purpose balance of payments support from banks and, in some cases, official coordination will be required to secure an adequate volume of such bank flows.

The mustering of concerted financing may be more difficult in the period ahead as bank cohesion is diminishing. Effective collaboration among banks is needed for the prompt assembly of financing packages in support of growth-oriented adjustment policies. Banks may need to introduce more flexible financing techniques to mitigate the problems of cohesion, including notably the difficulties of securing the participation of banks with a low level of claims on a country or a high level of provisioning. Banks, however, may seek guarantees from other creditors, and predicate their own assistance on prior actions or minimum levels of financial contribution by other creditors. In particular, banks may press for identical financial contributions and arrangements from other creditors, whereas a larger role by official creditors in assisting with the debt problems of low-income countries may appropriately counterbalance a larger role by banks in countries with substantial bank debt.

Differences in the impact of external developments and policy implementation have broadened the spectrum of economic prospects faced by debtor countries. Consequently, bank financing will need to be more differentiated on a case-by-case basis. This greater differentiation in restructuring and financing packages needs to reflect each debtor country's financial outlook and its prospects for regaining access to spontaneous financing. For countries seeking to resume access to spontaneous financing, market-related new money packages and bank and official MYRAs linked to appropriate macroeconomic policy reforms remain key modalities. For countries with more intractable payments problems, for example low-income countries with a high level of bank interest arrears, banks will need to adopt approaches which respond realistically to the country's medium-term prospects.

The role of the Fund in assisting developing countries to design growth-oriented adjustment programs is seen by banks as central in securing external capital flows. In a considerable number of cases the Fund's direct financial support will be of substantial importance. In other cases, the Fund's catalytic role will be of greater significance. For this catalytic role to be effective, banks have observed that the frankness of the Fund's policy assessments will be crucial.

Experience with enhanced surveillance has thus far been limited. Banks have not as yet received any Fund staff reports under the enhanced surveillance procedure. For enhanced surveillance to be effective in fostering a return of spontaneous financing in the future, debtor countries will need to show firm and continuing commitment to sound policies. In this connection, creditors must take responsibility for their own financing decisions, and take the initiative, where appropriate, to seek policies in debtor countries that are more consistent with a sustainable external position.

Nondebt-creating flows, especially foreign direct investment, are expected to represent a relatively higher share of capital flows to developing countries, although in real terms such flows have grown very

little since the early 1980s. The Multilateral Investment Guarantee Agency is expected to help foster additional private direct investment by reducing noneconomic risks. A number of major debtors have established or are actively studying schemes to convert bank debt to equity. Nevertheless, investment flows may expand only moderately in the near term, due to protectionism in industrial countries and limitations on equity investment in developing countries. Direct bilateral assistance will continue to provide a major share of the capital flows to many developing countries, especially low-income countries.

Structural changes in capital markets have offered new opportunities for borrowers--chiefly in industrial countries--to access new markets, hedge risks, and to reduce financing costs. The recent rapid changes in major financial markets have also, however, diminished the transparency of developments in these markets. Efforts by authorities in industrial countries and by international organizations, including the Fund, in the area of statistics can help improve the operation of financial policy through greater transparency. As markets become more integrated, supervision of both bank and nonbank financial institutions--coordinated within and among countries--becomes more important. Sound macroeconomic policies will be needed to provide an environment in which market discipline can operate effectively, diminishing the problem of moral hazard that greater official involvement could entail. Greater policy coordination among countries, supported by Fund surveillance, can make a key contribution to improving the allocation of resources through international capital markets.

