FOR AGENDA

SM/86/193
Correction 1

CONTAINS CONFIDENTIAL INFORMATION

August 28, 1986

To: Members of the Executive Board

From: The Acting Secretary

Subject: International Capital Markets - Developments and Prospects, 1986

The following corrections have been made in SM/86/193 (8/5/86):

Page 3, Table 1, and footnotes 3 and 4: revised

Page 6, para. 4, lines 5 and 6: for "countries increased...compared to"
read "countries were...an increase of"

Page 7, Table 3: revised

Page 8, 1st full para., line 2: for "80 percent," read "90 percent,"
line 3: for "$4.2 billion," read "$4.9 billion,"
line 4: for "Ecuador, Mexico, and Panama)"
read "Costa Rica, Ecuador, and Mexico)"
lines 7 and 8: for "totaled $1.4 billion...
Colombia and Costa Rica"
read "totaled $1.6 billion...
Colombia, Costa Rica, and Panama"

Corrected pages are attached.

Att: (4)

Other Distribution:
Department Heads

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	294	230	150	185	298
BIS based (net of redepositing)	179	194	144	131	152	176
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	195	200
Industrial countries	61	41	41	55	113	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/	65	100	91	49	22	21
Reserve accumulation of capital importing developing countries 7/ (accumulation +)	19.1	-3.3	-17.6	9.2	20.3	3.1
Growth rate in value of world trade	21.6	-0.6	-6.4	-1.9	6.1	1.1
Growth rate of real GNP of industrial countries	1.3	1.4	-0.5	2.6	4.7	3.0
Inflation rate of industrial countries (GNP deflators)	9.3	8.8	7.2	4.9	4.2	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 bank lending to 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 and including issues by borrowers in offshore centers.

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.

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 were unchanged in 1985, compared to an increase of $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	16.4	8.9
(Growth rate)	(7)	(3)	(2)
Africa	4.8	0.2	1.0
Of which:			
Algeria	0.3	0.7	1.6
Cote d'Ivoire	-0.1	-0.3	--
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	5.0
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	2.3
Malaysia	1.9	1.4	-1.4
Philippines	-1.4	0.1	-0.5
Europe	2.8	2.2	3.2
Of which:			
Greece	1.3	1.8	1.6
Hungary	0.9	0.2	1.8
Turkey	--	0.9	0.5
Yugoslavia	--	0.2	0.2
Middle East	3.5	-0.4	-2.1
Of which:			
Egypt	-0.7	0.6	-0.2
Israel	-0.4	-0.7	-0.8
Western Hemisphere	14.8	6.2	1.9
Of which:			
Argentina	2.3	0.3	0.6
Brazil	5.2	5.2	-1.0
Chile	0.3	1.2	0.3
Colombia	0.6	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	11.0	5.5	--
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 (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/ 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 90 percent, or about $4.9 billion, of these disbursements went to five countries in the Western Hemisphere (Argentina, Chile, Costa Rica, Ecuador, and Mexico); the remainder was directed to Cote d'Ivoire and the Philippines. During the first six months of 1986, disbursements of concerted bank finance totaled $1.6 billion and were confined to Argentina, Chile, and the Philippines. New concerted packages were also arranged for Colombia, Costa Rica, and Panama 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.