Table I. Total Cross-Border Bank Lending and Deposit Taking, 1982-85 1/

(In billions of U.S. dollars)

	1982	1983	1984	1985
Lending to 2/	186	149	181	234
Industrial countries	123	94	120	206
Of which:				
United States	61	40	36	54
Japan	...	10	19	42
Developing countries 3/	51	35	16	9
Offshore centers 4/	25	12	21	15
Other transactors 5/	-1	6	6	8
Unallocated (nonbanks) 6/	-12	3	17	-4
Memorandum items:				
Capital-importing developing countries 3/7/	...	31	16	10
Non-oil developing countries 3/8/	41	28	17	10
15 heavily indebted countries	...	11	5	1
Deposit taking from 9/	188	178	195	252
Industrial countries	150	90	113	196
Of which:				
United States	107	32	7	25
Japan	...	15	12	43
Developing countries 3/	4	20	23	16
Offshore centers 4/	25	34	19	31
Other transactors 5/	4	10	3	8
Unallocated (nonbanks) 6/	6	23	37	1
Memorandum items:				
Capital-importing developing countries 3/7/	...	27	25	15
Non-oil developing countries 3/8/	17	26	22	11
15 heavily indebted countries	...	9	14	4
Change in net claims on 10/	-2	-29	-14	-18
Industrial countries	-26	3	7	10
Of which:				
United States	-46	8	29	29
Japan	...	-5	7	-1
Developing countries 3/	47	14	-7	-7
Offshore centers 4/	--	-22	2	-16
Other transactors 5/	-5	-4	3	--
Unallocated (nonbanks)	-18	-20	-20	-5
Memorandum items:				
Capital-importing developing countries 3/7/	...	3	-9	-5
Non-oil developing countries 3/8/	24	2	-5	-1
15 heavily indebted countries	...	3	-9	-3

Note: Owing to rounding, components may not add.

Sources: International Monetary Fund, International Financial Statistics (IFS); and Fund staff estimates.

1/ Data on lending and deposit taking are derived from stock data on the reporting countries' liabilities and assets, excluding changes attributed to exchange rate movements.

2/ As measured by differences in the outstanding liabilities of borrowing countries defined as cross-border interbank accounts by residence of borrowing bank plus international bank credits to nonbanks by residence of borrower.

3/ Excluding offshore centers.

4/ Consisting of the Bahamas, Bahrain, Cayman Islands, Hong Kong, the Netherlands Antilles, Panama, and Singapore.

5/ Transactors included in IFS measures for the world, to enhance global symmetry, but excluded from IFS measures for "All Countries." The data comprise changes in identified cross-border bank accounts of centrally planned economies (excluding Fund members), and of international organizations.

6/ Calculated as the difference between the amount that countries report as their banks' positions with nonresident banks in their monetary statistics and the amounts that banks in major financial centers report as their positions with nonbanks in each country.

7/ Consisting of all developing countries except the eight Middle Eastern oil exporters (Islamic Republic of Iran, Iraq, Kuwait, Libyan Arab Jamahiriya, Oman, Qatar, Saudi Arabia, and the United Arab Emirates) for which external debt statistics are not available or are small in relation to external assets.

8/ Consisting of all developing countries except the eight Middle Eastern oil exporters (listed in footnote 7 above), Algeria, Indonesia, Nigeria, and Venezuela.

9/ As measured by differences in the outstanding assets of depositing countries, defined as cross-border interbank accounts by residence of lending bank plus international bank deposits of nonbanks by residence of depositor.

10/ Lending to, minus deposit taking from.

Table II. Cross-Border Interbank Lending and Deposit Taking, 1982-85 1/

(In billions of U.S. dollars)

	1982	1983	1984	1985
Lending to 2/	105	110	151	197
Industrial countries	73	79	114	178
Of which:				
United States	46	39	25	33
Japan	...	8	22	42
Developing countries 3/	16	16	12	8
Offshore centers 4/	18	11	20	5
Other transactors 5/	-2	4	5	6
Memorandum items:				
Capital-importing developing countries 3/ 6/	...	15	13	8
Non-oil developing countries 3/ 7/	15	15	12	8
15 heavily indebted countries	...	9	6	1
Deposit taking from 8/	125	100	144	209
Industrial countries	113	63	107	175
Of which:				
United States	81	16	14	11
Japan	...	15	11	42
Developing countries 3/	-9	3	21	2
Offshore centers 4/	17	26	13	25
Other transactors 5/	3	8	2	7
Memorandum items:				
Capital-importing developing countries 3/ 6/	...	11	21	3
Non-oil developing countries 3/ 7/	2	10	20	1
15 heavily indebted countries	...	-1	11	-3
Change in net claims on 9/	-20	10	7	-12
Industrial countries	-40	16	7	3
Of which:				
United States	-35	23	11	22
Japan	...	-7	11	--
Developing countries 3/	25	13	-9	6
Offshore centers 4/	1	-15	7	-20
Other transactors 5/	-5	-4	3	-1
Memorandum items:				
Capital-importing developing countries 3/ 6/	...	4	-8	5
Non-oil developing countries 3/ 7/	13	4	-8	7
15 heavily indebted countries	...	10	-5	4
Net errors and omissions 10/	20	-9	-7	11

Note: Owing to rounding, components may not add.

Sources: International Monetary Fund, International Financial Statistics (IFS); and Fund staff estimates.

1/ Data on lending and deposit taking are derived from stock data on the reporting countries' liabilities and assets, excluding changes attributed to exchange rate movements.

2/ As measured by differences in the outstanding liabilities of borrowing countries, defined as cross-border interbank accounts by residence of borrowing bank.

3/ Excluding offshore centers.

4/ Consisting of the Bahamas, Bahrain, the Cayman Islands, Hong Kong, the Netherlands Antilles, Panama, and Singapore.

5/ Transactors included in IFS measures for the world, to enhance global symmetry, but excluded from IFS measures for "All Countries." The data comprise changes in the accounts of the Bank for International Settlements with banks other than central banks; and changes in identified cross-border interbank accounts of centrally planned economies (excluding Fund members).

6/ Consisting of all developing countries except the eight Middle Eastern oil exporters (Islamic Republic of Iran, Iraq, Kuwait, Libyan Arab Jamahiriya, Oman, Qatar, Saudi Arabia, and the United Arab Emirates) for which external debt statistics are either not available or are small in relation to external assets.

7/ Consisting of all developing countries except the eight Middle Eastern oil exporters (listed in footnote 6), Algeria, Indonesia, Nigeria, and Venezuela.

8/ As measured by differences in the outstanding assets of depositing countries, defined as cross-border interbank accounts by residence of lending banks.

9/ Lending to, minus deposit taking from.

10/ Calculated as the difference between global measures of cross-border interbank lending and deposit taking.

Table III. International Bank Lending to Nonbanks and Deposit Taking from Nonbanks, 1982-85 1/

(In billions of U.S. dollars)

	1982	1983	1984	1985
Lending to 2/	80	40	31	36
Industrial countries	51	14	7	27
Of which:				
United States	14	1	11	21
Japan	...	2	-3	1
Developing countries 3/	35	19	4	1
Offshore centers 4/	7	1	2	10
Other transactors 5/	1	2	1	2
Unidentified borrowers 6/	-12	3	17	-4
Memorandum items:				
Capital-importing developing countries 3/ 7/	...	16	3	1
Non-oil developing countries 3/ 8/	26	13	4	1
15 heavily indebted countries	...	2	-1	--
Deposit taking from 9/	63	77	51	42
Industrial countries	37	27	6	21
Of which:				
United States	26	16	-7	14
Japan	...	--	1	1
Developing countries 3/	13	17	2	14
Offshore centers 4/	8	8	6	5
Other transactors 5/	1	2	--	1
Unidentified depositors 6/	6	23	37	1
Memorandum items:				
Capital-importing developing countries 3/ 7/	...	17	4	12
Non-oil developing countries 3/ 8/	15	16	3	9
15 heavily indebted countries	...	10	4	7
Change in net claims on 10/	17	-38	-20	-6
Industrial countries	14	-13	1	6
Of which:				
United States	-12	-15	18	7
Japan	...	2	-4	--
Developing countries 3/	22	2	1	-13
Offshore centers 4/	-1	-7	-4	5
Other transactors 5/	--	--	1	1
Unidentified (net) 6/	-18	-20	-20	-5
Memorandum items:				
Capital-importing developing countries 3/ 7/	...	-1	-1	-11
Non-oil developing countries 3/ 8/	12	-3	1	-8
15 heavily indebted countries	...	-8	-5	-7

Note: Owing to rounding, components may not add.

Sources: International Monetary Fund, International Financial Statistics (IFS); and Fund staff estimates.

1/ Data on lending and deposit taking are derived from stock data on the reporting countries' liabilities and assets, excluding changes attributed to exchange rate movements.

2/ As measured by differences in the outstanding liabilities of borrowing countries, defined as cross-border bank credits to nonbanks by residence of borrower.

3/ Excluding offshore centers.

4/ Consisting of the Bahamas, Bahrain, the Cayman Islands, Hong Kong, the Netherlands Antilles, Panama, and Singapore.

5/ Transactors included in IFS measures for the world, to enhance global symmetry, but excluded from IFS measures for "All countries." The data comprise changes in the accounts of international organizations (other than the Bank for International Settlements) with banks; and changes in identified cross-border banks accounts of nonbanks in centrally planned economies (excluding Fund members).

6/ Calculated as the difference between the amount that countries report as their banks' positions with nonresident banks in their monetary statistics and the amounts that banks in major financial centers report as their positions with nonbanks in each country.

7/ Consisting of all developing countries except the eight Middle Eastern oil exporters (Islamic Republic of Iran, Iraq, Kuwait, Libyan Arab Jamahiriya, Oman, Qatar, Saudi Arabia, and the United Arab Emirates) for which external debt statistics are either not available or are small in relation to external assets.

8/ Consisting of all developing countries except the eight Middle Eastern oil exporters (listed in footnote 7), Algeria, Indonesia, Nigeria, and Venezuela.

9/ As measured by differences in the outstanding assets of depositing countries defined as international bank deposits by nonbanks by residence of depositor.

10/ Lending to, minus deposit taking from.

Table IV. Long-Term International Bank Credit Commitments, 1981-First Half 1986

(In billions of U.S. dollars)

	1981	1982	1983	1984 1/	1985 2/	1st. Half 1985 3/	1st. Half 1986
			Long-term external credit commitments				
Industrial countries	44.8	51.6	27.9	29.9	31.6	16.2	14.6
Seven largest	27.8	31.2	15.0	18.2	23.9	11.9	10.0
Other	17.0	20.4	12.9	11.7	7.7	4.2	4.5
Developing countries	48.1	44.6	34.9	31.0	17.9	9.4	8.3
Capital-importing	47.0	42.6	32.6	29.9	16.1	8.6	6.9
Africa	4.1	2.7	2.7	0.5	1.4	1.1	0.8
Asia	12.8	12.6	10.4	10.2	7.5	3.0	4.1
Europe	4.7	3.7	3.5	3.4	4.4	2.3	1.9
Middle East	0.2	0.6	0.7	0.4	0.3	--	--
Western Hemisphere	25.2	23.0	15.3	15.4	2.5	2.1	0.1
Centrally planned economies 4/	0.7	0.2	0.5	2.2	3.5	1.6	1.1
International organizations and unallocated	1.0	1.8	3.9	3.5	2.5	1.3	0.4
Total	94.6	98.2	67.2	66.6	55.5	28.4	24.4
			Other international long-term bank facilities				
Industrial countries	46.5	3.1	12.4	47.8	51.6	17.9	14.5
Seven largest	45.9	1.4	10.6	33.9	35.9	13.0	7.3
Other	0.6	1.7	1.8	13.9	15.7	4.9	7.2
Developing countries	6.5	2.1	1.0	6.9	4.3	2.1	2.7
Capital-importing	6.5	2.1	0.9	6.6	4.1	1.9	2.7
Africa	0.1	--	--	0.2	--	--	--
Asia	0.2	0.5	0.4	1.5	3.0	1.3	1.5
Europe	--	0.4	0.3	0.7	0.9	0.5	1.2
Middle East	--	--	0.2	--	0.1	--	--
Western Hemisphere	6.2	1.2	--	4.3	0.1	--	--
Centrally planned economies 4/	--	--	--	--	--	--	0.3
International organizations and unallocated	0.1	0.2	0.1	0.6	0.9	0.5	--
Total	53.1	5.4	13.5	55.3	56.8	20.5	17.5
			Total international commitments				
Industrial countries	91.3	54.6	40.2	77.6	83.2	34.0	29.0
Seven largest	73.6	32.6	25.5	52.1	59.5	24.9	17.3
Other	17.6	22.1	14.7	25.5	23.4	9.1	11.7
Developing countries	54.6	46.8	35.9	37.9	22.2	11.4	11.0
Capital-importing	53.5	44.8	33.5	36.5	20.2	10.5	9.6
Africa	4.2	2.7	2.7	0.7	1.4	1.1	0.8
Asia	13.0	13.1	10.8	11.7	10.5	4.3	5.5
Europe	4.7	4.1	3.8	4.2	5.3	2.9	3.1
Middle East	0.2	0.6	0.8	0.4	0.4	0.1	--
Western Hemisphere	31.3	24.2	15.3	19.7	2.6	2.1	0.1
Centrally planned economies 4/	0.7	0.2	0.5	2.2	3.5	1.6	1.4
International organizations and unallocated	1.1	2.0	4.0	4.1	3.4	1.8	0.4
Total	147.7	103.6	80.7	121.8	112.3	48.9	41.7
Memorandum item:							
Other international long-term bank facilities, excluding merger-related facilities	...	5.4	9.5	28.9	46.8	...	...

Note: Owing to rounding, components may not add.

Sources: Organization for Economic Cooperation and Development, Financial Statistics Monthly; and Fund staff estimates.

1/ Includes agreements in principle with Argentina and the Philippines, and excludes the short-term trade deposit facility for Argentina of $0.5 billion.
2/ Includes $0.1 billion for Costa Rica.
3/ Includes agreements in principle with Chile and Colombia.
4/ Excludes Fund member countries.

Table V. New Publicized Long-Term External Bank Credit Commitments to Developing Countries, 1981-First Half 1986

(In billions of U.S. dollars)

	1981	1982	1983	1984 1/	1985 2/	1st. Half 1985 3/	1st. Half 1986
Developing countries	48.1	44.6	34.9	31.0	17.9	9.4	8.3
Capital-importing	47.0	42.6	32.6	29.9	16.1	8.6	6.9
Africa	4.1	2.7	2.7	0.5	1.4	1.1	0.8
Spontaneous lending 4/	4.1	2.7	2.7	0.5	1.3	1.0	0.8
Concerted lending 4/	...	...	--	--	0.1	0.1	--
Asia	12.8	12.6	10.4	10.2	7.5	3.0	4.1
Spontaneous lending 4/	12.8	12.6	10.4	9.3	7.5	3.0	4.1
Concerted lending	...	...	--	0.9	--	--	--
Europe	4.7	3.7	3.5	3.4	4.4	2.3	[illegible]
Spontaneous lending 4/	4.7	3.7	2.9	3.4	4.4	2.3	[illegible]
Concerted lending 4/	...	...	0.6	--	--	--	--
Middle East	0.2	0.6	0.7	0.4	0.3	--	--
Western Hemisphere	25.2	23.0	15.3	15.4	2.5	2.1	0.1
Spontaneous lending 4/	25.2	23.0	2.0	0.6	0.1	--	0.1
Concerted lending 4/	...	...	13.3 5/	14.8	2.4	2.1	--

Sources: Organization for Economic Cooperation and Development, Financial Statistics Monthly; and Fund staff estimates.

1/ Includes agreements in principle with Argentina and the Philippines, and excludes the short-term trade deposit facility for Argentina of $0.5 billion.
2/ Includes $0.1 billion for Costa Rica.
3/ Includes agreements in principle with Chile and Colombia.
4/ Concerted lending refers to bank credit commitments obtained during 1983-85 and coordinated by a bank advisory committee (i.e., Argentina, Brazil, Chile, Colombia, Cote d'Ivoire, Ecuador, Mexico, Panama, Peru, the Philippines, Uruguay, and Yugoslavia).
5/ Excludes the extension of a bridging loan of $1.3 billion to Argentina.

Table VI. Terms on New Publicized Long-Term International Bank Credit Commitments, 1980-First Half 1986

(In percent, unless otherwise indicated)

	1981	1982	1983	1984 1/	1985	Jan.-May 1986
Six-month Eurodollar interbank rate (average)	16.72	13.60	9.93	11.29	8.64	7.61
U.S. prime rate (average)	18.87	14.86	10.79	12.13	10.48	9.23 2/
Average maturity (in years/months)	7/8	7/7	7/3	7/9	7/8	7/2
OECD countries	7/8	8/3	7/8	7/4	7/3	6/10
Centrally planned economies	5/7	4/9	4/5	5/11	7/5	7/10
Oil exporting countries	7/9	6/0	7/2	7/7	6/11	8/9
Other developing countries	7/9	7/0	7/0	8/11	9/1	7/9
Average spread	0.80	0.77	1.15	0.93	0.60	0.41
OECD countries	0.58	0.56	0.65	0.55	0.41	0.39
Centrally planned economies	0.62	1.03	1.18	0.88	0.55	0.26
Oil exporting countries	0.79	0.94	0.85	0.76	0.72	0.44
Other developing countries	1.04	1.14	1.70	1.44	0.99	0.71

Sources: Organization for Economic Cooperation and Development, Financial Market Trends; International Monetary Fund, International Financial Statistics (for Eurodollar rate); Federal Reserve Bulletin (for prime rate).

1/ Does not include terms of agreements in principle with Argentina, and the Philippines.
2/ January-April average.

Table VII. Change in Bank Claims on Developing Countries, 1982-85 1/

(In billions of U.S. dollars and in percent)

	1982		1983		1984		1985	
	Billions of U.S. dollars	Growth rate	Billions of U.S. dollars	Growth rate	Billions of U.S. dollars	Growth rate	Billions of U.S. dollars	Growth rate
Developing countries								
BIS semiannual	39.3	10.0	26.0	6.0	4.7	1.0	31.4	6.8
U.S. claims data	11.5	8.2	6.2	4.1	-3.5	-2.2	-13.2	-8.5
U.K. claims data	6.4	11.2	2.3	3.7	-0.9	-1.4	-0.4	-0.6
Capital-importing developing countries								
BIS semiannual	38.2	10.2	21.7	5.3	4.7	1.1	30.7	7.0
U.S. claims data	11.6	8.5	5.7	3.9	-2.7	-1.8	-11.9	-7.9
U.K. claims data	6.2	11.7	2.0	3.3	-0.1	-0.2	-0.5	-0.8
Africa								
BIS semiannual	5.5	10.8	3.1	5.5	-1.0	-1.7	3.7	6.1
U.S. claims data	1.3	12.4	1.0	8.5	-0.8	-6.0	-2.8	-22.4
U.K. claims data	2.9	31.1	0.5	4.1	-0.2	-2.0	-0.8	-6.4
Asia								
BIS semiannual	10.4	17.1	8.7	12.2	3.8	4.7	9.3	10.9
U.S. claims data	3.8	14.2	1.4	4.5	-3.0	-9.5	-3.4	-11.9
U.K. claims data	1.4	16.5	0.4	3.6	-0.3	-3.0	0.2	2.3
Indonesia								
BIS semiannual	2.7	37.5	1.5	15.2	1.1	9.3	1.2	9.5
U.S. claims data	0.6	24.2	0.6	19.9	-0.2	-5.0	-0.6	-18.8
U.K. claims data	0.5	63.6	0.3	26.0	--	2.1	-0.1	-3.0
Korea								
BIS semiannual	3.3	16.6	1.9	8.2	0.3	1.2	2.8	10.6
U.S. claims data	2.1	24.1	0.5	4.1	-1.5	-13.3	-0.8	-7.9
U.K. claims data	0.3	10.8	-0.2	-7.4	-0.1	-2.5	-0.1	-2.0
Philippines								
BIS semiannual	2.4	23.5	0.6	4.8	-1.4	-10.1	0.5	4.0
U.S. claims data	0.4	6.9	0.3	5.5	-0.6	-10.0	--	-0.7
U.K. claims data	0.2	11.7	0.1	4.2	-0.2	-9.6	-0.1	-8.7
Europe								
BIS semiannual	-0.3	-0.7	1.6	3.5	-0.6	-1.2	7.5	15.8
U.S. claims data	-0.8	-7.0	0.9	9.5	-0.4	-3.6	-0.5	-4.8
U.K. claims data	-0.2	-2.7	0.2	3.2	-0.2	-2.5	0.2	3.0
Middle East								
BIS semiannual	3.5	19.7	0.7	3.3	-0.7	-4.5	1.2	8.4
U.S. claims data	0.3	8.1	0.3	8.5	-0.4	-9.0	-0.7	-18.8
U.K. claims data	0.5	32.0	-0.2	-11.2	-0.2	-13.3	--	2.0
Western Hemisphere								
BIS semiannual	19.1	9.6	7.7	3.5	3.2	1.4	9.0	3.9
U.S. claims data	6.9	8.2	2.1	2.3	1.8	1.9	-4.5	-4.7
U.K. claims data	1.6	6.1	1.1	3.9	0.8	2.8	-0.1	-0.5
Argentina								
BIS semiannual	0.9	3.6	0.2	0.8	-1.5	-5.6	4.1	16.3
U.S. claims data	-0.2	-2.0	0.3	3.3	-0.5	-6.3	0.4	5.5
U.K. claims data	-0.3	-7.8	0.1	2.8	-0.1	-1.3	0.3	8.3
Brazil								
BIS semiannual	8.0	15.2	1.7	2.8	4.8	7.9	1.3	1.9
U.S. claims data	3.6	21.5	0.2	1.1	3.2	15.6	-1.1	-4.5
U.K. claims data	1.2	18.2	0.7	8.5	0.7	8.5	-0.2	-2.2
Mexico								
BIS semiannual	5.8	10.2	5.5	8.7	1.6	2.3	0.8	1.1
U.S. claims data	2.9	13.4	2.0	8.0	0.2	0.7	-1.6	-6.0
U.K. claims data	0.2	3.1	0.3	3.8	0.1	1.1	-0.1	-0.9
Venezuela								
BIS semiannual	1.3	5.0	-0.3	-1.1	-0.9	-3.3	0.4	1.7
U.S. claims data	1.1	10.5	-0.3	-2.8	-0.4	-4.0	-0.7	-6.7
U.K. claims data	-0.1	-4.3	-0.2	-5.4	-0.1	-4.2	-0.1	-2.9

Note: Owing to rounding, components may not add.

Sources: Bank for International Settlements, The Maturity Distribution of International Bank Lending; Federal Financial Institutions Examination Council, Country Exposure Lending Survey; and Bank of England, Bank of England Quarterly Bulletin.

1/ These data are not adjusted for the impact of exchange rate movements and are based on consolidated reports of banks.

Table VIII. Capital-Asset Ratios of Banks in Selected Industrial Countries, 1978-85 1/

(In percent)

	1978	1979	1980	1981	1982	1983	1984	1985
Canada 2/	3.3	3.2	3.0	3.5 3/	3.7	4.1	4.4	4.6
France 4/	2.3	2.6	2.4	2.2	2.1	2.0	1.9	2.2
Germany, Federal Republic of 5/	3.3	3.3	3.3	3.3	3.3	3.3	3.4	3.5
Japan 6/	5.1	5.1	5.3	5.3	5.0	5.2	5.2	4.8
Luxembourg 7/	...	...	3.5	3.5	3.5	3.6	3.8	4.0
Netherlands 8/	3.9	4.3	4.2	4.3	4.6	4.7	4.7	4.9
Switzerland 9/								
Largest 5 banks	7.8	7.6	7.6	7.4	7.3	7.1	7.1	7.8
All banks	7.8	7.6	7.6	7.5	7.5	7.3	7.4	7.8
United Kingdom								
Largest 4 banks 10/	7.5	7.2	6.9	6.5	6.4	6.7	6.3	7.9
All banks 11/	5.2	5.1	5.0	4.5	4.1	4.4	4.5	5.5
United States								
Nine money center banks 12/	4.7	4.5	4.5	4.6	4.9	5.4	6.2	6.8
Next 15 banks 12/	5.4	5.4	5.5	5.2	5.3	5.7	6.6	7.2
All country reporting banks 12/13/	5.5	5.3	5.4	5.4	5.6	5.9	6.5	6.9

Sources: Data supplied by official sources; and Fund staff estimates.

1/ Aggregate figures such as the ones in this table must be interpreted with caution, due to problems of consistency across national groups of banks and over time in the accounting of bank assets and capital. In particular, provisioning practices vary considerably across these countries as do the definitions of capital. Therefore, cross-country comparisons may be less appropriate than developments over time within a single country.

2/ Ratio of equity plus accumulated appropriations for contingencies (before 1981, accumulated appropriations for losses) to total assets (Bank of Canada Review).

3/ The changeover to consolidated reporting from November 1, 1981 had the statistical effect of increasing the aggregate capital-asset ratio by about 7 percent.

4/ Ratio of capital, reserves, and general provisions, to total assets. Data excludes cooperative and mutual banks (Commission de Controle des Banques, Rapport).

5/ Ratio of capital including published reserves to total assets. From December 1985, the Bundesbank data incorporate credit cooperatives (Deutsche Bundesbank, Monthly Report).

6/ Ratio of reserves for possible loan losses, specified reserves, share capital, legal reserves plus surplus and profits and losses for the term to total assets (Bank of Japan, Economic Statistics Monthly).

7/ Ratio of capital resources (share capital, reserves excluding current-year profits, general provisions, and eligible subordinated loans) to total payables. Eligible subordinated loans are subject to prior authorization by the Institut Monetaire Luxembourgeois and may not exceed 50 percent of a bank's share capital and reserves. Data in the table are compiled on a nonconsolidated basis, and as a weighted average of all banks (excluding foreign bank branches). An arithmetic mean for 1985 would show a ratio of 9.3 percent. Inclusion of current-year profits in banks' capital resources would result in a weighted average of 4.3 percent for 1985. Provisions for country risks, which are excluded from capital resources, have been considerably increased in the last few years, with a quadrupling of the level of provisions between 1982 and 1985.

8/ Ratio of capital, disclosed free reserves, and subordinated loans to total assets. Eligible liabilities of business members of the agricultural credit institutions are not included (De Nederlandsche Bank, N.V., Annual Report).

9/ Ratio of capital plus published reserves, a part of hidden reserves, and certain subordinated loans, to assets (Swiss National Bank).

10/ Ratio of share capital and reserves, plus minority interests and loan capital, to total assets (Bank of England).

11/ Ratio of capital and other funds (sterling and other currency liabilities) to total assets (Bank of England). Note that these figures include U.K. branches of foreign banks, which normally have little capital in the United Kingdom.

12/ Ratio of total capital includes equity, subordinated debentures, and reserves for loan losses, to total assets.

13/ Reporting banks are all banks which report their country exposure for publication in the Country Exposure Lending Survey, Federal Financial Institutions Examination Council.